



ASIC

Australian Securities & Investments Commission

REPORT 426

Payday lenders and the new small amount lending provisions

March 2015

About this report

This report sets out the findings of a review of the payday lending industry and its response to the additional protections for vulnerable consumers contained in the small amount lending provisions of the *Consumer Credit Legislation Amendment (Enhancements) Act 2012* (Enhancements Act).

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This report does not constitute legal advice. We encourage you to seek your own professional advice to find out how the National Credit Act and other applicable laws apply to you, as it is your responsibility to determine your obligations.

Examples in this report are purely for illustration; they are not exhaustive and are not intended to impose or imply particular rules or requirements.

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Executive summary

Small amount lending provisions

- 1 The *National Consumer Credit Protection Act 2009* (National Credit Act), including Sch 1 to the Act (National Credit Code), commenced in July 2010 and features a number of measures to improve protection for consumers who borrow money for personal, domestic or household needs and to deter predatory lending practices. These measures include requirements for credit providers to hold an Australian credit licence, develop policies and procedures to help them comply with their obligations under the law, and provide consumers with access to a no-cost forum for the resolution of complaints via internal dispute resolution (IDR) processes and membership of an ASIC-approved external dispute resolution (EDR) scheme.
- 2 Small amount or payday loans were identified by the Commonwealth Government as a product that held specific risks of financial detriment or harm to vulnerable consumers. Historically, the cost of small amount loans was very high and well above mainstream consumer lending rates. Consumers of payday loans were charged costs that, given their financial position, put them at risk of an ongoing cycle of disadvantage that reduced the potential for financial and social inclusion.¹
- 3 Laws imposing a cap on the cost of payday loans had previously operated in some states and territories with mixed success.² In 2013, the small amount lending provisions of the *Consumer Credit Legislation Amendment (Enhancements) Act 2012* (Enhancements Act) commenced. These provisions are designed to address particular risks associated with small amount lending, including the risk to consumers of falling into a debt spiral through the repeated or continued use of high-cost small amount credit contracts.³

Note: In this report we refer to ‘small amount credit contracts’ as ‘small amount loans’ or ‘payday loans’ and the Australian credit licensees that provide these loans as ‘payday lenders’.
- 4 ASIC supports these reforms. In enforcing the National Credit Act and the specific payday lending regulations, our aim is to ensure that consumers are not trapped in a cycle of disadvantage and that vulnerable consumers are protected from practices which reduce financial and social inclusion.⁴

¹ Revised Explanatory Memorandum to the Consumer Credit Legislation Amendment (Enhancements) Bill 2012 (Revised Explanatory Memorandum), paragraph 11.89.

² Revised Explanatory Memorandum, paragraphs 5.6 and 11.143.

³ Revised Explanatory Memorandum, paragraphs 4.12 and 4.30.

⁴ Media Release (14-313MR) *Payday lender penalised for breaching new responsible lending laws* (25 November 2014).

- 5 The small amount lending provisions introduced additional obligations for small amount loans, including:
- (a) the presumptions of unsuitability, which presume that a small amount loan will be unsuitable if either:
 - (i) the consumer is in default under another small amount loan (the default presumption); or
 - (ii) the consumer has had two or more other small amount loans in the last 90 days (the multiple loan presumption);

Note: The presumptions of unsuitability are not equivalent to a prohibition or 'line' that cannot be crossed.
 - (b) a cap on the fees and charges of the loan (an establishment fee of 20% of the amount of credit and an monthly fee of 4%);
 - (c) a requirement that consumers who default under a small amount loan must not be charged an amount that exceeds twice the amount of the loan;
 - (d) protections for consumers who receive 50% or more of their income under the *Social Security Act 1991* (Social Security Act);
 - (e) a prohibition on charging an establishment fee if any of the credit is to refinance another small amount loan;
 - (f) a requirement to obtain and consider account statements covering the 90 days prior to the assessment; and
 - (g) a warning statement to be displayed advising consumers of the alternatives to a small amount loan.
- 6 Credit contracts for \$2000 or less that have a term of up to 15 days (referred to as a 'short term loan') are now prohibited.
- 7 In June 2014 further provisions commenced, which in part sought to address specific schemes designed to avoid the cap on costs by clarifying the particular fees and charges that are to be included in the calculation of charges to determine if the credit is regulated under the National Credit Code.⁵
- 8 An independent review of the small amount lending provisions must be undertaken as soon as practicable after 1 July 2015.⁶
- 9 As a result of these developments in the law and due to developments in the payday lending industry (primarily the significant increase in internet-based services provided by payday lenders), we decided it was timely to review the level of compliance by payday lenders with the new Enhancements Act.

⁵ National Consumer Credit Protection Amendment (Small Amount Credit Contracts) Regulations 2014.

⁶ National Credit Act, s335A.

ASIC's previous work on payday lending

- 10 Payday lending has been a strong focus for ASIC since the commencement of the National Credit Act.
- 11 In 2011, we issued a report on payday lending⁷ that identified that payday lenders were at risk of not meeting their responsible lending obligations. We were particularly concerned that payday lenders were not clarifying conflicting information, were not keeping adequate records and were not meeting the responsible lending obligations, including concerns that payday lenders were not making sufficient inquiries or sufficiently verifying consumers financial expenses.
- 12 ASIC has also taken significant regulatory action against non-compliance with the National Credit Act. Our regulatory action has targeted lenders who have:
- (a) overcharged consumers;
 - (b) attempted to avoid the National Credit Act; and
 - (c) breached the responsible lending obligations.
- 13 Since 2010, ASIC action has resulted in close to \$2 million in refunds to over 10,000 consumers who have been overcharged when taking out a payday loan. Further, payday lenders have been issued with 13 infringement notices totalling approximately \$120,000 in response to ASIC concerns about their compliance with the credit laws.
- 14 We continue to target avoidance models and take action where we are concerned lenders are attempting to avoid obligations imposed by the consumer credit legislation.⁸
- 15 We have commenced proceedings against seven companies where we have identified systemic non-compliance with the law. Last year we successfully took civil penalty action against The Cash Store Pty Ltd and Assistive Finance Australia Pty Ltd for wholesale responsible lending failures and engaging in unconscionable conduct.
- 16 We held the view that The Cash Store provided unaffordable loans to a large number of their customers who were on low incomes or receiving Centrelink benefits. In addition, the company acted unconscionably and unfairly in selling insurance for these loans to these customers when it was unlikely that they could ever make a claim on that insurance.
- 17 The court upheld our view and found systemic and gross failures by both The Cash Store and Assistive Finance in complying with their legislative

⁷ Report 264 *Review of micro lenders' responsible lending and disclosure obligations* (REP 264).

⁸ Media Release (14-278MR) *ASIC continues crackdown on payday lending avoidance models* (22 October 2014).

requirements, and a wholesale failure of process. The court awarded record penalties totalling \$18.975 million against The Cash Store and Assistive Finance.⁹

What we did as part of this report

- 18 We identified 13 payday lenders to take part in our review. The lenders included both large national operators and small, locally based firms and included lenders with online businesses and those who operate over the telephone or through shopfronts. We estimate that the participants in the review are responsible for more than three quarters of the payday loans made to Australian consumers.
- 19 We obtained and reviewed the policies and procedures of the lenders, which included four lenders from an earlier review of this industry: see Report 264 *Review of micro lenders' responsible lending and disclosure obligations* (REP 264). We reviewed 288 individual files from those lenders to assess how lenders were complying with their Enhancements Act obligations, and more generally with their responsible lending and disclosure obligations.

What we found

The payday lending industry in 2014

- 20 The amount of payday lending in Australia appears to be growing, though it is difficult to determine the size of the industry.
- 21 We estimate the overall value of small amount loans written for the 12 months to June 2014 to be close to \$400 million.¹⁰ This is an increase of approximately 125% since 2008 and means that payday lenders represent approximately 0.4% of the total consumer credit market in Australia.¹¹ In comparison, the payday lending industry in the United Kingdom is estimated to be writing £2.5 billion worth of loans¹² and makes up approximately 1.2% of the total consumer credit market.¹³

Note: 'Consumer credit market' refers to credit provided by all financial institutions to individual persons or households, excluding student loans and lending for real property.

⁹ Media Release (15-032MR) *Federal Court orders record penalty* (19 February 2015).

¹⁰ Based on updated financial statements of publicly listed payday lending companies and methodology devised by the Consumer Action Law Centre and Zac Gillam in 2010. We note there has also been media commentary that estimates the Australian payday lending industry to be worth between \$800 million and over a billion dollars per annum: For example, A Uribe, 'Payday loans: Beware the lure of quick money', *The New Daily*, 23 February 2015, and S Drummond, 'Microfinancier says millions go to payday lenders after bank capital hiked', *Sydney Morning Herald*, 2 March 2015.

¹¹ See Table D6 *Lending commitments—All lenders* at www.rba.gov.au/statistics/tables/index.html.

¹² Financial Conduct Authority, *Proposal for a price cap on high-cost short-term credit* (CP14/10), consultation paper, July 2014.

¹³ See Table A5.6 *Consumer credit excluding student loans* at www.bankofengland.co.uk/statistics/Pages/bankstats/2014/dec.aspx.

- 22 There has been some commentary from the payday lending industry that the introduction of the Enhancements Act provisions has led to many lenders leaving the market. While ASIC data shows a reduction in licence numbers for lenders operating in this sector (from 1,208 in December 2013 to 1,036 in December 2014), it also shows that new entrants to the payday lending industry continue to apply for a credit licence in similar numbers over the last two years (68 licences granted in 2012–13 and 64 licences granted in 2013–14).
- 23 Approximately 70% of the payday lenders in the review indicated that they had diversified their business since the new cap-on-costs provisions commenced. This diversification includes expanding their loan book to provide credit products such as medium amount loans, and operating another business such as pawnbroking or gold buying (which are not regulated under the national credit regime).

90-day account statements

- 24 The Enhancements Act requires payday lenders to obtain and consider bank account statements for the consumer for the preceding 90 days.
- 25 Generally we found payday lenders were aware of this requirement and had implemented the necessary procedures to ensure the account statements were being collected. There were, however, varying levels of review of these statements, which is discussed further in paragraphs 190–199.
- 26 Of the 288 files reviewed, 272 (94%) contained account statements for the full 90-day period.
- 27 We identified one lender (Abaz Pty Ltd) which did not request the full 90 days for returning (as opposed to new) consumers. We issued an infringement notice to that lender, who has now paid a penalty of \$42,500.¹⁴ This lender has amended their policies to ensure compliance with the requirement to obtain the relevant bank statements for all of its customers.

Protected earnings amount

- 28 To provide further protection for consumers who receive the majority of their income under the Social Security Act, a specific provision was introduced in the Enhancements Act. This provision ensures that consumers in these circumstances will not have repayments on a small amount loan that would exceed 20% of their income.

¹⁴ 14-313MR.

- 29 Our review found that payday lenders were aware of this provision and sought to respond to this new requirement in one of several ways. Based on their internal policies they have either:
- (a) ceased offering small amount loans to consumers who receive the majority of their income from Centrelink (six lenders);
 - (b) ensured no repayments on a payday loan amount to more than 20% of a consumer's income, regardless of the source of the income (two lenders);
 - (c) excluded any income from Centrelink in the calculation of income (two lenders); or
 - (d) had no specific protected earnings amount policy and rather relied on their responsible lending policy (three lenders).
- 30 We found that approximately a quarter of the 288 loans we reviewed were entered into with consumers who received more than 50% of their income from Centrelink. All of these loans had repayments that were less than 20% of the consumer's income.
- 31 However, our review found that in many instances lenders were not complying with their own policies. For example, loans were provided to a consumer who hit the protected earnings threshold in circumstances where the lender's internal policy was to reject all applications from consumers who received income from Centrelink.
- 32 While we found no evidence that the protected earnings amount provision was not being complied with, we are concerned that some payday lenders do not comply with their own policies on this issue. Such behaviour by payday lenders may indicate that there are other weaknesses in their overall compliance with their obligations as licensees.

Cap on costs

- 33 To address concerns regarding the potential exploitation of vulnerable consumers in urgent need of a loan by the payday lending industry, and the subsequent lack of competition and continual high cost of small amount loans, the Enhancements Act introduced a cap on the maximum amount a payday lender can charge a consumer (an establishment fee of 20% of the amount of credit and an monthly fee of 4%). Third-party direct debit fees are also allowed to be charged in some circumstances.¹⁵

¹⁵ Class Order [CO 13/818] *Certain small amount credit contracts*.

- 34 The introduction of price caps on credit contracts sought to address specific risks of financial detriment or harm to consumers that are present in the use of relatively high-cost credit.¹⁶
- 35 The Senate Economics Legislation Committee, in its report on the Consumer Credit Legislation Amendment (Enhancements) Bill 2012, stated:
- There is, therefore, a sound and principled case for national legislation to curb excessive interest rates, fees and charges by the payday loan industry in Australia.¹⁷
- 36 Generally, our review found that industry has a good understanding of the new fee structure and appears to be applying it in accordance with the legislation. Only one lender was identified as not charging the correct amount, and we have worked with the lender to ensure they have ceased offering loans.
- 37 We are encouraged to see that many lenders have ceased using the cap-on-cost law avoidance schemes that operated under the previous state and territory credit laws.
- 38 However, we have identified problematic practices where payday lenders set the loan term on credit contracts at 12 months or more in circumstances where the relevant file indicated that the consumer requested a shorter loan term of well under 12 months. We have strong concerns about these fee structure, including that the contract may not meet the consumer's requirements and objectives. Payday lenders need to be cautious in setting up their loans in this way and charging consumers fees calculated on a term that is longer than the consumer requested.
- 39 We will not tolerate payday lenders that charge fees in circumstances where they are prohibited.

Warning statement

- 40 The Enhancements Act requires payday lenders to disclose a warning statement advising consumers of the alternatives to a small amount loan. The warning statement is designed to help consumers make better and more informed financial decisions and to seek out lower cost alternatives to relatively higher cost short-term credit.¹⁸ Warnings statements must also include a reference to ASIC's MoneySmart website (www.moneysmart.gov.au).

¹⁶ Revised Explanatory Memorandum, paragraph 5.6.

¹⁷ Senate Economics Legislation Committee, *Consumer Credit and Corporations Legislation Amendment (Enhancements) Bill 2011 [Provisions]*, report, December 2011, www.aph.gov.au/Parliamentary_Business/Committees/Senate/Economics/Completed%20inquiries/2010-13/consumercreditenhancementsbill2011/report/index, paragraph 2.46.

¹⁸ Revised Explanatory Memorandum, paragraph 4.3.

- 41 A review of ASIC data relating to MoneySmart shows that the number of consumers who clicked through to MoneySmart from payday lenders' websites has dramatically increased since the introduction of the warning statement requirement. For the 12-month period before the provision commenced, consumers clicked through to MoneySmart 189 times from the website of one of the 13 payday lenders we reviewed. In the 18 months following the commencement of the warning requirement this number was 19,777.
- 42 Consumers are much more likely to visit MoneySmart on reading the warning statement in circumstances where the payday lender provides a hyperlink to our website rather than simply a reference to the site. Five of the 13 payday lenders provided such a link in their websites.
- 43 As part of our review, we asked the 13 payday lenders how they disclosed the warning statements to consumers in store, online and over the telephone. We also reviewed the individual lenders' websites.
- 44 While the majority of payday lenders have made genuine efforts to introduce a warning statement for consumers, five of the 13 lenders had a statement that was not sufficiently prominent to attract consumers' attention.
- 45 It is pleasing to see that payday lenders operating through a website have been endeavouring to ensure that the numerous pages on their sites are updated to include the warning statement. Where we have identified a concern, we are working with lenders to ensure their website warning statement is updated to meet the intent of the legislation.
- 46 Our review also identified instances where lenders with more than one entrance to their premises only displayed the warning statement on one entrance. Payday lenders must satisfy themselves that consumers entering their premises have been provided with an opportunity to see the warning statement, regardless of how they have entered the premises.

Unsuitable loans—Presumption tests

- 47 There are risks that the repeated or continued use of payday loans will result in consumers entering into multiple contracts where the overall level of indebtedness increases over time. This leads to an increasing amount of the consumer's income being used to meet the repayments and, as a result, the ability for the consumer to use the credit to improve their standard of living diminishes.¹⁹
- 48 The Enhancements Act introduced statutory presumptions in response to concerns that consumers using small amount loans were at risk of entering

¹⁹ Regulatory Guide 209 *Credit licensing: Responsible lending conduct* (RG 209) at RG 209.13.

into a debt spiral. These presumptions are not the same as a prohibition or 'line' that cannot be crossed. Payday lenders may still provide a loan to a consumer that triggers the presumptions; however, unless the lender rebuts the presumption, there is a risk that such a loan will be unsuitable.

- 49 To determine whether a presumption applies to a particular transaction, payday lenders must make reasonable inquiries into whether the consumer is currently, or has been within the preceding 90-day period, a debtor under any other small amount loans, and whether the consumer is in default in payment of an amount under those loans.²⁰ These inquiries must be appropriately verified.
- 50 We saw payday lenders take one of three different policy approaches in response to the introduction of the presumptions—that is, they either:
- (a) treated the presumptions as a prohibition and did not lend to those consumers;
 - (b) made further inquiries and made a decision based on those inquiries; or
 - (c) ignored whether a presumption was triggered and relied on their existing responsible lending practices.
- 51 In all instances, the payday lenders in our review had a process in place to identify whether the presumptions of unsuitability had been triggered using standard questions on an application form or by reviewing the consumer's account statements.
- 52 Some payday lenders in the review had policies and procedures that indicated they would not lend to a consumer who triggered a presumption; however, a review of their files found they did not follow these procedures on all occasions. Again, this conduct may indicate that there are other weaknesses in a payday lender's overall compliance with their obligations as licensees.
- 53 Our review found that nearly two thirds of the 288 files reviewed indicated that the payday lender had entered into a small amount loan with a consumer who appeared to trigger the presumptions of unsuitability, with 8% triggering the default presumption and 54% triggering the multiple loan presumption. It is clear from the file reviews that payday lenders are continuing to allow some consumers to use small amount loans as part of their monthly budget, despite the introduction of these presumptions
- 54 One of the 13 payday lenders reviewed identified that a presumption was triggered and sought to overcome (rebut) it by making further inquiries of the consumer or other lenders, or obtaining the consumer's credit file. The inquiries made included requesting further information from the consumer

²⁰ RG 209.60.

about how they could afford the new loan or contacting lenders and confirming previous loans had been finalised.

- 55 The files of the remaining lenders did not contain any records that indicated how the presumptions of unsuitability were rebutted. Lenders who enter into a small amount loan with a consumer in circumstances where the presumptions of unsuitability are triggered, and have no information on file to indicate how the presumptions were rebutted, will be very unlikely to be able to establish that they have met their responsible lending obligations in relation to the particular loan.
- 56 Given the issues noted above, we will continue to focus our surveillance and investigation work on these important small amount loan provisions, and will take appropriate regulatory action against payday lenders that are not meeting their obligations.

Consumers' requirements and objectives

- 57 Payday lenders have been required since 1 July 2010 to inquire into a consumer's requirements and objectives before they enter into a loan. There is considerable material and guidance available to assist payday lenders to meet this obligation, such as the relevant explanatory memorandums, Regulatory Guide 209 *Credit licensing: Responsible lending conduct* (RG 209) and ASIC reports.
- 58 RG 209 makes it clear that the obligation to make reasonable inquiries into a consumer's requirements and objectives requires the credit licensee to find out sufficient details about why the particular consumer requires credit, to enable it to understand whether the credit contract they are being offered will meet that purpose.²¹
- 59 The recent decision in *ASIC v The Cash Store Pty Ltd (in liquidation)* [2014] FCA 926 (*ASIC v TCS*) also dealt with a consumer's requirements and objectives in small amount lending. In that decision, Davies J found that for a lender to meet their obligation to make reasonable inquiries into a consumer's requirement and objectives, the loan purpose stated must be reasonably specific and the amount of credit provided to the customer must be consistent with that purpose.²²
- 60 Our review found that some payday lenders continue to inappropriately use high-level statements, such as 'personal' or 'temporary cash shortfall', to describe the purpose of the loan. In addition, some online lenders restrict consumers to high-level pro forma responses with no ability for the consumer to provide the payday lender with more granular information

²¹ RG 209.34.

²² *ASIC v TCS* at 37(a).

about the purpose of the loan. It is clear that general or high-level descriptions of the purpose of the loan and inflexible online pro forma responses are not by themselves sufficient to comply with the law. We are continuing to examine several lenders in the review regarding these issues.

61 If a payday lender does not make appropriate inquiries into the consumer's requirements and objectives and record these inquiries, it is clear the lender will not be able to establish the purpose of the loan.

62 When the cap-on-costs provisions commenced, one of the new provisions introduced a prohibition on charging an establishment fee in circumstances where any part of the funds advanced are to pay off another small amount loan.²³

63 In our review, we examined files where there was no evidence the lender had made inquiries about whether the loan funds were going to be used to pay off another loan. In a small number of files it appeared likely the loan funds were used to pay off an existing small amount loan. Payday lenders that inappropriately charge an establishment fee are at risk of civil action by consumers to recover the fee, civil or administrative action by ASIC, or penalties of up to \$600,000. We are looking closely at such cases to determine appropriate regulatory action.

Policies, procedures and record keeping

64 All 13 payday lenders reviewed had relevant and up-to-date policies and procedures that indicated they are aware of their responsible lending obligations and the specific Enhancements Act provisions relating to small amount lending.

65 We did note, however, that some policies contained high-level statements that replicated the credit laws and provided little guidance to indicate how in practice the lender would meet their obligations.

66 As mentioned at paragraphs 32 and 53, the file reviews also indicated situations where payday lenders did not follow their own policies and procedures in all circumstances.

67 Overall, we found that the record keeping by lenders in the review was inconsistent and incomplete. There were examples of lenders not maintaining copies of important documents (such as a consumer's application form) on file, no evidence that Credit Guides had been supplied to consumers and no records to show how conflicting information on the file had been reconciled.

²³ National Credit Code, s31A(1A).

- 68 We have previously highlighted the risk of poor record keeping in our guidance and in our first review of the payday lending industry (REP 264), and it is disappointing to see compliance in this area has not improved.
- 69 Further, three of the 13 payday lenders did not have any files that contained evidence of inquiries being made into the purpose of the funds; one other lender had inconsistent records, with some files showing no record of inquiries being made.
- 70 The recent *ASIC v TCS* decision provided comment on what inquiries should be made and information recorded on file to meet the obligation to make reasonable inquiries about the consumer's requirements and objectives.
- 71 Payday lenders that do not comply with their obligation to properly record information leave themselves at risk of action from ASIC, including licence suspension, licence cancellation, a banning order preventing them from engaging in credit activities or civil penalty action (in appropriate cases).
- 72 The risks of poor record keeping and the court's findings in relation to a lack of appropriate records in *ASIC v TCS* should now be well understood by payday lenders. ASIC will continue to take action against payday lenders where appropriate.

Inconsistent information

- 73 We have provided clear guidance that in circumstances where a lender has received inconsistent information about a consumer, additional inquiries about the consumer are warranted.²⁴
- 74 Further, we have previously highlighted the issue of payday lenders not clarifying conflicting information.²⁵ It is unacceptable to see that there are still payday lenders that continue to ignore information they have about a consumer that is inconsistent or does not make sense, without making additional inquiries and recording how the conflicting information was resolved. For example, in our review we identified files where information in the consumer's account statements was inconsistent with information provided by the consumer on an application form.
- 75 These lenders leave themselves at considerable risk that they will be unable to demonstrate that they have taken reasonable steps to verify a consumer's financial situation.

²⁴ RG 209.46.

²⁵ REP 264, Finding 4.4.

- 76 Some payday lenders in the review dealt with conflicting information by:
- (a) contacting the consumers to seek clarification or request further information;
 - (b) making notes on the consumer's account statements and including file notes of conversations with consumers discussing the information from the account statement; and
 - (c) where it was clear that a consumer's income fluctuated, relying on the lower income amount.

These are examples of good practice and help payday lenders ensure they satisfy their obligations as credit licensees.

- 77 Our review also identified situations where the consumer made one withdrawal of a significant amount of cash from an automatic teller machine each pay cycle. In these circumstances we would expect to see file notes showing other inquiries into and verification of the consumer's financial situation other than account statements, such as payslips and rent receipts. In all but a few cases, there were no such records kept. Once again, payday lenders are at serious risk that action will be taken against them if appropriate inquiries into and verification of a consumer's financial situation are not made and properly recorded.

Third-party software providers

- 78 We found payday lenders used a number of methods to obtain account statements; either receiving hard copies directly from the consumer or through a third-party software provider that accessed the data from the consumer's online banking account.
- 79 We are aware of several third-party software providers who offer a service where:
- (a) the consumer is asked to enter their internet banking log-in information;
 - (b) the consumer logs into their internet banking portal and selects which accounts they wish to access statements from; and
 - (c) the software provider then accesses the consumers' statements and, in some circumstances, forwards them in a more reader-friendly format to the lender together with an overview of the data identifying the income and expenses.
- 80 While this type of technology is not new, it appears the use of this software by the payday lending industry has been driven by the introduction of the Enhancements Act provisions requiring the gathering and assessment of 90-day account statements.

- 81 Using third-party software providers may raise concerns for consumers relating to disclosure, privacy, security and difficulties accessing EDR schemes, given that for this service the consumer often has an agreement directly with the third-party software provider independent of the credit provider.
- 82 When using third-party software providers to gain and review consumers account statements, payday lenders should prominently disclose to consumers any risks of using these providers (especially in circumstances where they may lose their protections under the ePayments Code) and not discourage consumers from providing their account statements through other methods.
- 83 As the use of third-party software providers to assist with accessing consumer's account statements is relatively new in this industry, we are continuing to consider information about how these companies operate and interact with payday lenders. We are also considering the policies that lenders have to ensure that, when using these third-party software providers, the lender is satisfied that they are meeting their responsible lending obligations.
- 84 We have already identified some challenges with the data provided by these companies. On both original account statements and the third-party software summaries, we saw examples of incoming payments being identified as 'salary', which appeared to be loan payments from another payday lender. This was not identified as an error by the relevant payday lender and was generally not corrected. Licensees using third-party software providers need to have robust processes in place to check that the information being provided is accurate.

Further work

- 85 We have already taken significant enforcement action against payday lenders. We are following up directly with the payday lenders reviewed regarding specific concerns. We have addressed concerns raised in the review by using ASIC's regulatory powers, such as further enforcement action, issuing an infringement notice, working with lenders to ensure consumer refunds, and working with one entity to see it leave the payday lending industry.
- 86 We will continue to monitor the activities of payday lenders to ensure they comply with the credit legislation, including the Enhancements Act provisions, and will provide information and assistance to the independent review to be undertaken as soon as practicable after 1 July 2015.²⁶

²⁶ National Credit Act, s335A.

A Background

Key points

The Enhancements Act introduced specific provisions for small amount loans to address the particular risks of this type of credit.

We undertook a review to assess industry's compliance with the payday lending provisions in the Enhancements Act, which included reviewing 288 files from 13 payday lenders.

What is a 'small amount loan'?

- 87 When the National Credit Act commenced in July 2010 there was no legislative definition of the different types of credit offered by licensees. As such, numerous expressions were used to describe loans of small amounts for terms of less than a year, such as 'micro loans', 'short term loans', 'small amount loans' and 'payday loans'.
- 88 With the Enhancements Act, the Commonwealth Government introduced measures to address the particular risks associated with small amount lending, including the risk of consumers falling into a debt spiral through the repeated or continued use of high-cost small amount loans, with the result that:
- (a) an increasing proportion of their income becomes committed to meeting repayments; and
 - (b) the capacity of the consumer to use the credit for purposes that can improve their standard of living is diminished (and can result in consequent broader effects, including adverse effects on the health of the consumer).²⁷
- 89 The Enhancements Act defines a 'small amount credit contract' as a contract that:
- (a) is not a continuing credit contract and is unsecured;
 - (b) is not provided by an authorised deposit-taking institution (ADI);
 - (c) has a credit limit of \$2000 or less; and
 - (d) has a term between 16 days and one year.

Note: In this report we refer to 'small amount credit contracts' as 'small amount loans' or 'payday loans' and the licensees who provide these loans as 'payday lenders'.

²⁷ See, for example, Revised Explanatory Memorandum, paragraphs 4.6–4.8 and 5.6–5.12.

Legislation and guidance

- 90 The National Credit Act introduced a number of statutory obligations on credit licensees in July 2010. These measures include licensing requirements and general conduct and responsible lending obligations, together with requirements for IDR processes and membership of an ASIC-approved EDR scheme.
- 91 The responsible lending obligations require credit licensees (including payday lenders) to:
- (a) make reasonable inquiries into a consumer's requirements and objectives;
 - (b) make reasonable inquiries into a consumer's financial situation;
 - (c) take reasonable steps to verify a consumer's financial situation;
 - (d) assess whether a proposed credit contract will meet the consumer's requirements and objectives; and
 - (e) assess whether a consumer will be able to meet their obligations under a proposed credit contract without substantial hardship.
- 92 RG 209 sets out our expectations and offers practical guidance to help credit licensees understand and comply with their responsible lending obligations. It was initially released in February 2010, updated in light of the Enhancements Act provisions in February 2013 and further updated in November 2014 to reflect the *ASIC v TCS* decision and clarify existing guidance.
- 93 We also issued REP 264 in November 2011, which sets out the findings of our review of 19 payday lenders who offered payday loans at that time. This report identified a number of potential compliance risks for payday lenders.
- 94 The responsible lending obligations and payday loans have been the subject of judicial consideration in the *ASIC v TCS* decision, where the Federal Court ruled that The Cash Store Pty Ltd (in liquidation) and loan funder Assistive Finance Australia Pty Ltd had failed to comply with their responsible lending obligations in relation to their customers, the majority of whom were on low incomes or receiving Centrelink benefits.
- 95 Where we have identified systemic non-compliance with the law we have also commenced separate proceedings against Teleloans Pty Ltd and Finance & Loans Direct Pty Ltd, and Fast Access Finance Pty Ltd, Fast Access Finance (Beenleigh) Pty Ltd and Fast Access Finance (Burleigh Heads) Pty Ltd.²⁸

²⁸ 15-032MR and Media Release (14-150MR). *ASIC takes action against payday lending businesses* (3 July 2014).

96 We continue to provide guidance to consumer credit industry associations, both informally and via presentations at annual conferences or training days.

Small amount lending provisions

97 The Enhancements Act was introduced as the result of concerns about the repeated use of high-cost credit, particularly the risk to consumers of falling into a debt spiral. There was also a concern that the responsible lending obligations may not, on their own, be satisfactory in ensuring effective consumer protection in the small amount loans industry for the most vulnerable consumers.²⁹

98 Concerns were also held about various business models that were being used to avoid the state-based interest rate caps, particularly in New South Wales and Queensland.³⁰

99 In response to these concerns, the Enhancements Act introduced additional provisions for small amount loans, including:

- (a) the presumptions of unsuitability, which are made up of the presumption that a small amount loan will be unsuitable if either:
 - (i) the consumer is in default under another small amount loan; or
 - (ii) the consumer has had two or more other small amount loans in the last 90 days;
- (b) a cap on the fees and charges of the loan;
- (c) a requirement that consumers who default under a small amount loan must not be charged an amount that exceeds twice the adjusted credit amount;
- (d) a prohibition on entering into a small amount loan where the consumer receives at least 50% of their gross income under the Social Security Act and the repayments under the proposed small amount loan would exceed 20% of the consumer's gross income (protected earnings amount);
- (e) a prohibition on charging an establishment fee if any of the credit is used to refinance another small amount loan;
- (f) a requirement to obtain the consumer's account statements for the 90-day period prior to the assessment, and consider this financial information when determining whether or not the proposed loan is suitable; and
- (g) disclosure of a small amount loans warning statement advising consumers of alternatives to a small amount loan.

²⁹ Revised Explanatory Memorandum, paragraph 11.107–11.11.

³⁰ Revised Explanatory Memorandum, paragraphs 5.6 and 11.143.

- 100 Further, in June 2014 the National Consumer Credit Protection Amendment (Small Amount Credit Contracts) Regulation 2014 commenced. The regulation included particular fees and charges that are to be included in the calculation of charges to determine if the credit is regulated under the National Credit Code.³¹
- 101 This provision is expressed to be for the avoidance of doubt and addresses particular avoidance schemes used by payday lenders.
- 102 These provisions address the risks associated with using small amount loans and ensure consumers who enter into these contracts are provided extra protections.

Purpose of our review

- 103 As the Enhancements Act recently commenced it was timely for ASIC to conduct a review of the payday lending industry, given the additional small amount lending provisions and the risk to vulnerable consumers should the provisions be avoided.
- 104 The purpose of the review was to:
- (a) assess industry's awareness and compliance with the small amount lending provisions in the Enhancements Acts and National Consumer Credit Protection Regulations 2010 (National Credit Regulations);
 - (b) enhance our understanding of current industry practice; and
 - (c) assess industry's compliance in light of our findings in REP 264 and guidance in RG 209.

Methodology

- 105 We reviewed intelligence and reports of misconduct we had received from consumers, consumer advocates and members of the industry. We selected lenders that we identified as being at higher risk of non-compliance with responsible lending and disclosure obligations.
- 106 We also identified a sample of payday lenders who operated across Australia, including in regional areas, and lenders who were part of REP 264. We selected a mix of lenders who conducted business online, over the telephone and in shopfronts. We selected 17 payday lenders to participate in this review, which included eight lenders who had participated in REP 264.

³¹ National Credit Code, s6.

107 We wrote to these lenders and informed them that they had been selected to
take part in the review. In the initial stage, four lenders stated that they had
not provided small amount loans since the Enhancements Act commenced;
they were subsequently removed from the review.

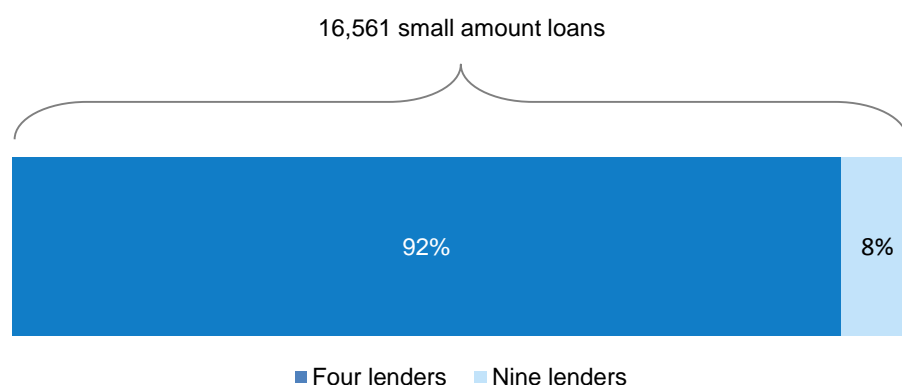
108 From the remaining 13 payday lenders (four of which were from our earlier
review) we then obtained information covering:

- (a) their business, the types of loans they provided and the ways consumers
approach them for a loan; and
- (b) the processes they had in place to comply with the Enhancements Act
provisions.

109 The participants were also asked to provide details of the small amount loans
they entered into during a two-week period in August 2013.

110 The selected payday lenders reported that a total of 16,561 small amount
loans were entered into during the two-week period. Four of the 13 lenders
were responsible for 92% of the loans: see Figure 1.

Figure 1: Small amount loans entered into by the payday lenders reviewed (18–30 August 2013)



111 We selected a number of consumer files from the lists provided by the
payday lenders for further review. This selection aimed to get a sample of
files that represented the amount and term of the loans, whether any of the
presumptions were triggered, a mix of loans entered into online, via a
shopfront or over the telephone, and to consumers with different sources of
income.

112 We then reviewed the 288 files to assess the processes and record keeping
undertaken by the payday lenders. Our review focused on whether the loans
appeared to be not unsuitable for the consumer based on their objectives,
requirements and financial position, as set out in the information on the file.
To do this, we considered how the lenders approached the enhanced

responsible lending provisions, particularly the presumptions of unsuitability.

- 113 We have established from the information provided by the 13 lenders that our review has captured lenders who cover approximately three quarters of the payday lending industry.

B Key findings

Key points

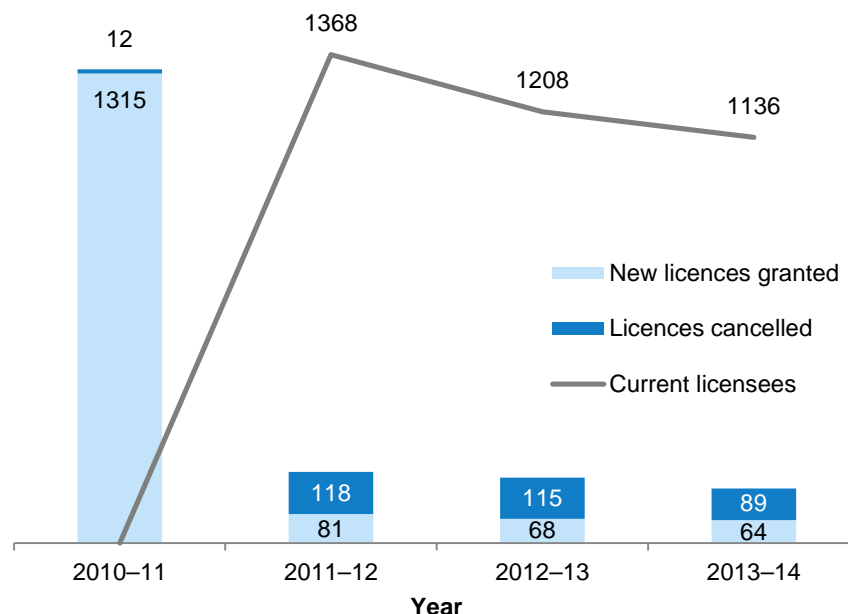
The payday lending industry is aware of its obligations and the new provisions in the Enhancements Act, and has adapted to the cap-on-costs provisions by diversifying the products and services it offers.

Industry has moved away from previous state and territory cap-on-costs law avoidance schemes, has a strong internet presence and is moving to more automated processes to assist in meeting its obligation to inquire into and verify a consumer's financial situation.

Despite triggering the presumptions of unsuitability, payday lenders are allowing a large number of consumers continue to use payday loans to increase their regular monthly budget.

The payday lending industry in 2014

- 114 There has been some commentary from the payday lending industry that the introduction of the Enhancements Act provisions has led to many lenders leaving the market. While ASIC data does show a reduction in licence numbers for people operating in this sector, it also shows applications for credit licences continued to be received from new entrants to the market.
- 115 As at December 2014 there were approximately 1,136 Australian credit licensees that identified that they operate in the payday lending industry (out of a total of 5,842 Australian credit licensees). This figure has declined slightly (by about 6%) over the last 12 months.
- 116 ASIC continues to receive new licence applications for lenders that identify as offering small amount loans, with 64 such applications being approved by ASIC in the 2013–14 financial year, slightly down from 68 in the previous year.
- 117 The number of lenders leaving the credit industry (licence cancellations) has also been declining, with 89 cancellations for payday lenders in the 2013–14 financial year, down from 115 in the previous year.

Figure 2: Credit licensing data for the payday lending industry

Note: The data for 'Current licensees' is drawn from the number of annual compliance certificates lodged by credit licensees in the relevant time period that indicated the licensee was engaged in the payday lending industry.

118 We have seen some consolidation in the industry, with some smaller lenders who were operating on the margins taken over by larger operators.

119 Nine of the 13 payday lenders in the review have also diversified their business since the new cap-on-costs provisions commenced. Other business interests and products offered identified in the review include:

- (a) medium amount loans;
- (b) other credit contracts;
- (c) cheque cashing;
- (d) gold buying;
- (e) purchasing delinquent debts;
- (f) secured loans; and
- (g) pawnbroking.

120 We estimate the number of payday loans being entered into continues to grow, with the value of loans written as at June 2014 being approximately 125% above what was written in 2008.³²

³² Based on updated financial statements of publicly listed companies and the methodology devised by the Consumer Action Law Centre and Zac Gillam in 2010.

90-day account statements

- 121 The responsible lending obligations that commenced in 2010 require payday lenders to make reasonable inquiries into and verification of a consumer's financial situation.
- 122 The Enhancements Act introduced a requirement that payday lenders must obtain and consider account statements for the consumer for the preceding 90-day period. It should be noted that this is an additional requirement, and does not limit the steps needed to verify the information a payday lender obtains under their usual responsible lending obligations. The Revised Explanatory Memorandum to the Consumer Credit Legislation Amendment (Enhancements) Bill 2012 (Revised Explanatory Memorandum) notes:
- This provision seeks to ensure that the licensee considers the income and expenses of the consumer as disclosed by their transaction history in the account statement. It could ordinarily be assumed that licensees would obtain this type of information in order to comply with the responsible lending obligations. However, a specific obligation has been introduced in relation to small amount credit contracts, given, first, the particular risks associated with this product, and, second, the evidence from reviews undertaken by ASIC since the commencement of responsible lending conduct obligations has found that there are inconsistent standards in this sector, resulting in a greater need for statutory direction.³³
- 123 Our review found payday lenders were aware of this requirement and had adequate systems in place to ensure they received the necessary account statements. There were, however, varying levels of consideration of these statements by lenders, which is discussed further in paragraphs 190–199.
- 124 Of the 288 files reviewed, 94% contained account statements for the full 90-day period.
- 125 Only one payday lender did not obtain account statements covering the full 90-day period for any of its files and, after ASIC intervention, this lender is no longer offering small amount credit contracts.
- 126 There was one other lender who did not collect 90-day account statements for returning customers, and we have used our regulatory powers to issue an infringement notice to address the non-compliance. The lender has also updated their policies and procedures to ensure compliance in the future.³⁴

Protected earnings amount

- 127 To provide further protection for consumers who receive the majority of their income under the Social Security Act, the Enhancements Act ensures

³³ Revised Explanatory Memorandum, paragraph 4.26.

³⁴ 14-313MR.

that consumers in these circumstances who take out a small amount loan will not have repayments that would exceed 20% of their income (the protected earnings amount provision).

128 Payday lenders have responded positively to this new requirement and have systems in place to ensure they are not offering loans at repayment rates above the mandated level.

129 Our review identified different practices in response to this provision, with two of the payday lenders reviewed stating that they had adopted a 20% repayment ceiling for all consumers, regardless of the source of the consumer's income.

130 Others approaches taken included excluding any income received from Centrelink in the calculation of a consumer's income or relying on the lender's responsible lending policies.

131 Six of the 13 payday lenders have ceased offering small amount loans to consumers who receive the majority of their income from Centrelink.

132 We found that 24% of the 288 loans were entered into with consumers who received more than 50% of their income from Centrelink. None of these 68 loans included terms requiring repayments that were more than 20% of the consumer's income.

133 However, our review found that in many instances lenders were not complying with their own policies. For example, loans were provided to a consumer who hit the protected earnings threshold in circumstances where the lender's internal policy was to reject all applications from consumers who received income from Centrelink.

134 While we found no evidence that the protected earnings amount provision was not being complied with, even in circumstances where the lender acted contrary to their internal policy, we are concerned that some payday lenders do not comply with their own policies.

Cap on costs

135 Historically, there were significant differences in the level of costs charged by payday lenders, in part reflecting the difficulties some consumers have obtaining credit from other lenders, with the result that they enter into loans irrespective of the costs being charged.

136 The risk to a consumer of financial detriment increases:

- (a) the lower the consumer's income,
- (b) the shorter the term of the loan,

- (c) the higher the number of loans they take out; and
- (d) the higher the level of costs charged by the payday lender.

137 The combination of these factors can result in such a reduction in income that the consumer may, in a very short period, be placed in a position where the debt cannot be repaid, or can only be repaid through a significant drain on the consumer's financial resources.³⁵

138 To address this, the Enhancements Act introduced a cap on costs that restricts the maximum amount that can be charged on a small amount loan to an upfront fee (maximum of 20% of the adjusted credit amount) and a monthly fee (maximum of 4% of the adjusted credit amount). In certain circumstances a payday lender may also collect third-party direct debit fees.

Note: 'Adjusted credit amount' is the first amount of credit that is, or is to be, provided under the contract.

139 Generally, the payday lending industry has a good understanding of the new fee structure and appears to be applying it in accordance with the legislation. The industry has adapted to the new cap-on-costs provisions and the majority of industry has ceased using previous state and territory cap-on-costs law avoidance schemes.

140 One payday lender did not appear to understand how to apply the cap on costs and we have ensured that this lender has left the industry and that the relevant consumers were not disadvantaged.

141 We continue to work with industry to ensure they are not charging fees in circumstances where they are prohibited. We have been encouraged to see many of the avoidance schemes (such as the diamond trading scheme) that operated previously—to avoid state and territory interest rate caps—have ceased, and the majority of payday lenders have sought to return to a more traditional lending model.

142 While we are seeing fewer lenders using avoidance schemes, we are taking action to address avoidance schemes—for example, the legal action we have commenced in the Federal Court of Australia against Fast Access Finance Pty Ltd, and against Teleloans Pty Ltd and Finance and Loans Direct Pty Ltd.

143 However, we have identified problematic practices where payday lenders set the loan term on credit contracts 12 months or more in circumstances where the relevant file indicated that the consumer requested a shorter loan term of well under 12 months. This seems to be an attempt to ensure, even if the consumer pays out the loan earlier than the term, the lender still recovers

³⁵ Explanatory Memorandum to the Consumer Credit and Corporations Legalisation Amendment (Enhancements) Bill 2011, paragraphs 5.7 and 5.8.

12 months' worth of monthly fees. In these circumstances, the contract may not meet the consumer's requirements and objectives. Payday lenders need to be cautious in setting up their loans in this way and charging consumers fees calculated on a term that is longer than the consumer requested.

Warning statement

- 144 The Enhancements Act introduced a requirement that payday lenders disclose a warning statement advising consumers of the alternatives to a small amount loan. The warnings statement must also include the following text:
- It can be expensive to borrow small amounts of money and borrowing may not solve your money problems.
- Check your options before you borrow:
- For information about other options for managing bills and debts, ring 1800 007 007 from anywhere in Australia to talk to a free and independent financial counsellor
 - Talk to your electricity, gas, phone or water provider to see if you can work out a payment plan
 - If you are on government benefits, ask if you can receive an advance from Centrelink: Phone: 13 17 94
- The Government's MoneySmart website shows you how small amount loans work and suggests other options that may help you.
- 145 The warning statement must be given regardless of the how the consumer contacts the lender—for example, over the internet, via a shopfront or over the telephone.
- 146 The Explanatory Memorandum to the Consumer Credit and Corporations Legislation Amendment (Enhancements) Bill 2011 states:
- Improving disclosure about the availability of alternatives will help consumers to make better and more informed financial decisions and to seek out lower cost alternatives to relatively higher cost short-term credit contracts.³⁶
- 147 We asked the 13 payday lenders in our review how they disclosed the warning statement to consumers in different circumstances, and also reviewed the lenders' websites.
- 148 We found that the number of visits to MoneySmart from the websites of the payday lenders who participated in the review increased dramatically for the 12 month period from 1 March 2013, when compared with the 12 months prior. These numbers continue to increase. We also saw that consumers are

³⁶ Explanatory Memorandum to the Consumer Credit and Corporations Legislation Amendment (Enhancements) Bill 2011, p. 5.

much more likely to visit MoneySmart where the lender provides hyperlinks in the warning statement to that website.

- 149 The majority of payday lenders have made genuine efforts to introduce a warning statement for consumers. However, five of the 13 lenders had a warning statement that was not sufficiently prominent to attract consumer's attention.
- 150 One of the five lenders included statements about gambling and alcohol use in their warning statement, which may detract from the prominence of the information about alternatives to a small amount loan.
- 151 When alerted to potential non-compliance, two of the five lenders took immediate steps to update their warning statements and remedy our concerns. Another undertook their own internal review and self-reported a failure to provide consumers with the telephone warning statement in certain circumstances.
- 152 We have communicated with the other two lenders to provide further guidance. We acknowledge that payday lenders operating via a website have been working hard to ensure that numerous pages on their sites are updated to include the warning statement.
- 153 Payday lenders are at risk of breaching the specific provisions on warning statements (which have criminal and civil consequences) and their licensee obligations if the wording and the placement of the warning statement are not in compliance with the small amount lending provisions and the intent of those provisions.
- 154 The warning must be effectively communicated to consumers. Lenders should be mindful of this when creating their websites; for example, they should:
- (a) avoid placing the warning statement at the bottom of a long page that requires a consumer to scroll down to it;
 - (b) be careful that any pop-up browser windows on the website does not make it difficult for consumers to see the warning statement; and
 - (c) ensure that consumers must acknowledge that they have read the warning statement before they can apply for a loan..
- 155 Our review also identified instances where lenders with more than one entrance to their shopfront premises only displayed the warning statement on one entrance. Payday lenders must satisfy themselves that consumers entering their premises have been provided with an opportunity to see the warning statement, regardless of how they have entered the premises.

Unsuitable loans—Presumption tests

- 156 The Commonwealth Government introduced measures to address the particular risks associated with small amount lending, including the risk of consumers falling into a debt spiral through the repeated or continued use of high-cost small amount loans. One of these measures was the introduction of rebuttable presumptions, known as the presumptions of unsuitability.
- 157 The Revised Explanatory Memorandum states:
 The effect of the presumptions is that, unless the contrary is proven, a consumer would be considered to be in substantial hardship. The provisions therefore place an onus on a licensee to establish that the [small amount] credit contract was suitable for the consumer. These provisions provide targeted reform to address concerns in relation to both debt spirals and recurrent use of small amount credit contracts. The more credit contracts that the borrower takes out within a short period of time (whether concurrently or successively), the more likely it is that income is being continually diverted to meet the repayments, and the greater the risk that they may experience consequent financial hardship.³⁷
- 158 ASIC policy states:
 Additional responsible lending requirements for small amount credit contracts have been imposed because of the particular risks to consumers that can result from using these kinds of credit contracts. In particular, there are risks that the repeated or continued use of credit provided through this form of credit contract will result in consumers entering into multiple contracts where the overall level of indebtedness increases over time so that:
- (a) an increasing proportion of the consumer's income will need to be used to meet the repayment; and
 - (b) the capacity of the consumer to use the credit to improve their standard of living is diminished.³⁸
- 159 We asked the payday lenders in our review to explain how they identified if a presumption applied. All 13 stated that they asked the consumer to identify if a presumption had been triggered using an application form and verified this by reviewing the consumer's account statements. Three lenders also obtained the consumer's credit report.
- 160 Two lenders stated that if they identified that the consumer had another small amount loan, they requested the consumer's permission to contact the other lender to confirm the consumer's position.
- 161 Generally, we saw three approaches in the way payday lenders responded to these presumptions. Lenders either:
- (a) treated the presumptions as a prohibition;

³⁷ Revised Explanatory Memorandum, paragraph 4.30.

³⁸ RG 209.13.

- (b) used the presumptions as a trigger to make further inquiries; or
- (c) relied on their responsible lending practices and ignored whether a presumption was triggered.

162 Our review found approximately 62% of the 288 files indicated that the payday lender had entered into a loan with a consumer who triggered one of the presumptions of unsuitability.

163 We found that payday lenders are still allowing some consumers to use payday loans as part of their monthly budget, despite triggering the presumptions of unsuitability. The majority of files reviewed indicated that each consumer had taken out two or more small amount loans with the same payday lender within the review period. Some consumers had as many as five or six loans with the same payday lender.

164 From the information contained in the files we reviewed, at the time of the lender's assessment of unsuitability, in the previous 90 days:

- (a) on 7.6% of files, of consumers were in default under another small amount loan;
- (b) on 10.4% of the files it was unclear if the default presumption was triggered;
- (c) on 54.2% of files, consumers had entered into two or more small amount loans; and
- (d) on 2.8% of the files, it was unclear if the multiple loan presumption was triggered.

165 We also identified that seven of the 13 lenders entered into a loan that required repayment via a single payment. In these circumstances, a high percentage of a consumer's fortnightly or monthly income would be required to meet their obligations under the contract. This may increase the chances that repaying the loan would cause a consumer substantial hardship, particularly where it is clear from the account statements that the consumer regularly takes out small amount loans and has no identifiable savings.

166 For one lender that identified that a presumption was triggered and sought to rebut it, our review identified that they did this by doing one or more of the following:

- (a) making further inquiries directly with the consumer about any current small amount loans, such as when the loan term ended and what the repayments were;
- (b) contacting the other payday lender directly to confirm details of the loan;
- (c) obtaining the consumer's credit file;

- (d) asking the consumer to sign a declaration of the purpose of their loan, their financial position and ability to service the loan;³⁹ and
 - (e) asking the consumer how they could meet the repayments without substantial hardship.
- 167 Our review identified only one of the 13 payday lenders reviewed was using this approach. The files of the remaining lenders did not indicate any rebuttal of the presumptions of unsuitability.
- 168 Lenders who enter into a small amount credit contract with a consumer in circumstances where the presumptions of unsuitability are triggered, and have no information on file to indicate how the presumptions were rebutted, will be very unlikely to be able to establish that they have met their responsible lending obligations in relation to the particular loan.

Consumers requirements and objectives

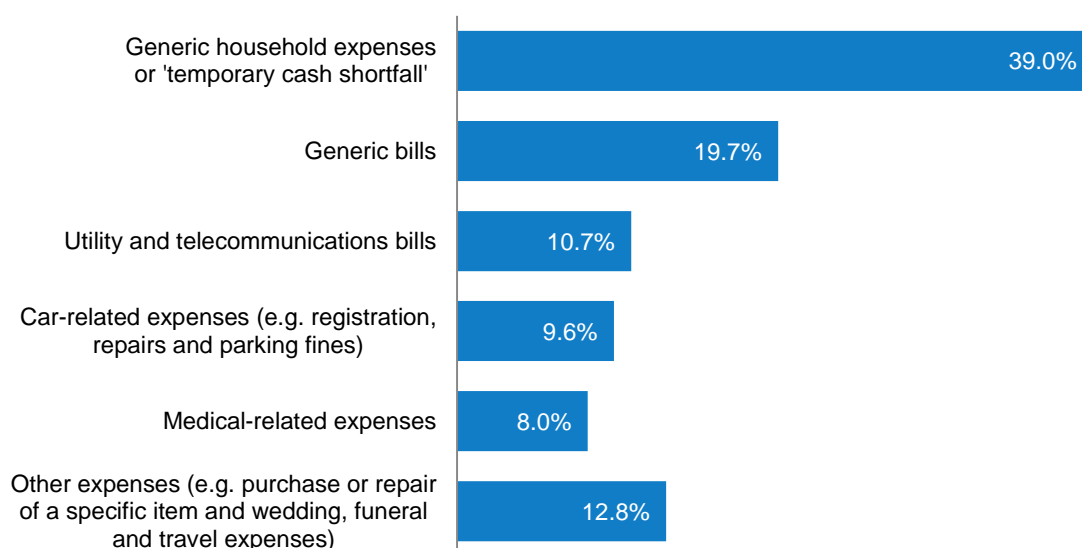
- 169 The National Credit Act introduced general obligations for payday lenders, including an obligation to make reasonable inquiries about the consumer's requirements and objectives in relation to the loan. This obligation applies to all lenders, including payday lenders.
- 170 In RG 209.33 we list potentially relevant inquiries that a lender should make, which include:
- (a) the amount of credit needed or the maximum amount of credit sought;
 - (b) the timeframe for which the credit is required;
 - (c) the purpose for which the credit is sought and the benefit to the consumer;
 - (d) whether the consumer seeks particular product features or flexibility, the relative importance of different features to the consumer, and whether the consumer is prepared to accept any additional costs or risks associated with these features; and
 - (e) whether the consumer requires any additional expenses and whether the consumer is aware of the additional cost of these expenses being financed.
- 171 The Revised Explanatory Memorandum states:
- even if a consumer can repay a small amount credit contract (or other type of credit contract) without such hardship it does not mean that the contract necessarily or invariably meets their requirements and objectives. A licensee would still need to make additional inquiries to meet their statutory

³⁹ Any consumer declaration does not discharge the lender's responsibility to comply with their responsible lending obligations.

obligations; for example, some research has found that some consumers have conflicted objectives in that they still use small amount credit contracts when their preference would be to avoid this outcome if at all possible.⁴⁰

- 172 REP 264 highlights that:
- maintaining details on file as to the specific purpose of the individual loan (e.g. car repairs) reduces the risk of micro lenders not being able to demonstrate that they have made reasonable inquiries into a consumer's requirements and objectives.⁴¹
- 173 How the purpose of each loan was recorded differed between the payday lenders, with a small number of files having multiple purposes listed. Of the 288 files reviewed, 187 recorded the consumer's purpose for the loan.

Figure 3: Breakdown of loan purpose



- 174 Our review found there are still some payday lenders who have not responded to earlier ASIC guidance and continue to use high-level statements to describe the purpose of the loan, such as 'temporary cash shortfall'.
- 175 Further, as more payday lenders gain an online presence, many are reverting to pro forma responses on application forms that do not provide consumers with an opportunity to present their individual requirements and objectives on all loans.
- 176 Payday lenders should be mindful of the recent *ASIC v TCS* decision, where Davies J noted that to meet their obligation to make reasonable inquiries into a consumer's requirements and objectives a lender must ensure the purpose

⁴⁰ Revised Explanatory Memorandum, paragraph 4.32.

⁴¹ REP 264, Finding 4.1.

provided for a loan is reasonably specific and the amount of credit provided to the customer is consistent with that purpose.

- 177 The decision also noted that using general information would not enable a lender to sufficiently understand a consumer's requirements and objectives in obtaining the credit.
- 178 Payday lenders who only provide consumers with a drop-down list of set options to record the purpose of the loan, or only record high-level statements, are very unlikely to meet their obligation to ascertain the consumer's requirements and objectives for a loan in every case.
- 179 Payday lenders that are not making reasonable inquiries about a consumer's requirements and objectives also leave themselves at risk of breaching other provisions in the Enhancements Act, should they charge an establishment fee in circumstances where any part of the funds advanced will be to pay off another small amount loan.
- 180 Payday lenders who charge an establishment fee in these circumstances are at risk of civil action to pay the fee back to consumers, administrative action by ASIC or penalties of up to \$600,000.

Policies, procedures and record keeping

- 181 At the time of our original review (REP 264), many lenders were still testing and updating their responsible lending procedures. The 13 payday lenders in our review had settled their original general responsible lending procedures; however, these had recently been updated to factor in the new Enhancement Act requirements.
- 182 Despite having settled their policies and procedures, we were concerned to see instances of payday lenders not following their own internal policies and procedures.
- 183 For example, the responsible lending policies of one lender stated that consumers who triggered the presumptions of unsuitability would be declined a loan. However, when we reviewed the files for that lender's loans, we identified that 89% of those loans may have triggered the presumptions but there was no further information on file to record why the loan applications had progressed and the loans entered into.
- 184 Payday lenders who have written policies and procedures that are not being followed are at just as much risk of breaching their general conduct obligations as lenders who have no written policies and procedures in place.
- 185 The holder of an Australian credit licence must keep a record of all material that forms the basis of an assessment of whether a loan will be unsuitable for

a consumer. The material must be in a form that will enable the credit licensee to give the consumer a written copy of the assessment if requested.⁴²

186 Generally, payday lenders recorded the consumer's financial information sufficiently; however, some payday lenders in the review did not adequately record the consumer's requirements and objectives on the file. Some payday lenders chose not to keep any physical records; rather, they scanned all documents relating to a consumer's loan or received and saved these documents electronically, particularly credit reports, as some lenders were concerned about keeping the hard copy document once it had been reviewed.

187 We also found evidence of payday lenders keeping records across several different media or venues. In circumstances where a payday lender holds the file in separate systems or formats, they must ensure that they can access a consumer's full file when required. For example, during the review we served a notice on a payday lender requiring them to provide full copies of files. Some documents were provided, but the files did not contain any supporting documents such as income documentation. The lender was approached three times before all the relevant records were collected.

188 A payday lender who is not easily able to access all relevant information regarding a consumer's file, or who does not adequately record all relevant information on the consumer's file, leaves themselves at risk of being in breach of their obligations as a credit licensee and their record keeping licence condition. This means that the licensee is at risk of action from ASIC, including licence suspension, cancellation or a banning order preventing them from engaging in credit activities. Consumers may also take action to recover money in circumstances where they have suffered a loss.

Inconsistent information

189 Our review identified instances where the information on the consumer's account statements conflicted with earlier information recorded on the file. This is not a new area of concern, as we raised this issue in REP 264 in November 2011.

190 Further, we have provided guidance in RG 209 where we note that in circumstances where consumers provide inconsistent information additional inquiries about the consumer are warranted.

191 In circumstances where the information on a consumer's account statement conflicts with information previously given or does not provide specific information, a payday lender must make further inquiries into and

⁴² Pro Forma 224 *Australian credit licence conditions* (PF 224), condition 17.

verification of the consumer financial situation, and make file notes or keep records of these further inquiries.

192 We found some payday lenders dealt with conflicting information by:

- (a) contacting the consumers to seek clarification or provide further information;
- (b) making notes on the account statements and file notes of conversations with consumers discussing the information from the account statement; and
- (c) where it was clear that a consumer's income fluctuated, relying on the lower income amount.

193 Those payday lenders who are not dealing with conflicting information using one of the above strategies leave themselves at risk of being unable to provide enough information from their records to establish that they have met their responsible lending obligations.

194 Our review of payday lenders' files also identified situations where the consumer had made one or two large withdrawals each pay cycle leaving the lender with no information on the account statement as to what the money was being spent on.

195 In these circumstances we would expect to see evidence on the file of other inquiries into and verification of the consumer's financial situation, such as rent receipts and payslips.

196 Lenders must remain vigilant when using information gained via a third party and ensure that they have the necessary procedures in place to identify discrepancies and ensure further inquiries will be made.

197 Some payday lenders were not making adequate inquiries with a consumer about whether they had more than one account with an ADI where income is received. One payday lender had statements from the consumer covering the 90-day period on file. However, a review of the statements showed no income being paid into that account.

198 In this circumstance, not only is the lender in breach of the specific 90 day account statement requirement, they are also at risk of breaching the general responsible lending obligations as they haven't gained enough information to ascertain whether the contract would be not unsuitable.

Third-party software providers

199 The Enhancement Act specifies that payday lenders must obtain and consider account statements for the preceding 90 days as one of the steps necessary to verify a consumer's financial situation.

- 200 Our review found payday lenders were aware of the requirement to obtain and review account statements. They have generally introduced new procedures to ensure these statements are obtained for the full 90-day period.
- 201 These procedures include asking consumers to produce their account statements via email, fax, in hard copy or via using third-party software providers to draw the statement from the consumer's internet banking portal.
- 202 The third-party software systems have been around for some time and we considered the use of similar products (known as account aggregation products) in 2001: Consultation Paper 20 *Account aggregation in the financial services sector* (CP 20). At that time the technology was not being used by payday lenders.
- 203 CP 20 identified that consumers using these software platforms to access their banking data may:
- (a) not understand that they are providing these details to a third-party software provider and not to the lender;
 - (b) not be comfortable with the security standards of the third-party software provider;
 - (c) not understand and agree to the privacy policy of the third-party software provider;
 - (d) not understand that their information may be sent outside Australia,
 - (e) not understand that by providing internet banking log-in information via a third-party software provider's system the consumer may be breaching the relevant ADI's terms and conditions of using internet banking;
 - (f) not have access to EDR schemes if there is a complaint against the third-party software provider.
- 204 It is unclear at this early stage how the use of third-party software providers by payday lenders interacts with consumer protections against fraud and unauthorised transactions under the ePayments Code.
- 205 Specifically, it appears that consumers are not protected under the ePayments Code if they access their internet banking portal via a third-party software provider's system and the third party was not promoted, endorsed or authorised by the consumer's banking institution.
- 206 When we reviewed payday lenders' files in 2010 (see REP 264), we found the use of account statements was common, with 11 of the 19 lenders at that time collecting statements from consumers. All 11 lenders gained the account statements directly from consumers.

- 207 However, we found at the time that the information contained on the statements was often not used by the payday lender for the purposes of the assessment of unsuitability.
- 208 In our current review, we found seven of the 13 lenders were using third-party software providers for the purposes of gaining the 90-day account statements. These lenders have differing information available to consumers that explain the role of those providers.
- 209 While we are pleased that some lenders have identified and disclosed risks for consumers in using the third-party software provider's system, we encourage payday lenders to review any statements made to consumers to ensure they are prominently explaining the risks of using this service.
- 210 Further, we would encourage payday lenders to provide consumers with alternative options for how they wish to produce their account statements should they chose not to use the third-party software provider.
- 211 As the use of third-party software providers to assist with accessing consumer's account statements is relatively new in the payday lending industry, we are continuing to consider information about how these providers operate and interact with payday lenders.
- 212 We are also considering the policies lenders have to ensure that, when using the information provided by third-party software providers, the lender is satisfied that they are meeting their responsible lending obligations. We saw a small number of account statements provided to lenders, from both third-party software providers and directly from consumers, where a loan payment from a lender to a borrower was incorrectly identified as 'salary'. We easily identified this as an error and would expect payday lenders in this situation to consider the information in the consumer's application, or make further inquiries of the consumer.
- 213 Lenders must remain vigilant when using information gained via third-party software providers and ensure they have the necessary procedures in place to identify discrepancies and make further inquiries.

C Further work

Key points

We are working with payday lenders and industry bodies to ensure they understand their obligations. We continue to gain information about new developments in the payday lending industry.

We consider the findings of this review relevant for all lenders, and encourage lenders to regularly review their processes and procedures.

- 214 We are raising any concerns directly with the individual payday lenders and will consider specific circumstances when assessing the use of our regulatory tools.
- 215 We will also be raising key issues with industry bodies and will continue to work with them to help their members meet these requirements.
- 216 We will continue to gain information about how third-party software providers are operating in the payday lending industry and the effect on consumers' protections under relevant laws and codes of practice.
- 217 Although this review focused on small amount loans, many of the findings are equally relevant for lenders offering other products—for example, in circumstances where the information on a consumer's account statement conflicts with information previously given or does not provide specific information, a lender must make further inquiries into a consumer's financial situation, and make file notes and keep records of these further inquiries.
- 218 We encourage payday lenders to regularly review their processes and procedures to ensure that they are able to demonstrate that they are meeting their responsible lending and disclosure obligations.
- 219 We will provide assistance to the independent review of the small amount lending provisions in the Enhancements Act to be called later this year.

Key terms

Term	Meaning in this document
14-313MR (for example)	An ASIC media release (in this example numbered 14-313)
ADI	Authorised deposit-taking institution
adjusted credit amount	The first amount of credit that is, or is to be, provided under the contract
ASIC-approved EDR scheme, EDR scheme or scheme	An external dispute resolution scheme approved by ASIC under RG 139
<i>ASIC v TCS</i>	<i>ASIC v The Cash Store (in liquidation)</i> [2014] FCA 926
assessment of unsuitability	The requirement contained in Ch 3, Pt 3-2, Div 3 of the National Credit Code
cap-on-costs provision	The provisions contained in Sch 1, Pt 2, Div 4 of the National Credit Code
[CO 13/818] (for example)	An ASIC class order (in this example numbered 13/818)
credit licence	An Australian credit licence under s35 of the National Credit Act that authorises a licensee to engage in particular credit activities
credit licensee	A person who holds an Australian credit licence under s35 of the National Credit Act
default presumption	The presumption contained in s131(3A)(a) of the National Credit Act
EDR	External dispute resolution
Enhancements Act	<i>Consumer Credit Legislation Amendment (Enhancements) Act 2012</i>
IDR	Internal dispute resolution
IDR procedures, IDR processes or IDR	Internal dispute resolution procedures/processes that meet the requirements and approved standards of ASIC under RG 165
MoneySmart	ASIC's financial consumer information website at www.moneysmart.gov.au
multiple loan presumption	The presumption under s131(3A)(b) of the National Credit Act
National Credit Act	<i>National Consumer Credit Protection Act 2009</i>
National Credit Code	National Credit Code at Sch 1 of the National Credit Act

Term	Meaning in this document
National Credit Regulations	National Consumer Credit Protection Regulations 2010
payday lender	A credit provider that provides small amount loans
payday loan	Has the meaning given to 'small amount credit contract' in Sch 3 of the Enhancements Act
presumptions of unsuitability	The presumptions of unsuitability contained in s131(3A) of the Enhancements Act
protected earnings amount	The amount of money a lender cannot access for the purposes of loan repayments, according to reg 28S(3) of the National Credit Regulations
REP 264 (for example)	An ASIC report (in this example numbered 264)
Revised Explanatory Memorandum	Revised Explanatory Memorandum to the Consumer Credit Legislation Amendment (Enhancements) Bill 2012
RG 209 (for example)	An ASIC regulatory guide (in this example numbered 209)
small amount lending provisions	The provisions in Sch 3 of the Enhancements Act
small amount loan	Has the meaning given to 'small amount credit contract' in Sch 3 of the Enhancements Act
Social Security Act	<i>Social Security Act 1991</i>
warning statement	Statement required by Pt 3.5 of the National Credit Regulations

Related information

Headnotes

assessment of unsuitability, cap on costs, credit licensee, default presumption, multiple loan presumption, payday lenders, payday loans, presumptions of unsuitability, responsible lending obligations, small amount lending provisions, small amount loans

Class orders and pro formas

[CO 13/818] *Certain small amount credit contracts*

PF 229 *Australian credit licence conditions*

Regulatory guides

RG 209 *Credit licensing: Responsible lending conduct*

Legislation

National Credit Act, s335A; National Credit Code, s6, 31A(1A) and 31B; Enhancements Act; National Credit Regulations, reg 51; National Consumer Credit Protection Amendment (Small Amount Credit Contracts) Regulation 2014

Explanatory Memorandum to the Consumer Credit and Corporations Legislation Amendments (Enhancements) Bill 2011

Explanatory Memorandum to the National Consumer Credit Protection Bill 2009

Revised Explanatory Memorandum

Social Security Act

Cases

ASIC v TCS

Consultation papers and reports

CP 20 *Account aggregation in the financial services sector*

REP 264 *Review of micro lenders' responsible lending conduct and disclosure obligations*

Financial Conduct Authority, CP14/10 *Proposal for a price cap on high cost short-term credit*

Media releases

14-150MR *ASIC takes action against payday lending businesses*

14-278MR *ASIC continues crackdown on payday lending avoidance models*

14-313MR *Payday lender penalised for breaching new responsible lending laws*

15-032MR *Federal Court orders record penalty*