ASIC

Australian Securities & Investments Commission

Recommendations of the Review of the small amount credit contract laws

Submission by the Australian Securities and Investments Commission

June 2016

Contents

A Executive summary

1 The Australian Securities and Investments Commission (ASIC) is Australia's national consumer credit regulator, with oversight of lenders, consumer lessors and credit assistance providers who offer consumer credit products (including small amount or payday loans[1]) to Australians.

2 We provided two submissions to the review of the small amount credit contract laws (the review). Our first submission contained a number of suggestions for improvements to the rules that currently apply to payday loans and consumer leases.[2] Our second submission provided our comments on the observations and policy options identified in the review's interim report.[3]

3 We are making this submission to provide our feedback to Government on the final recommendations made by the review panel.[4] We consider the recommendations will deliver significant benefits, as they will:

(a) promote financial inclusion for low-income consumers, particularly by:

(i) reducing the amount they are charged when leasing household goods;

(ii) encouraging longer term contracts with lower repayments that reduce the risk of a debt spiral;

(iii) encouraging more use of low-cost alternatives; and

(iv) targeting practices that have a high risk of adverse financial outcomes; and

(b) provide greater certainty to credit providers and lessors through 'bright-line' obligations, such as a protected earnings amount for payday loans and consumer leases. This will both simplify compliance and assist ASIC to take enforcement action.

4 This submission also has a number of proposals that we consider are consistent with the objectives of the recommendations, and would facilitate credit providers' compliance or help them meet those objectives. These include:

(a) the introduction of a narrow-scope national database to ensure that credit providers and lessors can accurately identify a consumer's payday loan and consumer lease repayment obligations;

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[1] In this submission 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' or 'licensees'.
[2] ASIC, *Review of the small amount credit contract laws: Submission by the Australian Securities and Investments Commission* (PDF 452 kb), submission, October 2015.
[3] ASIC, *Review of the small amount credit contract laws: Second submission by the Australian Securities and Investments Commission* (PDF 190 kb), submission, January 2016.
[4] Treasury, *Review of the small amount credit contract laws: Final report*, March 2016.

(b) the introduction of a mandated delay between payday loans, to address the risk of prolonged or continued indebtedness through back-to-back payday loans; and

(c) the desirability of a tiered cap for consumer leases, with a lower cap applying to higher value goods (as is the case with credit contracts).

B Payday lending recommendations

Key points

The panel of the review of the small amount credit contract laws made 10 recommendations for law reform specifically in relation to payday loans (combined payday loan and consumer leasing recommendations are discussed in Section D). We generally support these recommendations and have made specific comments about the recommendations in this section.

Recommendation 1: Affordability

Recommendation 1

Extend the protected earnings amount regulation to cover SACCs provided to all consumers.

Reduce the cap on the total amount of all SACC repayments (including under the proposed SACC) from 20 per cent of the consumer's gross income to 10 per cent of the consumer's net (that is, after tax) income.

Subject to these changes being accepted, retain the existing 20 per cent establishment fee and 4 per cent monthly fee maximums.

5 We support the extension of the protected earnings amount regulation to all payday loans, and consider this regulation will deliver significant benefits to consumers. The introduction of a broad 10% net income cap on repayments also provides a clear, 'bright-line' limit on what consumers will be required to repay.

6 We understand that the intention of Recommendation 1 is that payday lenders would continue to be required to comply with their general responsible lending obligations (such as conducting a suitability assessment, making inquiries of the consumer's requirements and objectives and financial situation, and verifying this information). Following completion of these steps, payday lenders would then be required to ensure that the consumer's repayment obligations under all of their current payday loans, including the proposed loan, does not exceed 10% of the consumer's net income.

Determining a consumer's income

7 As indicated in our second submission, consideration will need to be given to how the limits on repayments would apply where a consumer's income fluctuates. We have seen examples of lenders relying on an average income amount without further inquiries and verification that justify such a figure.

Changes to the repayment amount

8 Our understanding is that the protected earnings amount would be measured against the minimum repayment obligation under the payday loan contract. We have previously seen instances of payday lenders setting loan repayment amounts in a manner that sought to avoid consumer protection provisions in the *National Consumer Credit Protection Act 2009* (National Credit Act); however, in practice repayments were made for much higher amounts.[5]

9 We expect that the implementation of a protected earnings amount would address these potential avoidance practices.

Compliance with the protected earnings amount requirement

10 To ensure a protected earnings amount is effective, it is important that lenders have up-to-date information about a consumer's current payday loan obligations. Innovations and changes to lenders' practices have in some instances made this information less accessible and transparent. For example, an increasing number of payday lenders are loading funds onto prepaid debit cards instead of transferring the funds into a consumer's bank account. This means that there may be a lack of visibility for payday lenders when assessing a consumer's current payday lending obligations, as deposits of loan funds would not be on a bank statement.

11 Further, as consumers may be able to enter into multiple payday loans within a short period of time, a lack of objective real-time information may prevent lenders from identifying all of a consumer's current repayment obligations.

12 To overcome this challenge (which also exists with the current presumptions against unsuitability), lenders will need to have some mechanism to determine whether a consumer has existing payday lending repayment obligations. As noted in our first two submissions, a narrow-scope national database to identify a consumer's current payday loan repayment obligations could simply and efficiently facilitate compliance for lenders.

Mandated delay between payday loans

13 In our first submission to the review we referred to the cooling-off period mandated in Florida, which requires a 24-hour gap between payday loans. In addition, we noted that the US Government was considering nationwide regulation of payday lending, which included a proposal to mandate a

[5] For example, see our media release on Fair Go Finance Pty Ltd: Media Release (16-027MR) *Payday lender penalised for overcharging consumers* (9 February 2016).

60-day cooling-off period that would apply after a consumer has had three payday loans in succession.[6]

14 We consider that, in the absence of the multiple-loan presumption against unsuitability, the introduction of a cooling-off period between payday loans in Australia (in addition to the protected earnings amount) is likely to be beneficial. It would also complement the effectiveness of the policy objective of the protected earnings amount.

15 A protected earnings amount would limit the maximum amount a consumer would be required to repay under all of their current payday loans. For example, if a consumer had a payday loan with repayments requiring 7% of their net income, any repayments under further payday loans would not be permitted to exceed 3% of their net income (i.e. a maximum of 10%). This places a cap on a consumer's maximum payday loan repayment obligations. However, a protected earnings amount would not prevent a consumer entering into back-to-back payday loans, with each new loan commencing immediately or shortly after the previous loan or loans have been repaid (with the consumer potentially making repayments of up to 10% of their net income over an extended period of time).

16 In our experience debt spirals can arise in both of these scenarios (i.e. from excessive repayment obligations from one or more payday loans and from back-to-back payday loans). In the case of back-to-back payday loans subsequent loans may, in effect, be paying for essential consumption that was forgone to repay the prior loan(s). A cooling-off period would address both potential debt spiral scenarios—but, in particular, it would address prolonged indebtedness resulting from back-to-back payday loans.

17 A cooling-off period would encourage competition between lenders. In the absence of a mandatory break between loans, the existing lender—equipped with knowledge of the consumer's loan balance—can make approaches to the consumer when the loan is about to be paid out (i.e. when the consumer is likely to be seeking a new loan). Other lenders do not have this advantage. Introducing a mandatory break would allow consumers to review other payday loan providers in the market—some of which, we have observed, are beginning to compete on price by charging reduced establishment and/or monthly fees.[7]

18 Some consumers develop a close relationship with, and reliance on, a single payday lender. A cooling-off period has the potential to disrupt this reliance and positively affect the manner in which consumers deal with financial difficulty.

[6] First submission, paragraph 106. We note the CFPB released new proposals on 2 June 2016.
[7] First submission, paragraph 159.

19 The absence of a cooling-off period may also undermine the ability of payday lenders to compete for new business. A consumer that obtains a payday loan that takes up 10% of their income is prevented from obtaining a concurrent payday loan from another lender. Once the consumer has repaid their payday loan, only the lender that provided the concluded payday loan is aware that the consumer may be provided with a new payday loan. This information may provide a powerful competitive advantage by facilitating 'sticky' repeat borrowers for the payday lender.

20 A cooling-off period could operate in a number of ways. Similar to the proposal in the United States, it could apply for an extended period after the consumer has entered into a specified number of back-to-back or multiple payday loans. It could also operate for a shorter period after the consumer has entered into a smaller number of payday loans or even a single payday loan, as is the case in Florida. A payday lending database would also help lenders comply with any cooling-off requirement.

21 In considering the length of any cooling-off period, it will be important to balance the benefit to consumers of having time to consider and investigate alternatives to payday loans with a short-term restriction on access to credit to some consumers.

22 The review has also recommended (Recommendation 8) that payday lenders be prohibited from making unsolicited offers to consumers. A cooling-off period would target similar objectives to a prohibition on unsolicited offers. We consider that these options would be most effective when used in tandem. This is discussed further in our comments on Recommendation 8 at paragraphs 45–52.

23 If a cooling-off period is implemented, it could be supplemented by messages or assistance specifically targeted towards affected consumers. These messages could be developed by ASIC as part of the implementation of Recommendation 21. In particular, messages could be directed to the following two distinct situations:

(a) before the consumer takes out a loan, so consumers are aware that there will be a period during which they will not be able to access a payday loan, allowing time for consumers to prepare for this period and consider alternatives; and

(b) during the cooling-off period, with consumers advised of potential options they could pursue during this period. For example, no-interest loan schemes and low-cost alternatives.

Recommendation 2: Suitability

Recommendation 2

Remove the rebuttable presumption that a loan is presumed to be unsuitable if either the consumer is in default under another SACC, or in the 90-day period before the assessment, the consumer has had two or more other SACCs.

This recommendation is made on the condition that it is implemented together with Recommendation 1.

24 We agree that if the protected earnings amount is implemented the presumption should be removed.

Recommendation 6: Database of small amount credit contracts

Recommendation 6

A national database of SACCs should not be introduced at this stage. The major banks should be encouraged to participate in the comprehensive credit reporting regime at the earliest date.

25 The review considered the introduction of a payday lending database in Recommendation 6. Although the review acknowledged that a 'database could improve the capacity of SACC providers to comply with these responsible lending obligations' ultimately the review did not recommend that a database be established. In particular, this was due to concerns around the expense of establishing a database and existing availability of information (e.g. through bank statements).

26 Other options canvassed by the review included greater use of comprehensive credit reporting and the use of unique direct debit identifiers for payday loan repayments.

Current limitations on identifying a consumer's payday loans

27 We have observed limitations with payday lenders' current practices to identify a consumer's current payday loans, which may impact on lenders' ability to comply with a protected earnings amount requirement. These limitations include payday lenders:

(a) increasingly using means other than a consumer's bank account to distribute funds, such as through reloadable prepaid non-cash payment facilities (e.g. prepaid debit cards);

(b) not adequately using the consumer's bank statement information when assessing a loan application; and

(c) miscategorising information from bank account statements (e.g. categorising a payday loan as income).

28 In addition, we refer to our investigation into the online payday lender Nimble Australia Pty Ltd (Nimble).[8] One of the issues we identified with Nimble's practices was that it had failed to consistently recognise where consumers had obtained repeat payday loans within a short period of time. It is likely that a database would have assisted Nimble to identify these other loans.

29 Noting the limitations with payday lenders' practices that we have encountered, for a protected earnings amount to be most effective there will need to be a clear and simple mechanism for lenders to identify all of a consumer's current payday loans.

Comprehensive credit reporting

30 Payday lenders are not currently participating in comprehensive credit reporting and we consider that they are unlikely to do so in the future. In particular, we understand that the costs associated with comprehensive credit reporting are likely to be prohibitive for many payday lenders when compared with the size of their loans.

31 In addition, we understand that comprehensive credit reporting may not be updated in real time by all providers. If that is the case it poses a potential difficulty, as each loan may not be immediately visible to other potential lenders from the consumer's credit report.

Unique direct debit identifiers

32 Industry suggested that direct debit identifiers could be used to identify a consumer's payday loan repayments. The review considered that the Government should undertake further consultation on this option.

33 Allocating direct debit identifiers is likely to involve costs to ASIC and, under the forthcoming industry funding model for ASIC, these costs would be passed on to lenders. Further, we expect that lenders will incur costs setting up their systems to both use identifiers for their own direct debits and to correctly classify direct debit identifiers on bank statements.

34 Setting up any system or process to identify a consumer's current payday loan repayments will incur costs. As detailed at paragraphs 35–37, we consider that the best use of this expenditure is to develop a narrow-scope national database.

[8] Media Release (16-089MR) *Payday lender Nimble to refund $1.5 million following ASIC probe* (23 March 2016).

Payday lending database

35 We consider that the establishment of a payday lending database has benefits beyond comprehensive credit reporting or unique direct debit identifiers. A database could simplify compliance by giving lenders a prompt 'yes' or 'no' answer about whether they are prohibited from providing the credit sought by the consumer.

36 Further, we understand that a database could be implemented in a relatively cost-effective manner with only a small cost applicable for each individual database inquiry. In our first submission to the review we provided detailed information on how databases operate overseas and their application to Australia. We also referred to the 2013 consultation we undertook in relation to a payday lending database: Consultation Paper 198 *Review of the effectiveness of an online database for small amount lenders* (CP 198).

37 Our views in relation to a database are further set out in Section D of our first submission to the review.

New Payments Platform

38 The New Payments Platform is a new payments infrastructure currently being developed by some authorised deposit-taking institutions. The platform is intended to provide 'fast, versatile and data-rich payments' between institutions.[9] We understand that this will allow data about payments to travel with the funds, potentially providing valuable information about the nature of the payment.

39 Although we understand that the New Payments Platform was not raised as an option to identify payday loans and repayments during the review, it may have the potential to facilitate compliance with a protected earnings amount and other responsible lending obligations.

40 The platform is intended to be operational in the second half of 2017.

Recommendation 4: Direct debit fees

Recommendation 4

Direct debit fees should be incorporated into the existing SACC fee cap.

41 Class Order [CO 13/818] *Certain small amount credit contracts* allows a third party who processes direct debits for payday loan repayments to charge

[9] Australian Payments Clearing Association, *New Payments Platform: Phases 3 & 4—Design, build and test*, webpage.

a consumer for their services outside of the payday loan cap on costs. Without [CO 13/818], the third-party processor, or anyone else, would be prohibited from recovering these costs through a separate fee.

42 Implementation of this recommendation would involve ASIC repealing [CO 13/818]. We are currently considering this recommendation and we note the Government's support for ASIC acting on it.[10]

Recommendation 5: Equal repayment and sanction

Recommendation 5

In order to meet the definition of a SACC, the credit contract must have equal repayments over the life of the loan (noting that there may need to be limited exceptions to this rule).

Where a contract does not meet this requirement the credit provider cannot charge more than an annual percentage rate (APR) of 48 per cent.

43 We support Recommendation 5. Consultations on this recommendation should identify any legitimate exceptions to this obligation that can be facilitated through regulations.

44 We could use ASIC's exemption and modification powers to address any other legitimate circumstances that arise after the commencement of such a provision.

Recommendation 8: Unsolicited offers

Recommendation 8

SACC providers should be prevented from making unsolicited SACC offers to current or previous consumers.

45 We are aware that most payday lenders encourage past and current customers to apply for further payday loans by sending SMS messages and other communications. Offers for further payday loans can be very attractive to many payday lending consumers, as these consumers tend to be vulnerable and have limited access to financial resources; however, these offers can adversely affect consumers by discouraging them from seeking cheaper alternatives. We agree with the review that a decision for a

[10] The Hon Kelly O'Dwyer MP, Minister for Small Business, Assistant Treasurer, Media Release No. 038, *Small amount credit contract final report released*, 19 April 2016.

consumer to apply for a payday loan should be an active decision by the consumer and not in response to a direct invitation from a payday lender.[11]

46 Further, consumers who receive unsolicited offers to apply for a payday loan are less likely to consider other options that may be available to them, some of which may be more affordable and better suited to their situation. We consider that there is a risk that consumers who receive and accept payday loan offers are likely to be increasingly indebted over time, and therefore be required to repay debt over a longer period. This makes it more difficult for consumers to fully cover their other expenses or to build up savings that would help prevent their need to access payday loans in the future.

47 The need to address the risk of financial distress from unsolicited offers has similarly been recognised in the context of credit cards. Since the review's final report was released, Treasury has released the consultation paper *Credit cards: Improving consumer outcomes and enhancing competition* (May 2016). One of the proposals raised in this paper to address 'over-borrowing contributing to financial distress' is to extend the current prohibition on credit card issuers making unsolicited offers to increase a consumer's credit card limit. The current credit card offers prohibition is limited to offers made in writing and in circumstances where the consumer has not provided prior consent to receive such offers. The proposal is to extend this prohibition to cover all offers, including those made over the phone, and to remove the ability of consumers to provide consent to receive offers. The consultation paper explains the rationale for this proposal as follows.

> The Government is aware that some card issuers circumvent the spirit of the legislation by making unsolicited offers by other means, such as over the phone or via online banking portals. Consumers are also often unaware that they have granted their prior consent to receiving unsolicited offers, because of the way in which consent is sought at the time of applying for a credit card.[12]

48 This proposal is consistent with the review's Recommendation 8.

49 Additionally, we consider that a prohibition on making unsolicited payday loan offers is consistent with the objectives of payday lenders being required to display a warning statement. These objectives, referred to in the discussion around Recommendation 21 of the review's final report, include ensuring that consumers have appropriate information to make a more informed decision before obtaining a payday loan and increasing the incidence of consumers using low-cost alternatives to payday loans. We consider that providing unsolicited payday loan offers to consumers is likely to draw consumers away from, rather than towards, payday lending alternatives.

[11] Final report, p. 35.
[12] Treasury, *Credit cards: Improving consumer outcomes and enhancing competition*, May 2016, p. 18.

50 This recommendation, if implemented, would not appear to prevent payday lenders from more general advertising via other means, aside from direct offers to consumers.

51 We consider that a prohibition on unsolicited payday loan offers would be most effective if complemented by a cooling-off period. As discussed at paragraphs 13–23, a cooling-off period would disrupt the relationship between the payday lender and the consumer and allow a period while a payday loan is not available for the consumer to genuinely consider options. A ban on unsolicited payday loan offers would support this consideration by preventing consumers from being influenced by unsolicited offers, both during this period and at other times.

52 A cooling-off period, without a prohibition on unsolicited offers, would enable payday lenders to continue to contact consumers about applying for a payday loan. Further, payday lenders could target their offers at the point when they know the consumer is nearing the end of their cooling-off period, thereby reducing its effectiveness.

Recommendations 3, 7, 9 and 10: Short term credit contracts, early repayment, default fees and referrals to other providers of small amount credit contracts

53 We have no further comments in relation to Recommendations 3, 7, 9 and 10 and refer to our earlier submissions where we expressed broad support for the principles of these reforms.

C Consumer lease recommendations

Key points

We agree that a cap on costs should be introduced and at a level below the current payday lending cap. All add-on services and other features should be included in the cap with the exception of delivery.

We support an objective basis for determining the base price or cash price of the leased good on which the cap on costs will be based.

We consider that a cap on costs, and the other recommendations in relation to consumer leases, should apply to all consumer leases currently regulated by the National Credit Act.

Recommendation 11: Cap on cost to consumers

Recommendation 11

A cap on the total amount of the payments to be made under a consumer lease of household goods should be introduced. The cap should be a multiple of the Base Price of the goods, determined by adding 4 per cent of the Base Price for each whole month of the lease term to the amount of the Base Price. For a lease with a term of greater than 48 months, the term should be deemed to be 48 months for the purposes of the calculation of the cap.

54 We agree that a cap on costs for consumer leases should be introduced. As we highlighted in Report 447 *Cost of consumer leases for household goods* (REP 447), we have observed large price variations both across different lessors and within individual lessors for different consumer segments. We also identified some leases with charges significantly exceeding what could have been charged if the cost caps applying to other forms of credit applied to consumer leases (e.g. the payday lending cap or 48% interest rate cap for other credit contracts).

55 One lessor we looked at charged Centrelink recipients (in 20 out of 39 leases with a two-year term) more than five times the retail price of the leased goods—the equivalent of an interest rate of over 248%.[13] Our findings in REP 447 also indicated that competition in the consumer lease market operated unevenly. A cap on costs for consumer leases would address the harmful price dispersion we have observed and reduce the overall cost of leases.

[13] REP 447, paragraph 12.

56 In our experience many consumers who enter into lease arrangements are vulnerable, are on low incomes and have limited access to other forms of finance. As a consequence, high-cost consumer leases, which regularly have a term that extend over a number of years, can entrench consumers in a cycle of disadvantage and financial exclusion.

57 A cap on costs for consumer leases would alleviate some of this harm by limiting the amount that consumers can be charged under a lease. In particular, limiting lease charges will likely lead to reduced lease payments, reduced lease terms or both. This will make available to consumers funds that would have otherwise been devoted to lease payments.

58 The review recommended a cap in excess of the 48% credit cap that generally applies to other credit products, but less than the cap that currently applies to payday loans. As stated in our second submission to the review, our view is that the consumer lease cap on costs should be set at a level that reflects the similarities between consumer leases and other credit products (such as payday loans and sales of goods by instalment).

59 However, we agree that the cap for lessors should be set below that for payday loans. Leases generally run for terms that far exceed 12 months and consequently exceed typical payday loan terms (that are only for several months). In many instances consumer lease terms are comparable to those for other credit facilities, such as personal loans and sale of goods by instalments, to which the 48% interest rate cap applies. These longer terms provide added time and more repayment cycles for lessors to recoup their costs and generate a profit without imposing charges in excess of 48%.

60 In considering a cap on costs, the review has predominantly looked at leases for household goods. If the Government was to accept the lease cap on costs recommended by the review, and extend this to all regulated leases, consideration could be given to implementing a tiered lease cap, similar to the caps that apply to credit contracts.

61 For example, the recommended concessional higher cap could be applied to lower value short-term leases where lessors’ establishment costs are higher relative to the value of the leased good(s). Longer term and/or higher value leases would be subject to a reduced cap, noting that the policy rationale for a higher than 48% cap for these leases would be diminished.

62 By better aligning the lease cap with the caps that apply to corresponding credit contracts, this approach would provide greater regulatory consistency and reduce potential arbitrage (by removing the incentive for longer term credit contracts to be structured as consumer leases to take advantage of the higher cap).

Recommendation 12: Base price of goods

Recommendation 12

The Base Price for new goods should be the recommended retail price or the price agreed in store, where this price is below the recommended retail price.

Further work should be done to define the Base Price for second hand goods.

63 We agree that there should be a clear mechanism for determining the value of leased goods, in particular as this is the value on which the cap on costs will be based. Consideration should be given to addressing potential manipulation of the cap by lessors, such as by maximising the value of the leased good.

64 For example, one potential effect of the base price is that the lessor benefits from the difference between the retail price available to consumers and the wholesale price charged to the lessor. As a result of our inquiries, we found that a small lessor was able to negotiate a discount of around 25% on the wholesale price. Under the proposed cap, that lessor would be able to earn:

(a) an additional $25 for every $100 of the wholesale price (as it could charge this amount on money it has not expended in obtaining the goods); and

(b) an extra 4% of the amount in paragraph 64(a) for each month of the contract.

65 It is likely that larger lessors would be able to negotiate wholesale prices that are either similarly discounted or even further reduced compared to the retail price, given the volume of business they would be able to direct to the retailer.

66 The use of a base price also does not easily address situations where lessors source goods for which there is either no recommended retail price (RRP) or for which the lessor sets the RRP. In particular, this approach has the potential to result in lessors actively sourcing goods (such as through white-labelling arrangements) in a manner that allows them to inflate the base price, and thereby undermine the application of the cap on costs. Consideration will need to be given to addressing these and other practices that would make it difficult to objectively determine the base price.

67 In our first submission to the review we suggested that the current definition of 'cash price' in the National Credit Code (at Sch 1 to the National Credit Act) could be applied to consumer leases for the purposes of the cap on costs.[14] The 'cash price' of goods and services is defined as:

[14] First submission, paragraphs 261–266.

(a) the lowest price that a cash purchaser might reasonably be expected to pay for them from the supplier; or

(b) the market value of the goods or services, if the goods or services are not available for cash from the supplier or are only available for cash at the same price as, or a reasonably similar price to, the price that would be payable for them if they were sold with credit provided.

68 We consider that this definition would provide an appropriate basis on which to set the price of leased goods.

69 In relation to second-hand goods, we consider that the base price should take into account the reasonable depreciation of the value of the good, its condition and its likely resale value.

Recommendation 13: Add-on services and features

Recommendation 13

The cost (if any) of add-on services and features, apart from delivery, should be included in the cap. A separate one-off delivery fee should be permitted. That fee should be limited to the reasonable costs of delivery of the leased good which appropriately account for any cost savings if there is a bulk delivery of goods to an area.

70 We consider that the cost of add-on services and features should be included in a consumer lease cap on costs. In particular, this would increase consumer awareness of the total amount payable for the lease, and reduce the potential for lessors to avoid the cap on costs by charging separately for add-on products or services.

71 Further inquiries by ASIC since our submissions to the review have confirmed our view that these products can provide very poor value to consumers, and so be a way of increasing lessor profitability. For example, we compared the number of leases where the consumer had a claim paid under an add-on product with the number of all leases that had financed the add-on product (with one major lessor). This product, a liability waiver, provided consumers with cover for loss or damage to the leased good that arose in limited circumstances. We found that, across the three-year period, the number of consumers who had a claim paid was only 0.14% (in 2012), 0.13% (in 2013) and 0.12% (in 2014) of all consumers with an active lease in that year.

72 In relation to the cost of delivering the leased goods to consumers we are also generally supportive of this cost being included within the cap. However, as referred to in our second submission, consideration of an exclusion from this general position may be appropriate for delivery

expenses to regional and remote communities. We agree that it would be beneficial to allow a tightly controlled delivery charge outside of the cap on costs.

73 We have seen an example of one lessor who charges a delivery fee of $1 per kilometre where delivery is more than 50 kilometres from the lessor's premises (if delivery is 100 km away, this component would be $100).

74 We repeat our comments from our second submission to the review, which noted that any exemption for delivery costs should:

(a) reflect current industry practice (where goods may be delivered to remote communities in bulk, reducing the effective cost of moving each item);

(b) provide an objective standard for industry to follow; and

(c) be sufficiently constrained so that excessive delivery costs do not become a means of avoiding general cost restrictions.

75 We consider that a possible cap for delivery expenses could be limited to the lower of the lessor's actual delivery expenses or a specified amount set at a low level, such as $50.

Recommendation 14: Consumer leases to which the cap applies

Recommendation 14

> The cap should apply to all leases of household goods including electronic goods.
>
> Further consultation should take place on whether the cap should apply to consumer leases of motor vehicles.

76 The Government has specifically asked whether the review's recommendations in relation to consumer leases should apply to all regulated consumer leases (including motor vehicles).

77 We consider that it would be beneficial to apply the review's consumer lease recommendations to all currently regulated consumer leases. Providing exceptions for some regulated leased goods from some requirements may create uncertainty about which goods are and are not included, potentially leading to complexities for compliance and enforcement.

78 Many motor vehicle leases are unlikely to be a regulated consumer lease under to s171(2) of the National Credit Code, which exempts

> consumer lease[s] under which goods are hired by an employee in connection with the employee's remuneration or other employment benefits.

79 However, we are aware that some lessors have a business model in which they lease used vehicles to low-income or otherwise vulnerable consumers, who are presumably unable to obtain mainstream finance or pay cash for the vehicle. We have made initial inquiries in relation to this market sector and consider that there is a risk of lessors engaging in conduct similar to the concerning conduct engaged in around consumer leases for household goods—for example, high amounts being charged relative to the value of the goods and for add-on products, such as warranties. We observed in one instance a lessor requiring the consumer to make fortnightly rental payments of $310 over a five-year period on a vehicle with a market value of $9,420. This equated to total payments of $40,300 (more than four times the value of the vehicle), or an interest rate of approximately 84%.

80 Consequently, we consider that the same basis for applying a cap on costs to leases of household and electronic goods applies to leases for motor vehicles, and that it would be particularly beneficial for low-income consumers who need a car to travel to work.

81 If a tiered cap was introduced, as raised in our discussion under Recommendation 11, motor vehicles and other high-value and/or longer term leases would presumably be subject to a 48% cap.

Recommendation 15: Affordability

Recommendation 15

A protected earnings amount requirement be introduced for leases of household goods, whereby lessors cannot require consumers to pay more than 10 per cent of their net income in rental payments under consumer leases of household goods, so that the total amount of all rental payments (including under the proposed lease) cannot exceed 10 per cent of their net income in each payment period.

82 Recommendation 15 would introduce the same protected earnings amount requirement to consumer leases that is being proposed for payday loans and would similarly apply in addition to the general responsible lending obligations. We agree with the objectives of this recommendation to ‘promote financial inclusion by ensuring that consumers do not enter into unaffordable consumer lease contracts that expend a large portion of their income’ while still permitting consumers to access goods through consumer leases.[15]

[15] Final report, p. 59.

83 We consider that a protected earnings amount, with a cap on costs, would help address the harm caused by consumers entering into leases with high repayments over an extended period of time. Consumers who are required to devote significant portions of their income to lease payments can often be left with insufficient funds to cover other expenses and build financial resilience through savings.

84 We understand that each of the protected earning amount caps, for payday lending and consumer leases, are intended to operate separately. This means that at a single point in time a consumer could have up to 10% of their net income devoted to repaying payday loans and another 10% of their net income to lease payments (therefore up to 20% of their net income devoted to payday loans and consumer leases).

85 Similar to a protected earnings amount for payday loans, it will be important to address issues around simplicity of compliance and enforcement. In our second submission to the review we indicated that where consumer lease payments are made via Centrepay, consumers' bank statements will not provide evidence of those consumer lease arrangements.

86 Recommendation 19 will only require lessors to obtain bank statements, and not a consumer's Centrepay statements. Consideration should be given to how lessors will identify the level of payments consumers are obliged to make under their current leases. This could include lessors being required to review a consumer's Centrepay statement, or potentially the development of a consumer lease database.

87 We consider that a database would be a more timely and cost-effective mechanism for lessors to establish a consumer's current lease payments. It would remove any logistical difficulty in lessors obtaining a consumer's Centrepay statement and verifying its currency.

88 Based on our understanding of how a payday lending database could be developed, we consider that a consumer lease database, depending on how it is implemented, could be quite cost effective.

Recommendation 16: Centrepay implementation

Recommendation 16

The Department of Human Services consider making the caps in Recommendations 11 and 15 mandatory as soon as practicable for lessors who utilise or seek to utilise the Centrepay system.

89 We have no comment on this recommendation.

Recommendation 17: Early termination fees

Recommendation 17

The maximum amount that a lessor can charge on termination of a consumer lease should be imposed by way of a formula or principles that provide an appropriate and reasonable estimate of the lessors' losses from early repayment.

90 As indicated in both of our submissions to the review, our experience has been that lessors charge substantial termination fees to consumers who have ended their lease early—including, in some instances, requiring the consumer to pay all outstanding rental payments, rather than giving them a discount for early payment before the due date.

91 We support the creation of a 'bright-line' limit or formula capping the maximum amount that can be charged in the event of early termination. We would be supportive of an objective formula for calculating termination fees, based on common law principles.

92 In our second submission to the review we suggested one approach could be to include early termination fees within a broader cap on costs, as is the case for credit contracts. That is, any amount payable under the contract by the consumer on early termination would be subtracted from what the lessor can charge under the consumer lease cap on costs. Lessors would be responsible for determining these amounts and they could be set out in their contracts.

93 For example, using the panel's proposed consumer lease cap, the maximum a lessor could recover under a two year lease with goods valued at $1,000 would be $1,960. If the lessor decided to set an early termination fee at $200, the maximum amount the lessor could recover in lease payments would be $1,760 ($1,960 less $200).

94 This would provide lessors with the incentive to set their repayment amounts and early termination fee at a level that best matches their costs and business models (taking into account the incidence of early termination), while ensuring costs are contained within the single cap on costs.

95 If a separate formula is used to determine early termination fees, consideration should be given to ensuring that the formula is not excessively complex, to enable:

(a) lessors to easily apply and comply with the formula and for us to identify and enforce compliance; and

(b) consumers to easily identify throughout the contract term the costs that will be payable if they terminate early.

Recommendation 18: Ban on the unsolicited marketing of consumer leases

Recommendation 18

There should be a prohibition on the unsolicited selling of consumer leases of household goods, addressing current unfair practices used to market these goods.

96 We are concerned about some of the practices engaged in by lessors to market their products. In particular, we are concerned about some of the practices that have arisen in remote and Indigenous communities, some of which are referred to on page 72 of the review's final report. Many of these practices are predatory and seek to take advantage of vulnerable consumers.

97 For example, we are aware of practices such as lessors entering Indigenous communities with a van full of goods and attracting consumers by honking their horn, hosting a barbeque or offering inducements to a senior community member to provide introductions to other community members. We consider these practices encourage poor purchasing decisions and inhibit or detract from sensible budgeting.

98 In our experience, many consumers who enter into leases in these communities have a limited understanding of the terms and conditions of the lease—and, in particular, the total amount payable under the lease. Further, as consumers in these communities often have few options to access electronics and whitegoods—and therefore limited opportunity to compare products and offerings or select an alternate provider—lessors can be in a strong position to persuade consumers to enter into a lease.

99 In addition to the protection that a cap on costs and protected earnings amount would provide from the harm associated with excessive lease payments, a ban on unsolicited marketing of consumer leases would prevent vulnerable consumers being specifically targeted by exploitative conduct.

100 We understand that industry and consumer advocates generally agree that these practices should be prohibited.

101 We agree with the panel that any prohibition on the marketing of leases should be broader than only preventing lessors visiting a place of residence, as highlighted by the above examples. However, it should be targeted to address the specific harms identified in the review.

D Combined recommendations

Key points

We support the combined recommendations made by the review.

In particular we agree that an anti-avoidance provision should be introduced to ensure that the reforms meet their intended policy objectives and to maintain competitive neutrality between providers.

Recommendation 19: Bank statements

Recommendation 19

Retain the obligation for SACC providers to obtain and consider 90 days of bank statements before providing a SACC, and introduce an equivalent obligation for lessors of household goods.

Introduce a prohibition on using information obtained from bank statements for purposes other than compliance with responsible lending obligations.

ASIC should continue its discussions with software providers, banking institutions and SACC providers with a view to ensuring that ePayment Code protections are retained where consumers provide their bank account log-in details in order for a SACC provider to comply with their obligation to obtain 90 days of bank statements, for responsible lending purposes.

102 We agree with extending the requirement to obtain 90 days of bank statement to providers of consumer leases. In our first submission we explained that:

> Obtaining bank account statements covering a 90-day period is an effective and relatively simple way to obtain information about a customer's financial situation. However, compliance with this requirement alone will not satisfy a credit licensee's responsible lending obligations—lenders should have systems in place to make additional inquiries and deal with any conflicting information provided by consumers.[16]

103 This will particularly be the case for consumer lease payments made through Centrepay, which are not recorded on a bank statement. This was further discussed in our comments on Recommendation 15, at paragraph 82–88.

104 We agree that the information in bank statements should only be used for compliance with responsible lending obligations.

[16] First submission, paragraph 112.

105 We note the review's position in relation to payday lenders' use of third-party software providers, where consumers give lenders access to their internet banking information via the third-party software provider's system. The review considered that restrictions on the use of these software providers was likely to stifle innovation and could reduce access to finance; however, this concern needed to be balanced with consumer protection. As indicated in our first submission to the review, and as suggested by the panel, we will continue to engage with stakeholders as we consider our approach in relation to this issue.

Recommendation 20: Documenting suitability assessments

Recommendation 20

Introduce a requirement that SACC providers and lessors under a consumer lease are required at the time the assessment is made to document in writing their assessment that a proposed contract or lease is suitable.

106 In our first submission to the review we expressed support for increased prescription in relation to the form and content of written assessments of unsuitability provided to consumers. We support the review's recommendation for the assessment to be documented at the time the assessment is made and for particular matters to be mandated.[17]

107 We consider that this requirement will provide further clarity to industry about what an assessment of unsuitability is expected to contain and will provide verification of the assessments that are undertaken.

108 The harm that can flow from inaccurate assessments of unsuitability is potentially greater for consumers on low incomes, or who are otherwise vulnerable. This is because these consumers often have access to few financial resources with which to meet their obligations. Consequently, even small increases in repayment amounts in dollar terms can significantly limit their ability to cover other expenses—including, in some cases, food and housing. A specific requirement to document the suitability assessment would provide further impetus to ensure assessments are carried out appropriately.

[17] Final report, pp. 82–83.

Recommendation 21: Warning statements

Recommendation 21

Introduce a requirement for lessors under consumer leases of household goods to provide consumers with a warning statement, designed to assist consumers to make better decisions as to whether to enter into a consumer lease, including by informing consumers of the availability of alternatives to these leases.

In relation to both the proposed warning statement for consumer leases of household goods and the current warning statement in respect of SACCs, provide ASIC with the power to modify the requirements for the statement (including the content and when the warning statement has to be provided) to maximise the impact on consumers.

109 We agree with this recommendation. In our first submission we explained that providing ASIC with the ability to specify warning statement requirements 'would allow for greater flexibility and responsiveness to changing business models, technology and consumer practices'.[18] Our views on this recommendation are further set out in paragraphs 138–143 and 268–270 of our first submission.

110 The review also suggested that the infringement notice regime in the National Credit Act should apply to the warning statement obligations. We support this proposal.

Recommendation 22: Disclosure

Recommendation 22

Introduce a requirement that SACC providers and lessors under a consumer lease of household goods be required to disclose the cost of their products as an APR.

Introduce a requirement that lessors under a consumer lease of household goods be required to disclose the Base Price of the goods being leased, and the difference between the Base Price and the total payments under the lease.

111 We agree with this recommendation. We consider that displaying consistent information about the cost of payday loans and consumer leases (including disclosure of the base price of leased goods) would help promote competition in these sectors. In particular, clearer price disclosure would

[18] First submission, paragraph 139.

make the costs associated with these products more visible to consumers and help consumers compare offerings in the market.

112 A requirement for payday lenders to disclose an annual percentage rate (APR) has previously been considered. The Revised Explanatory Memorandum to the Consumer Credit Legislation Amendment (Enhancements) Bill 2012 (which introduced the payday lending cap on costs) explained at para 5.20 that payday lenders would not be able to charge interest, only an upfront establishment fee and monthly fees, and therefore payday lenders needed to be exempt from the APR disclosure requirement. It further explained that the APR:

> has limitations in the context of short term loans, with industry participants arguing that it has the potential to be misleading.[19]

113 However, we consider that this recommendation is consistent with the policy objectives of other recommendations that seek to promote financial inclusion, including through the increased use of lower-cost products (e.g. as a result of the cap on costs and the protected earnings amount).

Recommendation 23: Penalties

> **Recommendation 23**
>
> Encourage a rigorous approach to strict compliance by extending the application of the existing civil penalty regime in Part 6 of the National Credit Code to consumer leases of household goods and to SACCs, and, in relation to contraventions of certain specific obligations by SACC providers and lessors, provide for automatic loss of the right to their charges under the contract.

114 We support this recommendation. In particular, where key consumer protection obligations are not complied with (e.g. the cap on costs), lessors and payday lenders should be unable to recover repayments from the consumer in excess of the base price of the goods or (in the case of a payday loan) the amount of principal. This approach is consistent with the approach to payday loans, where the lender can be penalised by being unable to recover more than the amount of credit provided.[20]

115 We note that further work is also currently being undertaken more generally on ASIC sanctions and penalties.

[19] Revised Explanatory Memorandum to the Consumer Credit Legislation Amendment (Enhancements) Bill 2012, footnote 199.
[20] National Credit Code, s23A.

Recommendation 24: Avoidance

Recommendation 24

The Government should amend the Credit Act to regulate indefinite term leases, address avoidance through entities using business models that are not regulated by the Credit Act, and address conduct by licensees adopting practices to avoid the restrictions on the maximum amount that can be charged under a consumer lease of household goods or a SACC, or any of the conduct obligations that only apply to a consumer lease of household goods or a SACC.

116 We strongly support the introduction of anti-avoidance provisions into the National Credit Act. The recommendation has benefited from previous Government consultations and we consider that it would provide ASIC with much more effective powers to address avoidance activity. We consider that this is important in:

(a) ensuring that the reforms meet their intended objectives; and

(b) maintaining competitive neutrality between providers (noting that avoidance activity places legitimate operators at a disadvantage to those not complying with the law).

117 Our experience in the payday lending industry has been that the introduction of the cap on costs, and other specific obligations, resulted in a number of lenders attempting to avoid these provisions. Our first submission to the review sets out some of the avoidance models we have seen, and some of the challenges we have encountered in addressing avoidance conduct under ASIC's existing powers.[21]

118 Based on this experience we consider that the introduction of a cap on costs and protected earnings amount for consumer leases, and the extension of the protected earnings amount to all payday loans, may result in some providers exploring various business models and practices aimed at circumventing these new requirements.

[21] First submission, paragraphs 182–203.

Key terms

Term	Meaning in this document
APR	Annual percentage rate
base price	The price specified as the value of the leased goods when determining the maximum amount that can be charged to a consumer under the proposed lease cap on costs. This value is to be disclosed to consumers
Centrepay	Centrepay is a payment system operated by the Department of Human Services, which allows Centrelink consumers to make payments for leases to Centrepay registered providers, through regular deductions from their benefit payment
[CO 13/818] (for example)	An ASIC class order (in this example numbered 13/818)
consumer lease	A consumer lease to which the National Credit Code applies Note: See s169–171 of the National Credit Code.
CP 198 (for example)	An ASIC consultation paper (in this example numbered 198)
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 a credit licence under s35 of the National Credit Act
final report	Treasury, *Review of the small amount credit contract laws: Final report*, March 2016
first submission	*Review of the small amount credit contract laws: Submission by the Australian Securities and Investments Commission*
lessor	A lessor under a consumer lease
National Credit Act	*National Consumer Credit Protection Act 2009*
National Credit Code	National Credit Code at Sch 1 to the National Credit Act
payday lender	A credit provider that provides small amount loans
payday loan	A small amount credit contract

Term	Meaning in this document
protected earnings amount	The amount of money a lender cannot access for the purposes of loan repayments. This submission refers to a protected earnings amounts in two ways: • the current protected earnings amount, set out in reg 28S(3) of the National Consumer Credit Protection Regulations 2009; and • the recommendations to extend protected earning amounts separately to all payday loan and consumer lease consumers, with the maximum amount of a consumer's net income able to be devoted to repayments set at 10%
s132 (for example)	A section of the National Credit Act (in this example numbered 132), unless otherwise specified
sale of goods by instalment	A credit contract of the kind described in s9 of the National Credit Code
second submission	*Review of the small amount credit contract laws: Second submission by the Australian Securities and Investments Commission*
small amount credit contract	Has the meaning given in Sch 3 to the *Consumer Credit Legislation Amendment (Enhancements) Act 2012*
small amount loan	A small amount credit contract