



**ASIC**

Australian Securities & Investments Commission

# **Review of the small amount credit contract laws**

## **Second submission by the Australian Securities and Investments Commission**

January 2016

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## 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<sup>1</sup>) to Australians.
- 2 In October 2015 we provided a submission (our first submission) to this review of the small amount credit contract laws.<sup>2</sup> That submission contained a number of suggestions for improvements to the rules that currently apply to consumer leases and payday loans; we continue to support these proposals for change.
- 3 We are making this submission (our second submission) to provide our comments on the observations and policy options the review has identified in its interim report.<sup>3</sup>
- 4 We agree with the review's observation that a key outcome of the regulation of payday loans and consumer leases is financial inclusion (Observation 1). We consider that this outcome is particularly important for these products given that they are frequently used by financially vulnerable and disadvantaged consumers.

### Payday loans

#### Measures to address repeat borrowing

- 5 The repeat use of small amount loans can lead to an ongoing cycle of disadvantage that reduces the potential for financial and social inclusion.<sup>4</sup>
- 6 We agree with the interim report's observation that additional consumer protections specific to payday loans are required in light of the risk of harm to consumers from these products (Observations 2 and 3). Our view is that the current rules, intended to address risks associated with repeated use of small amount loans, have had limited impact.
- 7 We support the policy options the interim report has identified in this area (Options 1–3). In particular, we support:

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<sup>1</sup> 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'.

<sup>2</sup> ASIC, *Review of the small amount credit contract laws*, submission, October 2015.

<sup>3</sup> Treasury, *Review of the small amount credit contract laws: Interim report*, consultation paper, December 2015.

<sup>4</sup> The Regulation of Short Term Small Amount Finance, Regulation Impact Statement, June 2011.

- (a) measures to better align establishment fees with lenders' actual administrative costs (and remove incentives to promote repeat borrowing); and
- (b) 'bright-line' alternatives to the current rebuttable presumptions that will better address the risks of repeat borrowing while simplifying compliance requirements for lenders.

8 We consider that effective measures to limit repeat borrowing that still allow for a viable payday lending industry, would be consistent with the goal of promoting financial inclusion. Our views on these issues are outlined in more detail at paragraphs 24–39.

### **Default fees**

9 Many payday lenders charge fees when a consumer defaults on their loan.

10 We do not have evidence to suggest that lenders are collecting fees that exceed the total amount recoverable, or that the total level of default fees that can be collected should be changed. However, we share the review's concerns about the speed at which some default fees accrue (Observation 4).

11 We consider that measures to limit the escalation of default fees are appropriate. In particular we support a supplementary cap that ensures fees are incurred at a rate that more closely reflects lenders' reasonable costs of recovery (Option 5)

12 Our views on default fees are provided at paragraphs 40–46.

### **Addressing anomalies**

13 There are some current fee-collection practices that are inconsistent with the intent of the rules that limit costs on payday loans.<sup>5</sup> These practices are reflected in Observation 5, which notes that consumers who repay a small amount loan early receive no discount or benefit.

14 We have not seen evidence of consumers voluntarily repaying payday loans early. In our experience, when consumers repay 'early' it is because they have been instructed that they should make payments more quickly than required under the loan contract (in a way that ultimately benefits the lender).

15 We support the creation of a requirement that repayments on small amount loans be substantially equal across the term of the loan (Option 8). Our views on the implementation of this option are outlined at paragraphs 50–52.

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<sup>5</sup> First submission, paragraphs 192–193.

## Consumer leases

### Cost of consumer leases

- 16 Unlike credit contracts, there is no limit on the maximum amount that consumers can be charged under a consumer lease.
- 17 We agree with the interim report's observation that the high cost of consumer leases appears to be causing financial harm to consumers (Observation 6). We note that this observation is consistent with our previous findings.
- 18 We support the introduction of a cap on costs for consumer leases (Option 9). Our view is that this cap should be set at a level that reflects the similarities between consumer leases and other credit products (such as small amount loans and sales of goods by instalment).
- 19 Our view is that cost restrictions should apply broadly to all consumer leases and include the cost of add-on products and services (Option 10). This approach:
- (a) would be consistent with the rules that apply to credit contracts;
  - (b) is likely to increase consumer awareness of the total amount payable; and
  - (c) would reduce scope for avoidance practices by lessors.
- 20 We also support additional rules that limit the proportion of income that can be spent on consumer lease repayments (Option 11). Implementing a version of the 'protected earnings amount' for consumer leases requires decisions to be made about how that requirement would interact with other cost restrictions and responsible lending obligations.
- 21 Our views on cost restrictions for consumer leases are outlined in more detail at paragraphs 53–69.

### Early termination fees

- 22 Our work has shown lessors generally disclose an early termination fee on lease contracts.
- 23 We have concerns that some early termination fees incurred when a consumer cancels a lease may exceed the lessor's reasonable costs. As a result, we support the policy options proposed by the interim report. Our view is that, of the options identified, an objective limit on early termination fees (Option 12) is the best way to address this issue.

## B Payday loans

### Key points

The interim report made a number of observations about, and proposed policy options to address, key issues relating to payday loans. These issues include:

- responsible lending obligations and repeat borrowing;
- fees incurred when a consumer defaults on a payday loan; and
- the effect of early repayments and uneven repayment schedules.

We support the options put forward in the interim report to address current issues in the payday lending industry.

In particular we support:

- objective rules to better address the risks associated with repeated use of payday loans (Options 1–3);
- limiting the speed at which default fees can be accrued (Options 4–6);
- rules to address conduct that is inconsistent with the limits on small amount loan fees and charges (Options 7 and 8).

### Responsible lending and repeat borrowing

- 24 The *National Consumer Credit Protection Act 2009* (National Credit Act) contains ‘rebuttable presumptions’ about the suitability of certain small amount loans. These rebuttable presumptions are intended to mitigate risks associated with repeat borrowing.
- 25 Our first submission outlined our view that the rebuttable presumptions have had limited effect on repeat borrowing. Our surveillance work to date has consistently identified that over 50% of payday loans are triggering the multiple loan presumption—this indicates consumers are not using these loans only as an emergency source of funding for one-off expenses.
- 26 Our first submission also noted that clearer, bright-line requirements would be preferable to the current rebuttable presumptions.

### Interim report: Responsible lending and repeat borrowing

#### Observation 3

High levels of repeat borrowing appear to be causing consumer financial harm. The structure of the SACC cap and industry costs appears to promote repeat borrowing and the rebuttable presumptions do not appear to have limited repeat borrowing.

### **Policy options for consideration**

#### *Option 1*

Reduce the establishment fee for subsequent loans for a returning consumer from 20 per cent to 10 per cent.

#### *Option 2*

Replace the rebuttable presumption that a SACC is unsuitable if a consumer has had two or more SACCs in 90 days, with a bright line test banning the provision of SACCs to consumers who have had two or more SACCs in the past 90 days.

#### *Option 3*

Extend the protected earnings amount for Centrelink recipients, where total SACC repayments cannot exceed 20 per cent of gross income, to all consumers and lower the protected earnings amount to no more than 10 per cent of net income.

### **Establishment fees for subsequent loans**

- 27 We support the rationale behind reducing the permitted establishment fee for subsequent loans for returning customers. A reduced fee may better reflect the costs incurred by lenders in providing subsequent loans to previous customers.
- 28 Lower establishment fees for existing customers that are more closely aligned with actual costs (e.g. administrative costs, anti-money laundering obligations and advertising) may reduce incentives to encourage repeat borrowing. However, we agree with the interim report that Option 1 alone is not sufficient to deter repeat borrowing that may be harmful for consumers.
- 29 We note that the law currently prohibits the charging of an establishment fee where a customer is refinancing a payday loan. In practice it can be difficult for lenders to determine whether ‘refinancing’ is occurring.<sup>6</sup> We consider that Option 1 would not result in the same compliance uncertainty for lenders if it replaced the current refinancing fee prohibition.

### **Other options to prevent harmful repeat borrowing**

- 30 We support the implementation of Option 3 (or, alternatively, Option 2). We consider that implementing one of these options would help to address the risks of repeat borrowing. We do not consider that both Option 2 *and* Option 3 are required at this time.
- 31 Option 2 and Option 3 are objective, bright-line requirements that would provide increased compliance certainty for industry relative to the current

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<sup>6</sup> First submission, paragraphs 164–166.

laws. Our experience is that objective rules lead to higher levels of compliance by payday lenders.<sup>7</sup>

- 32 However, the ease of complying with a prohibition (Option 2) may be determined by whether or not lenders have easy access to information about other loans held by a potential borrower. We note that our first submission discusses using a narrow-scope national database of payday loans to assist lenders to comply with a prohibition.<sup>8</sup> An independent source of information about previous loans may be important because some loans are not paid into a borrower's account and so would not be evident on that person's bank statements. For example, some payday loans are loaded on to stored value cards.
- 33 We support lowering the protected earnings amount to 10% of net income and applying it to all borrowers (Option 3). This change would reduce the risk of detriment and harm for financially vulnerable and disadvantaged consumers who often use payday loans.
- 34 However, 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 a discussion with the consumer to support such a figure.
- 35 We also support the proposal to change the basis for the protected earnings amount from gross income to net income. Lenders may find net income easier to verify than gross income, as these amounts are likely to be contained in bank statements.
- 36 Our view is that limiting repayments to 10% of net income would also be feasible for lenders. We have seen many examples of loans where repayments comprise less than 10% of the borrowers' income. Table 1 sets out the repayments as a percentage of net income from a sample of 50 files from each of two major payday lenders.

**Table 1: Repayments as a percentage of net income by number of files**

Percentage of net income attributable to repayments	Lender 1 (Employed borrowers)	Lender 2 (Centrelink recipients)
0–10%	13	24
10–20%	16	26
20–30%	15	0
30–40%	4	0

<sup>7</sup> First submission, paragraphs 81–83.

<sup>8</sup> First submission, Section D.

Percentage of net income attributable to repayments	Lender 1 (Employed borrowers)	Lender 2 (Centrelink recipients)
40–50%	1	0
more than 50%	1	0

Source: ASIC review of 100 files from two payday lenders (in 2015).

- 37 Lenders could respond to a lower, broader protected earnings amount by offering loans with a longer term and lower repayments. There is scope for loan terms to be lengthened. Responses to an industry-wide survey in August 2015 indicate that the average term of a payday loan in 2014–15 was approximately 50 days.<sup>9</sup> Longer loan terms (with lower periodic repayments) would increase affordability of payday loans for consumers and be consistent with the objective of promoting financial inclusion. We note some licensees have been supportive of this approach.<sup>10</sup>

### **New measures and responsible lending**

- 38 If Option 2 or 3 were implemented, it may be appropriate to consider whether all of the current responsible lending provisions would be required. In particular, the current rebuttable presumptions may no longer be necessary.
- 39 Thought could also be given to whether loans where repayments satisfy an even lower income threshold could be presumed to be suitable for the purposes of the general responsible lending provisions. A ‘safe harbour’ of this nature could:
- (a) simplify compliance for lenders where loans are less likely to cause risks of financial detriment for consumers; and
  - (b) promote the appropriate use of innovative automated systems.

## **Default fees**

- 40 Where there is a default on a payday loan, the maximum amount that can be recovered is twice the adjusted credit amount.<sup>11</sup> We are not aware of small amount lenders recovering more than this amount and we do not have evidence to suggest that the total amount recoverable where there is a default should be significantly altered.<sup>12</sup>

<sup>9</sup> First submission, paragraph 51.

<sup>10</sup> Submission by Credit Corp to the review of the small amount credit contract laws.

<sup>11</sup> Section 39B of the National Credit Code (Sch 1 to the National Credit Act). ‘Adjusted credit amount’ is the first amount of credit that is, or is to be, provided under the contract.

<sup>12</sup> First submission, paragraph 157.

41 However, we note that it is common for payday lenders to charge numerous fees for a single default, sometimes including daily fees. The effect of these fees is that the amount owed by the consumer quickly reaches the maximum amount recoverable. Table 2 outlines default fees charged by four payday lenders.

**Table 2: Default fees**

Lender	Fee	Amount
Lender 1	Direct debit dishonour fee or missed payment fee	\$35.00
	Weekly fee while account remains in arrears after original completion date	\$30.00
	Rescheduling fee	\$35.00
Lender 2	Dishonour fee	\$15.00
	Daily default fee	\$5.00
Lender 3	Dishonour payment fee (per missed payment)	\$38.50
	Missed payment fee (charged once)	\$38.50
	Collection transfer fee (charged once)	\$47.00
	Default notice/letter fee (applied at 7, 14, 21 and 30 days)	\$10.00
	Debt management fee (charged once)	\$50.00
Lender 4	Dishonour fee	\$3.00
	Late payment fee (charged monthly)	\$15.00
	Termination fee (charged where contract terminated due to default)	\$100.00 + (\$100.00 x P) / T
		P = number of payments still to run in loan term
		T = loan term as number of payments required

Source: ASIC review of payday lending websites (in 2015).

## Interim report: Default fees

### Observation 4

The limit on the amount that a SACC provider can recover in the event of default is an important safeguard for consumers. However, in some circumstances, the fees charged on default appear to be charged in a manner that significantly disadvantages vulnerable consumers.

### Policy options for consideration

#### *Option 4*

Introduce a default window, where no default fees can be charged until the consumer has missed a payment by one payment cycle.

#### *Option 5*

Maintain the current maximum amount recoverable for default of a SACC but introduce a supplementary cap to limit how quickly fees can be charged (for example, \$10 per week).

#### *Option 6*

Cap default fees as a percentage of the amount outstanding on the SACC.

## Limits on escalation of default fees

- 42 In light of our observations of industry practice, we support the principle that underpins Options 4, 5 and 6. That is, we would support a limit on the speed at which default fees can be incurred in relation to payday loans. We consider that a limit would help ensure that default fees reflect the reasonable costs incurred by lenders.
- 43 There is a risk that default fees that quickly escalate to the maximum amount recoverable may:
- (a) exceed lenders' reasonable costs; and
  - (b) provide an opportunity for lenders to maximise their profits from a loan in a way that is inconsistent with the intent of the restrictions on small amount loan fees and charges.
- 44 Of the options identified in the interim report, we prefer Option 5. We agree with the interim report's suggestion that a supplementary cap be set at a level that reflects the reasonable costs of recovery. In this context we note that many banks and other lenders have significantly reduced default fees over recent years—many institutions now charge no more than \$10 where a direct debit payment fails. Technological developments may have reduced costs associated with identifying defaults and taking action. This should be reflected in the default fees charged.

- 45 Although the other options proposed in the interim report may have merit, we note that a default window (Option 4):
- (a) may not align with lenders' actual costs;
  - (b) would not prevent the quick escalation of fees once the window lapses; and
  - (c) may encourage lenders to hold off contacting consumers to discuss their financial situation until the window lapses and they can charge a fee.
- 46 Similarly, a separate default fee cap linked to the amount outstanding (Option 6) may not correlate with lenders' recovery costs.

## Anomalies relating to fees and charges

- 47 A cap on costs was introduced for small amount loans to address concerns over the affordability of these loans and the level of price competition within the industry.<sup>13</sup>
- 48 Our first submission indicated that some payday lenders were acting in a way that is inconsistent with the intent of these restrictions. Relevant examples include lenders:
- (a) extending the loan term by reducing repayments in later months—with the effect that consumers pay up to an additional five months' worth of fees; and
  - (b) requiring the establishment fee and all monthly fees for the term of the contract to be paid when the loan commences, with no fee rebate where the loan is subsequently paid out early.<sup>14</sup>
- 49 We do not believe that consumers typically repay small amount loans early. Where we have seen examples of consumers repaying a loan early, those consumers were instructed by the lender to make repayments more quickly than was required (for the lender's benefit).

### Interim report: Anomalies arising from the small amount credit contracts cap

#### Observation 5

Some SACC providers do not appear to be giving consumers any benefit or discount when they make early repayments or pay back the loan in full before the due date. These practices may result from the SACC cap being based on a fee, rather than an interest rate.

<sup>13</sup> First submission, paragraph 149.

<sup>14</sup> First submission, paragraphs 192–193.

## Policy options for consideration

### *Option 7*

Provide SACC consumers with a benefit for early repayment by specifying the reduction in payment that would arise from early repayment of a SACC (whether in full or in part).

### *Option 8*

Require SACCs to have equal repayments over the life of the loan, while still allowing consumers the ability to pay off a SACC early.

## Addressing anomalies

- 50 We consider that the options identified by the interim report would prevent behaviour that is inconsistent with the intent of the restrictions on fees and charges. Our view is that Option 8 provides the simplest means of addressing this conduct.
- 51 However, we consider that any restrictions on repayment sizes should not prohibit unequal repayments altogether. Payday loans with substantially unequal repayments could be excluded from the definition of small amount credit contracts for specified provisions of the National Credit Code so that the general cost cap of 48% (inclusive of all fees and charges) applies to those loans.<sup>15</sup> This would give lenders an incentive to equalise repayments as the small amount loans provisions allow for the recovery of amounts that exceed the general cost cap.
- 52 Any implementation of Option 8 should also cater for reasonable variances within repayments (e.g. for smaller final payments or discrepancies caused by defaults).

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<sup>15</sup> This exclusion could be limited to Divs 4 and 4A of Pt 2 of the National Credit Code so that other consumer protections are maintained.

## C Consumer leases

### Key points

The interim report made a number of observations about, and proposed policy options to address, key issues relating to consumer leases. These issues included the lack of cost restrictions and high termination fees.

We support the options put forward in the interim report to address current issues in the consumer leasing industry.

In particular we support:

- cost restrictions on the maximum amount that can be charged under a consumer lease (Options 9–11);
- limits to the early termination fees that can be charged by lessors (Options 12–13).

### Addressing the cost of consumer leases

- 53 As outlined in our first submission, there is no statutory limit on the maximum amount that consumers can be charged under a consumer lease.
- 54 We have observed that the lack of cost restrictions on consumer leases is causing significant regulatory arbitrage. Leasing businesses are structuring their contracts to avoid the 48% cost cap that applies to credit contracts, such as sales of goods by instalment.
- 55 We have also found that some consumers, such as Centrelink recipients, are charged significantly more under a consumer lease than the maximum amount they would have been liable to pay if they had financed the purchase of the item under a small amount loan.<sup>16</sup>

### Cap on costs

#### Interim report: Cap on consumer leases

##### Observation 6

The high cost of consumer leases appears to be causing consumers financial harm. While there are technical differences between credit contracts and consumer leases, these differences do not appear to justify consumer leases being excluded from the consumer protection regulations that apply to other forms of finance under the Credit Act.

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<sup>16</sup> First submission, paragraphs 243–257. See also Report 447 *Cost of consumer leases for household goods* (REP 447).

## Policy options for consideration

### Option 9

Introduce a cap on the maximum amount a lessor can charge. The cap would apply to a defined class of leases covering low-value goods.

- 56 We support Option 9. We consider that a cap on costs would:
- (a) lead to more consistent treatment of consumer leases and credit contracts; and
  - (b) prevent consumer detriment as a result of very high-cost leases.

57 Our experience has been that the cap on costs for payday loans has significantly reduced the cost to consumers of these credit products. We expect a similar outcome from a cap on costs for consumer leases.

### Cap level

58 We consider that a cap on costs for consumer leases should be set at a level that reflects similarities between these products and other credit contracts, such as a sale of goods by instalments or a payday loan.<sup>17</sup>

59 The interim report has sought information on reasons why the general 48% cost cap for credit contracts should not apply to consumer leases. Setting the cost restrictions at this level for consumer leases would address the current regulatory arbitrage between consumer leases and sales of goods by instalments.

## What costs should be included under a cap?

60 In our first submission we stated our view that additional benefits and services, such as delivery, maintenance and repair of leased goods, should be included in any cap on costs.<sup>18</sup> We also noted that additional products, such as add-on insurance, should be included in the cost cap or subject to other restrictions.<sup>19</sup>

### Interim report: Whether a cap should include or exclude add-on products

#### Observation 7

During consultation, stakeholders noted that a large proportion of the cost of consumer leases can be attributed to add on products. There is little transparency regarding the nature or cost of these services and the value that they provide to consumers. It may not be clear to consumers that these features are available when they enter into a lease or that they

<sup>17</sup> First submission, paragraphs 253–254 and 259.

<sup>18</sup> First submission, paragraphs 263–264.

<sup>19</sup> First submission, paragraphs 282–286.

extend beyond the statutory guarantee under the Australian Consumer Law.

### **Policy options for consideration**

#### *Option 10*

Include the cost of add on features and products under the cap.

- 61 We support Option 10. As a general proposition, including the cost of additional benefits, services and products within the cost cap would be consistent with the treatment of some add-on costs under the rules that apply to most credit contracts.<sup>20</sup> This approach would also increase consumer awareness of the total amount payable if they choose to lease an item, as well as reducing the scope for lessors to avoid the cost restrictions by selling add-on products.
- 62 We note that:
- (a) some warranties, as well benefits offered in relation to maintenance and repair, may overlap with the Australian Consumer Law (Sch 2 to the *Competition and Consumer Act 2010*); and
  - (b) many add-on insurance or warranty products have very low claim ratios and are likely to be of limited value to consumers.<sup>21</sup>
- 63 While we are generally supportive of including delivery costs within the cap, consideration could be given to excluding delivery expenses for regional and remote consumers. 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.
- 64 For instance, the exemption for delivery expenses could be limited to the lower of the lessor's actual delivery expenses or a specified amount (such as \$50).

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<sup>20</sup> See s32B(3) of the National Credit Code.

<sup>21</sup> First submission, paragraphs 282–286.

## What leases should be subject to cost restrictions?

### Interim report: Addressing the risk of avoidance

#### Observation 8

If a cap were to be introduced on a restricted category of consumer lease, it should be designed in a way that limits the risk of avoidance. Although extending a cap to all leases and broadening the scope of the Credit Act to include indefinite term leases are matters outside the terms of reference of the review, government may wish to consider the implications for those leases outside the scope of this review.

65 Our view, as outlined in our first submission, is that cost restrictions should apply to all consumer leases. A more limited cost cap that only applies to some consumer leases may not adequately address the regulatory arbitrage and high costs we have observed.

66 We agree that the Government may wish to consider whether indefinite term leases should be subject to additional regulation, including cost restrictions. It may be timely to consider this issue as some lessors could respond to cost restrictions by offering unregulated leases. We note that the Government has previously made announcements about consulting on changes to address similar issues under the existing referral of powers to the Commonwealth.<sup>22</sup>

## Other proposals to address lease affordability

### Interim report: Lease affordability

#### Policy options for consideration

##### Option 11

Cap the amount of net income that can be used to service all lease repayments.

67 We support limits on the proportion of income that can be used to service all consumer lease repayments.

68 In our first submission, we supported extending the protected earnings amount rules to consumer leases.<sup>23</sup> We note that consumer leases are largely comparable to payday loans and a consistent regulatory approach is warranted in light of:

- (a) our findings about the cost of consumer leases; and

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<sup>22</sup> Senator the Hon Arthur Sinodinis, Assistant Treasurer, Media Release No. 12, *Addressing Consumer Credit Protection Shortfalls*, 26 February 2014, <http://axs.ministers.treasury.gov.au/media-release/012-2014/>

<sup>23</sup> First submission, paragraphs 271–273.

- (b) our experience with payday loans (e.g. that tailored protections over and above a cost cap are justified).

69 However, we note that developing a ‘protected earnings amount’ for consumer leases will require decisions about the following matters:

- (a) *The level of income that can be used to make lease repayments*—Unlike payday loans, consumer leases can run for more than 12 months. This means that there may be a case for any income-based cap on repayments to be lower than that which applies to payday loans. We agree with the interim report’s view that a lower limit would be consistent with promoting financial inclusion.
- (b) *Consistency with other obligations*—The interplay between a general cost cap, specific income-based restrictions and the responsible lending obligations would need to be considered. For example, there may be an argument for leases with sufficiently low repayments to be presumed to be suitable for the purposes of the general responsible lending obligations (see paragraph 39).
- (c) *How lessors could determine all consumer leases a consumer has entered into and their repayment amounts*—Where consumers make payments on their consumer lease via Centrepay, their bank statements would not provide evidence of other consumer lease contracts. Lessors may also need to obtain copies of Centrelink statements for customers that receive Government benefits.
- (d) *Interaction with the payday lending protected earnings amount*—Payday loans and consumer leases are used by a similar consumer base, and some individuals may have both types of products. A decision would need to be made about whether the income-based restrictions would be cumulative or operate separately. We note that obtaining data from both payday lenders and lessors in real time may pose challenges.

## Compliance with responsible lending obligations

70 The interim report has sought comments on whether there are broad or systemic problems with compliance by lessors with the responsible lending obligations.

71 We have concerns about standards of conduct in this market sector, including whether lessors are complying with their responsible lending obligations. We have particular concerns about inquiries into consumer income and expenditure, and the steps taken to verify those amounts. Potential issues include:

- (a) the lack of any steps to verify a consumer’s income;

- (b) the use of the consumer's self-assessment as to the amount of their living expenses, even where the assessment is unrealistically low (even less than a poverty benchmark – see Table 3); and
- (c) the use of a benchmark for consumer expenses, instead of inquiring into the consumer's actual spending patterns – our view is that the use of a benchmark is not a replacement for making inquiries of the borrower.<sup>24</sup>

72 Table 3 outlines how the weekly expense figures used for 53 consumer leases compare to the Henderson Poverty Index (HPI). In the majority of these files, the lessors assessed the affordability of the lease on the basis of unrealistically low estimates of consumer expenditure. We note that HPI, without an additional buffer amount, is very unlikely to be an appropriate benchmark for expenses.

**Table 3: Living expense figures and HPI**

Number of dependants	HPI – July 2015 (single person not in workforce, excluding housing)	Percentage of leases where expense figures used are less than HPI
0	\$250.42	91%
1	\$380.48	93%
2	\$503.55	100%
3	\$626.62	100%
4	\$749.69	100%

Source: ASIC review of 53 consumer lease files from two lessors

73 We have taken action in relation to lessors' compliance with the responsible lending requirements. Our first submission contains more information on our work enforcing the law in this area.<sup>25</sup> We will continue to take action, especially where we find that a lessor is engaging in systemic non-compliance with the responsible lending obligations.

74 In light of the issues we have observed to date, we would support changes that impose clear, objective obligations on lessors. One option may be to require lessors to obtain and consider bank account statements for the preceding 90-day period before they enter into a consumer lease to assist with their assessment of the consumer's financial situation. We also note that increased use of technology to analyse and categorise information on bank statements may assist lessors to better assess and verify consumer expense information.

<sup>24</sup> Regulatory Guide 209 *Credit licensing: Responsible lending conduct* (RG 209) at RG 209.105.

<sup>25</sup> First submission, see Appendix.

## Limits on early termination fees

- 75 Our experience has been that lessors charge substantial fees to consumers who seek to terminate a consumer lease before the contract has ended. Although lenders should be able to recover costs on the early termination of a lease, we have concerns that these costs do not justify the current levels of early termination fees that we have observed.

### Interim report: Early termination fees

#### Policy options for consideration

##### *Option 12*

Prescribe the maximum amount that can be charged on early termination of the contract.

##### *Option 13*

Provide a remedy for consumers similar to that in section 78 of the National Credit Code allowing action to be taken for an unconscionable termination charge.

- 76 Based on our experience to date, we support limits on the termination fees that lessors can charge. Of the options identified in the interim report, we prefer Option 12. We consider that this approach would:
- (a) provide a clear, objective limit to the termination fees that can be imposed;
  - (b) be more likely to change behaviour (and reduce termination fees) than Option 13; and
  - (c) allow consumers to avoid costs associated with taking action against lessors in relation to the fees they charge.
- 77 An alternate approach could be to include early termination fees within a broader cap on costs. We expect that this would reduce incentives for early termination fees to be set at a level that exceeds the lessor's costs.
- 78 Some lease payments may include amounts that are referable to additional products and services, such as warranties. We consider that these costs should be discounted for the purposes of calculating the termination fee payable and that no further payments for cancelled additional products should be required.
- 79 We consider that including payments for add-on products and services in termination fee calculations is inappropriate as those services will not be provided post-termination.

## Key terms

Term	Meaning in this document
Australian Consumer Law	Sch 2 to the <i>Competition and Consumer Act 2010</i>
consumer lease	A consumer lease to which the National Credit Code applies Note: See s169–171 of the National Credit Code.
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
first submission	Review of the small amount credit contract laws— Submission by the Australian Securities and Investments Commission
interim report	Review of the small amount credit contract laws: Interim report, consultation paper, December 2015
lessor	A lessor under a consumer lease
National Credit Act	<i>National Consumer Credit Protection Act 2009</i>
National Credit Code	National Credit Code at Sch 1 to the National Credit Act
National Credit Regulations	National Consumer Credit Protection Regulations 2010
payday lender	A credit provider that provides small amount loans
payday loan	A small amount credit contract
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
RG 209 (for example)	An ASIC regulatory guide (in this example numbered 209)
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
small amount credit contract	Has the meaning given in Sch 3 to the <i>Consumer Credit Legislation Amendment (Enhancements) Act 2012</i>
small amount loan	A small amount credit contract