ASIC

Australian Securities &
Investments Commission

CONSULTATION PAPER 316

Using the product intervention power: Short term credit

July 2019

About this paper

This consultation paper sets out ASIC's proposal for using our product intervention power in Pt 7.9A of the *Corporations Act 2001* (Corporations Act) in relation to short term credit. We are seeking the views of interested stakeholders, including industry and consumers, on our proposal.

About ASIC regulatory documents

In administering legislation ASIC issues the following types of regulatory documents.

Consultation papers: seek feedback from stakeholders on matters ASIC is considering, such as proposed relief or proposed regulatory guidance.

Regulatory guides: give guidance to regulated entities by:

- explaining when and how ASIC will exercise specific powers under legislation (primarily the Corporations Act)
- explaining how ASIC interprets the law
- describing the principles underlying ASIC's approach
- giving practical guidance (e.g. describing the steps of a process such as applying for a licence or giving practical examples of how regulated entities may decide to meet their obligations).

Information sheets: provide concise guidance on a specific process or compliance issue or an overview of detailed guidance.

Reports: describe ASIC compliance or relief activity or the results of a research project.

Document history

This paper was issued on 9 July 2019 and is based on the Corporations Act and the National Credit Act as at the date of issue.

Disclaimer

The proposals, explanations and examples in this paper do not constitute legal advice. They are also at a preliminary stage only. Our conclusions and views may change as a result of the comments we receive or as other circumstances change.

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The consultation process

You are invited to comment on the proposals in this paper, which are only an indication of the approach we may take and are not our final policy.

As well as responding to the specific proposals and questions, we also ask you to describe any alternative approaches you think would achieve our objectives.

We are keen to fully understand and assess the financial and other impacts of our proposals and any alternative approaches. Therefore, we ask you to comment on:

- the likely compliance costs;
- the likely effect on competition; and
- other impacts, costs and benefits.

Where possible, we are seeking both quantitative and qualitative information. We are also keen to hear from you on any other issues you consider important.

Your comments will help us develop our policy on exercising the product intervention power. In particular, any information about compliance costs, impacts on competition and other impacts, costs and benefits will be taken into account.

Making a submission

You may choose to remain anonymous or use an alias when making a submission. However, if you do remain anonymous we will not be able to contact you to discuss your submission should we need to.

Please note we will not treat your submission as confidential unless you specifically request that we treat the whole or part of it (such as any personal or financial information) as confidential.

Please refer to our privacy policy at www.asic.gov.au/privacy for more information about how we handle personal information, your rights to seek access to and correct personal information, and your right to complain about breaches of privacy by ASIC.

Comments should be sent by **Tuesday 30 July 2019** to:

Senior Manager, Financial Services Group
Australian Securities and Investments Commission
Level 7, 120 Collins Street
Melbourne VIC 3000
email: product.regulation@asic.gov.au

What will happen next?

ASIC will review and consider all submissions made before determining appropriate regulatory action.

A consultation paper with draft regulatory guide on the proposed use of our product intervention power was released on 26 June 2019 with comments closing on 7 August 2019: see Consultation Paper 313 *Product intervention power* (CP 313).

We will not make a decision on the proposed exercise of the product intervention power in relation to short term credit until the close of consultation on the regulatory guide.

A Background to our proposal

Key points

This consultation paper seeks feedback on a proposal to use ASIC's product intervention power under Pt 7.9A of the Corporations Act to address the significant consumer detriment arising from some short term lending models.

This power was introduced by the *Treasury Laws Amendment (Design and Distribution Obligations and Product Intervention Powers) Act 2019* (Product Regulation Act) by making amendments to the Corporations Act and *National Consumer Credit Protection Act 2001* (National Credit Act).

The impact of some short term lending models

1 ASIC is aware of a model of lending structured such that it benefits from the exemption in s6(1) of the National Credit Code (Sch 1 of the National Credit Act), and which involves the provision of short term credit at high cost to consumers, including consumers who may be on low incomes or in financial difficulties and so may not reasonably be able to afford the repayments.

Note: In this paper, we refer to this model as the 'short term lending model'. 'Short term credit' has the meaning in s6(1) of the National Credit Code. This is different to the meaning of 'short-term credit contract' in s5 of the National Credit Act (see paragraph 23). We refer to the exemption in s6(1) as the 'short term credit exemption'.

2 The short term lending model operates in the following way:

(a) The short term credit provider offers short term credit to consumers, mostly for small amounts up to $1,000. The application process is advertised as taking about two weeks.

(b) An associate of the short term credit provider offers collateral services under a separate services agreement for a 'fast track application' if the consumer wants the money immediately. The fees for the collateral services are very high relative to the amount borrowed—total fees and repayments can amount to up to 990% of the loan amount (see Table 4 under paragraph 57).

(c) The money must be repaid within a maximum term of 62 days and sometimes a shorter period of time, increasing the risk of default as repayments are based on the term of the credit rather than being based on capacity to repay.

3 The short term lending model was previously used by Teleloans Pty Ltd (Teleloans) and Finance Direct Limited Pty Ltd (FLD). ASIC is aware of one entity (Gold-Silver Standard Finance Pty Ltd (GSSF)) and its associate (Cigno Pty Ltd (Cigno)) currently using the short term lending model.

4 The short term lending model can and, on the evidence available to ASIC, does cause significant consumer detriment. This is primarily because:

(a) the target market is consumers in urgent need of relatively small amounts of money—for example, Cigno advertises that it can arrange credit of as little as $50 (indicating the vulnerability of the target market);

(b) the total cost payable under the credit contract and services agreement is significantly higher than the maximum charges permitted by the National Credit Act, which imposes caps on costs payable for short term and small amount lending;

(c) there is no adequate assessment of a consumer's capacity to meet repayments—for example, GSSF/Cigno have provided credit to many consumers who were likely to default;

(d) consumers who default are charged high fees, again in excess of the maximum amount that can be charged for loans regulated by the National Credit Act; and

(e) there are high levels of repeat use, so that some consumers who use the short term lending model end up in a high cost debt spiral.

5 The following case studies are based on real examples of consumers who have obtained credit through the short term lending model, and show the significant detriment they have suffered.

Case study 1: Impact of default fees

Consumer A was on a Centrelink Newstart allowance when she obtained short term credit through Cigno for $120.

Under the contract:

- Cigno charged a $90 financial supply fee;
- Cigno charged $5.95 in weekly account keeping fees;
- GSSF charged a credit fee of $6; and
- the total amount to be repaid was $263.60, by four fortnightly payments of $66 (with the fourth payment being $65.60).

Consumer A could not afford the repayments and immediately defaulted. She was charged various dishonour fees and ongoing weekly account-keeping fees. As a result, Consumer A became liable to repay $1,189 on the original amount of $120 (or 990% more than she borrowed).

Case study1 (cont.)

By comparison, if Consumer A had entered into a small amount credit contract regulated by the National Credit Act, she could have been charged a maximum total fee of $33.60 comprising:

- an establishment fee of up to 20% of the amount of credit ($24); and
- a monthly fee of up to 4% of the amount of credit for four fortnights ($9.60).

The total amount repayable under the contract would have been $153.60 compared to $263.60 with the Cigno product.

If Consumer A had entered into an exempt short term credit facility,she could have paid a maximum of $130.64 comprising:

- the initial amount of $120;
- a 5% fee on this amount ($6); and
- 24% p.a. interest for 56 days ($4.64).

Case study 2: Short term credit and consumers in financial difficulties

Consumer B was a 27 year-old mother with three dependants. Her income was just under $1,600 per fortnight from Centrelink payments.

In June 2018, Consumer B received $300 in short term credit from Cigno and GSSF. She could not afford any repayments for the following reasons:

- Her account had been overdrawn for the majority of the month before the credit was provided.
- Her account was overdrawn by approximately $500 the day the credit was provided.
- She failed to make the first payment when it fell due two weeks after the credit was provided. When Cigno debited her account for a repayment of $151, her account was already overdrawn by approximately $600. The repayment was reversed by the bank the following day.
- Even though Consumer B could not make the repayments, Cigno provided further short term credit of $300 in October 2018. Her bank account was overdrawn over 100 times between the first and second amount of credit being provided.

By comparison, if Consumer B had entered into a small amount credit contract regulated by the National Credit Act, it is likely the responsible lending obligations would have meant she would not have been eligible *for this credit*, as she had no demonstrated capacity to meet the repayments.

Source: Case study 1, Report of misconduct provided to ASIC; Case study 2: Information provided to ASIC under statutory notice.

6 The detriment that can arise from high-cost low-amount credit has been recognised by the Government when introducing a cap on costs for credit contracts regulated by the National Credit Act under the Consumer Credit Legislation Amendment (Enhancements) Bill 2012 (Enhancements Bill):

5.6 The Enhancements Bill introduces caps on credit contracts to address specific risks of financial detriment or harm to consumers, through the use of relatively high-cost credit.

5.7 The risk to a consumer of this financial detriment increases according to the following factors:

- the borrower's income—the lower the income the greater the reduction in income that will result from having to meet repayments under a credit contract (noting that a significant percentage of borrowers who use these products will have very low incomes);
- the term of the credit contract—the shorter the term the less income the borrower can expect to receive from other sources while they need to repay it, so that there is less opportunity for a borrower to receive sufficient income to either repay the debt or avoid an immediate need for additional credit to meet expenses temporarily deferred in order to make that repayment;
- the number of credit contracts—the more credit contracts that the borrower takes out within a short period of time (whether concurrently or successively), the more likely it is that income is being diverted to meet repayments, rather than ongoing expenses; and
- the level of costs charged by the credit provider—there can be significant differences in the level of costs charged by credit providers, in part reflecting the difficulties some debtors have in being able to obtain credit from other credit providers (with the result they enter into contracts irrespective of the costs being charged).

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

Note: See the Explanatory Memorandum to the Enhancements Bill, pp. 60–61. The *Consumer Credit Legislation Amendment (Enhancements) Act 2012* (Enhancements Act) came into force on 17 September 2012.

7 In ASIC's view, this analysis directly applies to the short term lending model.

ASIC's proposal to address significant consumer detriment

8 We propose to use our product intervention power under Pt 7.9A of the Corporations Act to address the significant consumer detriment caused by the short term lending model.

9 This consultation paper considers the following options to address this conduct:

(a) *Option 1*—Use of product intervention power to prohibit specific short term lending models which benefit from the short term credit exemption (ASIC's preferred option).

(b) *Option 2*—Encourage use of alternative products or action through warning messages.

(c) *Option 3*—No change (status quo option).

10 Under Option 1, ASIC would make an industry-wide product intervention order by legislative instrument to prohibit credit providers and their associates from providing short term credit and charging for additional or collateral services where the total fees that can be charged exceed the maximum permitted under the short term credit exemption to prevent future specific use of the short term lending model structured around this exemption.

11 The proposed industry-wide product intervention order will not extend all the consumer protections available under the National Credit Act for consumers who take out regulated payday loans (such as responsible lending obligations, access to external dispute resolution). Instead, it will be a targeted measure to prevent the charging of fees beyond that which would be permitted under the short term credit exemption.

12 In ASIC's view, Option 1 will produce the best outcomes for consumers. It will:

(a) prohibit the use of short term lending models which allow credit providers and their associates to charge fees or other charges in excess of the cost restrictions under the short term credit exemption; and

(b) protect vulnerable consumers from the significant detriment caused from the use of the short term lending model.

13 We are seeking stakeholders' views on these options before deciding whether or not to make a product intervention order to address the significant consumer detriment arising from the use of the short term lending model.

14 The draft product intervention order is included as an attachment to this paper so that stakeholders can comment on the impact it may have.

15 If we proceed with Option 1, we intend to monitor the impact of the order by assessing changes in the short term credit market to see whether businesses develop new models that warrant further intervention, and to inform our decision about whether the order should be extended in the future.

B The product intervention power and short term credit

Key points

This section explains the legislative underpinning of the proposed use of our product intervention power in relation to short term credit, including a more detailed discussion of the significant detriment we seek to address.

ASIC's product intervention power

16 The product intervention power is a proactive way for ASIC to intervene where a product has resulted, will result or is likely to result in significant consumer detriment. A breach of the law is not required for ASIC to exercise the product intervention power.

Note: In this paper, we use the term 'consumer' to mean both a retail client for a financial product and a consumer for a credit product, unless otherwise specified.

17 ASIC can intervene in relation to:

(a) financial products as defined by the Corporations Act;

(b) credit products as defined by the National Credit Act;

(c) financial products as defined by the *Australian Securities and Investments Commission Act 2001* (ASIC Act); and

(d) additional products prescribed by regulation.

18 ASIC can make two types of order under the product intervention power:

(a) an individual product intervention order, which applies to a specified person, or specified persons, in relation to a product; or

(b) a market-wide product intervention order, which applies to a person, in relation to a class of products.

19 We can make an order that a person not engage in specified conduct in relation to a product (or class of products):

(a) entirely (including, therefore, prohibiting the sale or distribution of a financial product); or

(b) except in accordance with certain conditions.

20 There are specific limitations on what can be included in a product intervention order. An order cannot:

(a) require a person to satisfy a standard of training, or meet a professional standard, other than a standard prescribed for the person:

(i) for a financial product—by or under the Corporations Act; or

(ii) for a credit product—by or under the National Credit Act;

(b) require a person who is not required to hold an Australian financial services (AFS) licence to join an external dispute resolution (EDR) scheme; or

(c) impose requirements for a person's remuneration, other than so much of the remuneration as is conditional on the achievement of objectives directly related to the product. This does not prevent us from intervening in relation to remuneration that is linked to the distribution of the product.

21 We may only intervene prospectively. This means that a product intervention order cannot apply to a product held by a person if the person acquired the product, or entered into a contract for the acquisition of the product, before the order came into force.

22 We can make an initial intervention for up to 18 months. This can be extended or made permanent with the approval of the Minister.

The short term credit exemption

23 Under the short term credit exemption, the National Credit Code and National Credit Act do not apply to credit if:

(a) under the contract, the provision of credit is limited to a total period that does not exceed 62 days; and

(b) the maximum amount of credit fees and charges that may be imposed or provided does not exceed 5% of the amount of credit; and

(c) the maximum amount of interest charges that may be imposed or provided for does not exceed an amount equal to the amount payable if the annual percentage rate were 24% per annum.

Note: The meaning of 'short term credit' in s6(1) of the National Credit Code is different to the meaning of 'short-term credit contract' in s5 of the National Credit Act, which refers to credit under $2,000 on a term of 15 days or less and which is prohibited under s133CA of the Act.

24 A contract providing short term credit is also a financial product under s12BAA(7)(k) of the ASIC Act as a credit facility within the meaning of reg 2B of the Australian Securities and Investments Commission Regulations 2001.

25 As noted in paragraph 17, ASIC can make a product intervention order in relation to financial products covered by the ASIC Act.

26 Short term credit is available to consumers as retail clients.

What is 'significant detriment'?

27 ASIC can make a product intervention order if we are satisfied that a product (or class of product) has resulted, will result or is likely to result in significant detriment to retail clients: see s1023D(1)(b) of the Corporations Act and s301D(1)(b) of the National Credit Act.

28 The legislation sets out the criteria that we are required to take into account in considering whether a product has resulted, will result or is likely to result in significant consumer detriment. These are:

(a) the nature and extent of the detriment;

(b) without limiting paragraph (a), the actual or potential financial loss to consumers resulting from the product;

(c) the impact that the detriment has had, will have or is likely to have on consumers; and

(d) any other matter prescribed by regulations (see s1023E(1) of the Corporations Act and s301E(1) of the National Credit Act).

29 In addition, we may also consider other factors: see s1023E(2) of the Corporations Act and s301E(2) of the National Credit Act.

Short term lending models used to provide short term credit

Previous use of the short term lending model: ASIC court action

30 In 2014 ASIC commenced civil proceedings against Teleloans and FLD, who operated a short term lending model which relied on the short term credit exemption.

Note: See *Australian Securities and Investments Commission v Teleloans Pty Ltd* [2015] FCA 648.

31 Under this model, Teleloans assisted consumers to access credit provided by FLD. The short term credit exemption applied as the fees charged by FLD did not exceed 5% of the credit amount and the term did not exceed 62 days. Teleloans also entered into a services agreement with consumers, charging service fees for the credit, which were considerably more than the fees permitted under the small amount credit contract cap in s31A of the National Credit Code.

32 The court did not accept that the overall arrangement between consumers, Teleloans and FLD amounted to a tripartite credit contract to which the National Credit Code applied. The court found that:

(a) there was a contract between the consumer and Teleloans and FLD was not a party to that contract;

(b) the credit provided by FLD was exempt under s6(1) of the Code; and

(c) the amount Teleloans could charge was unregulated and not subject to any caps or statutory requirements.

33 The companies Teleloans and FLD are no longer being used to operate this model. In 2016 Cigno and GSSF set up a similar model.

34 Given the court's decision, ASIC is now proposing to use our product intervention power to address the current and future use of this short term lending model.

Current use of the short term lending model

35 Cigno and GSSF currently use a similar model to Teleloans and FLD, providing short term credit and collateral services under the short term credit exemption.

36 Cigno and GSSF do not hold an Australian credit licence (credit licence) and are not members of the Australian Financial Complaints Authority (AFCA). GSSF does not have an internal dispute resolution (IDR) scheme and claims not to have received any complaints. Cigno has an IDR scheme for consumers to raise complaints.

37 With the Cigno/GSSF product, GSSF typically offers credit of up to $1,000 for a term of 62 days or less and imposes a 'non-interest charge' equal to 5% of the credit amount, meeting the technical requirements of the short term credit exemption.

38 GSSF provides a 'direct loan' option under which there are no other fees payable by the consumer, but the application process is advertised as taking about two weeks.

39 Cigno provides a 'fast tracked' service for GSSF, which offers same or next day bank deposits, and includes significant 'financial supply' and account fees. However, because the fees are charged by Cigno under a separate services agreement, rather than under the credit contract, Cigno and GSSF have advised ASIC that the credit provided is exempt under s6(1) of the National Credit Code.

40 The practical effect of Cigno charging consumers 'financial supply' and account fees to obtain credit from GSSF results in the overall fees paid by the consumer being significantly higher than what is permitted under s6(1) of the National Credit Code.

41 Because the contracts provided under the product are not 'small amount credit contracts' as defined by the law, consumers suffer significant detriment as they do not have the following rights (among others):

(a) not to be charged more fees and costs than credit providers can charge if the contract was a small amount credit contract (being an establishment fee of up to 20% of the credit amount, and a monthly fee of up to 4% of the credit amount);

(b) not to be charged an establishment fee if they refinance;

(c) not to be obliged to repay more than double the amount borrowed in the event of default;

(d) to have a proper responsible lending assessment by the credit provider about whether the credit amount is affordable and meets their requirements and objectives;

(e) for Centrelink recipients who receive at least 50% of their gross income as payments under the *Social Security Act 1991*, to ensure that repayments do not exceed 20% of their gross income for that payment cycle;

(f) to insist that credit providers have IDR processes and are a member of an EDR scheme, which would make it possible for them to complain (free of charge) to the EDR scheme in the event of a dispute;

(g) to apply for hardship and be given the relevant protections under s72 of the National Credit Code;

(h) to be provided with a warning statement before they enter the contract, which explains and outlines the costs payable and alternatives available to them; and

(i) to rely on the various other protections and provisions of the National Credit Act and Code (e.g. the rebuttable presumption that if they were in default under a small amount credit contract or had two or more such contracts at the time of a preliminary assessment, they could only comply with their financial obligations under the relevant contract with substantial hardship).

Significant consumer detriment identified

42 To exercise the product intervention powers, ASIC must be satisfied that there is significant detriment to retail clients.

43 Subject to the consultation process, in ASIC's view, it is likely that the short term lending model used by Teleloans/FLD and Cigno/GSSF, has resulted in significant consumer detriment. This is because the contracts provided through the short term lending model:

(a) targeted vulnerable consumers experiencing financial stress;

(b) have significantly higher upfront costs compared to regulated credit products, or if the short term credit exemption was strictly applied;

(c) have high and uncapped fees payable on default creating a financial incentive to offer credit to consumers who are unable to meet repayments;

(d) funnelled consumers to a high-cost alternative, given that the cheaper direct loan option is offered on terms which make it impractical for the target market; and

(e) required consumers to repay the credit amount and fees via direct debit, which can adversely affect the consumer's financial situation when they are charged overdrawn fees as a result of attempts to deduct repayments from the consumer's account when it has insufficient funds.

Targeting of vulnerable consumers

44 Consumers who use short term credit are often from low socio-economic backgrounds and/or are experiencing financial stress. In the examples we have seen, consumers have generally used these loans to pay for basic expenses such as food, bills, and car-related expenses.

45 The fees charged through the short term lending model are high by comparison both to the amount borrowed and the income of many of the consumers. For example, if a consumer has a Centrelink income of $1,000 a fortnight and has to make repayments of $150 a fortnight, they face a reduction in their income of 15% and are likely to have no or minimal discretionary expenses. Repayments on the short term credit provided through this model are likely to place pressure on their other expenses and result in them defaulting on other debts.

46 Cigno's advertising on its website targets vulnerable consumers in financial stress, claiming to be an 'emergency cash specialist' with a 'high approval rate'. Cigno offers 'Bad credit', 'No credit', 'Unsecured', 'Payday', 'Centrelink' and 'Unemployment' loans, with the following statements:

> 'Unlike banks, we are more understanding of your needs and circumstances. We don't turn away customers with bad credit history, in fact we welcome them!'
>
> 'Are you in need of emergency cash? Do you need a loan urgently…approved today, with no long wait times or paperwork?'
>
> 'At Cigno we specialise in accessing short-term emergency loans for our customers for amounts between $50 and $1000.'

Note: As at 28 June 2019. See Cigno's website, 'How it works', 'Bad credit loans', 'Disclosure and Authorisations', 'Unsecured loans'.

47 Since July 2016, ASIC has received 165 reports of misconduct about the conduct of Cigno and GSSF from consumers and consumer advocates, particularly in relation to the charging of excessive fees.

48 The reports of misconduct received by ASIC indicate that the consumers who obtain short term credit from GSSF include:

(a) Indigenous consumers;

(b) Centrelink recipients;

(c) unemployed consumers;

(d) young consumers (18–21 years old);

(e) elderly consumers (65+ years old);

(f) consumers with disabilities/serious medical conditions; and

(g) consumers with addiction problems (gambling or drugs).

49 ASIC also understands that Cigno receives referrals from licenced payday lenders who pass on the contact details of consumers who have been assessed as ineligible to obtain a small amount credit contract. This practice means that Cigno's market includes consumers who have already been assessed by another lender as incapable of meeting repayments under such a contract, where, due to regulation under the National Credit Act, repayments would be lower than those under a Cigno/GSSF product: see paragraph 54.

Higher upfront costs

50 Consumers suffer detriment as the short term lending model allows entities to charge higher upfront fees and/or other charges than the maximum amount permitted if the contract was a small amount credit contract, or if the short term credit exemption was strictly applied.

51 For example:

(a) GSSF charges a 5% fee; and

(b) Cigno charges consumers up to 115% of the loan amount in 'financial supply fees'.

52 Cigno offers six payment options based on the number of repayments with a different financial supply fee for each option. Table 1 sets out the options and supply fees that Cigno charges in addition to the 5% credit fee charged by GSSF.

Table 1: Cigno's payment options and upfront fees (as at 28 June 2019)

Payment option	Financial supply fee
1 payment option	35% of loan amount
2 payment option	45% of loan amount
3 payment option	60% of loan amount
4 payment option	75% of loan amount
6 payment option	95% of loan amount
8 payment option	115% of loan amount

Source: Cigno's website as at 28 June 2019

Note: The six and eight payment options are only offered to existing customers. Additional fees include an account keeping fee of $5.95 per week, a same day deposit fee of $16 (optional) and a priority transfer fee of $16 (optional).

53 By comparison, the maximum fee for a regulated small amount credit contract is a one-off establishment fee of 20% of the loan amount and a monthly fee not exceeding 4% of the loan amount.

54 Table 2 compares the amount payable for credit under different lending models.

Table 2: Upfront cost comparison

Loan for $120	Exempt short term credit facility (40 days)	Small amount credit contract (40 days)	Cigno/GSSF product (40 days: 4 payment option)
Establishment fee	—	$24.00	—
Credit fees	$6.00	$9.60	$6.00
Interest	$3.31	—	—
Financial supply fee	—	—	$90
Account keeping fees	—	—	$29.75
Total charges	$9.31	$33.60	$125.75
Total to be repaid	$129.31	$153.60	$245.75
Repayments	$43.10 per fortnight (3 repayments)	$51.20 per fortnight (3 repayments)	$61.44 every 10 days (4 repayments)

Source: ASIC calculations

55 If the cost of short term credit provided by Cigno/GSSF was expressed as an interest rate (using the same assumptions that apply to regulated loans), the interest rate would be 938% on a loan where:

(a) the consumer borrows $200, repayable by four fortnightly instalments over an eight-week period; and

(b) the consumer is charged a 5% credit fee by GSSF of $10.00, weekly account fee of $5.95 totalling $47.60, and a 'Financial supply fee' of 75% of the loan ($150), so that the total amount repayable is $407.60.

Uncapped default fees

56 The short term lending model also allows entites to charge uncapped default fees. For example, Cigno charges significant uncapped default fees (see Table 3), whereas the maximum amount recoverable under a small amount credit contract in default is twice the adjusted credit amount (which includes all repayments).

Note: See s39B of the National Credit Code.

Table 3: Cigno's default-related fees (as at 28 June 2019)

Fee	Amount
Change of payment date/amount fee	$20
Payment reschedule fee	$30
Dishonoured payment fee	$49
First dishonoured letter fee	$30

Fee	Amount
Second dishonoured letter fee	$50
Third dishonoured letter fee	$50
Collections phone contact fee	$8.80
Collections tracking fee	$50
Investigator/hand over fee	$175 (plus legal fees)

Source: Cigno's website

57 Table 4 gives examples of short term credit provided by Cigno/GSSF where the default fees have accumulated significantly. It shows that Cigno is charging significant amounts, both in dollar terms and in the amount charged relative to the cap applying to small amount credit contracts.

Table 4: Case studies of loans with fees charged by Cigno to individual consumers

Loan amount	Total fees and repayments	Percentage of loan amount in fees and repayments	Amount paid above loan amount
$120	$1,189	990%	$1,089
$200	$1,370.95	685%	$1,170.95
$150	$1,258.65	839%	$1,108.65

Source: Reports of misconduct provided to ASIC

Failure to assess capacity to pay

58 As the short term lending model allows entities to provide short term credit outside of the National Credit Act, there is no obligation to assess a consumer's capacity to repay. For example, ASIC is aware that Cigno and GSSF do not adequately consider a consumer's ability to repay, despite often being aware of issues that are likely to affect repayment, such as reliance on Centrelink payments and negative cash flow based on bank account statements.

59 Under the National Credit Code, the amount of repayments for Centrelink recipients would be capped at 20% of their income. The case study below indicates the significant detriment that a disability support pensioner suffered due to unregulated short term credit through a Cigno/GSSF product.

Case study 3: Impact of no assessment of capacity to repay

Consumer C was on a Centrelink disability support pension of $850 per fortnight.

He applied for a loan on a third party website and was declined based on his income. He then received an unsolicited loan offer from Cigno.

He applied for two loans of $200 and $150 through Cigno. The fortnightly repayments for these two loans ($170 and $95) exceeded 20% of his fortnightly income.

Consumer C was unable to afford the repayments and defaulted. He was charged various dishonour fees and ongoing weekly account keeping fees. As a result, Consumer C became liable to repay $2,630 on the original loan amounts of $350 (or 750% more than he borrowed).

Source: Reports of misconduct provided to ASIC

The direct loan option: An impractical option

60 The short term lending model offers consumer two options to obtain short term credit, either directly through the short term credit lender, or through an associate of the lender, who provides a fast track service. The direct option is a longer process which can take up to two weeks.

61 For example, Cigno's website gives consumers the option to obtain a loan directly through GSSF, without incurring Cigno's fees through a services agreement.

62 The GSSF direct loan option is designed to be a lengthier process, which takes up to two weeks to process:

(a) an application form must be downloaded, and returned by post, email or fax to GSSF;

(b) GSSF will assess the application;

(c) if approved, a cheque will be mailed to the consumer; and

(d) once the cheque is deposited, the consumer will need to wait for the cheque to clear.

63 A key requirement for consumers obtaining short term credit is the speed in which they can obtain the money, as it is often used to pay for essential items such as food and utility bills. Despite being cheaper, the direct loan is impractical for the consumers the product is targeting, because they generally require the money urgently.

Direct debit authority

64 The payment terms of contracts made through the short term lending model can also add to the detriment suffered by consumers. Cigno and GSSF require repayments to be made through direct debit arrangements to maximise their collections. Since the term of the credit provided is under 62 days and many

consumers do not have the capacity to make the repayments, there is a high chance of default. This increases the detriment suffered by consumers, where they are charged default or overdrawn fees on their savings or debit account, in addition to the default fees charged by Cigno.

65 Some reports of misconduct allege that Cigno has varied repayment amounts and dates without notification, contrary to its undertaking to provide 14 days' notice if it proposes to vary the terms of the debit arrangements. This allowed Cigno to continue to debit maximum repayments from the consumer's account without the consumer having control over the timing of those deductions, with a significant risk of creating difficulties for consumers when they have less money in their account to meet planned expenses.

66 By comparison, a credit provider must refrain from seeking a repayment due under a small amount credit contract by relying on a direct debit request if they have twice sought to obtain the repayment using this request and have not told the debtor that the requests have been unsuccessful, or if they have not made reasonable attempts to contact the debtor.

Note: See reg 79C of the National Consumer Credit Protection Regulations 2010.

67 The Explanatory Memorandum to the Enhancements Act stated at paragraph 5.76:

> This provision is intended to address the risk of fees accruing to a debtor's account through repeated unsuccessful use of a direct debit.

C Our proposal

Key points

This section outlines our proposal to use our product intervention power in relation to short term credit.

It discusses the nature of each option in detail and sets out the impact of each option on credit providers, businesses and consumers.

Use of product intervention power in relation to short term credit

Proposal

C1 We propose to make a product intervention order by legislative instrument under s1023D(3) of the Corporations Act to prohibit credit providers and their associates from providing short term credit and collateral services except in accordance with a condition which limits the total fees that can be charged: see the draft product intervention order in the attachment to this paper

Note: For the definition of 'collateral services', see 'Key terms'.

Your feedback

C1Q1 Do you consider that the short term lending model causes detriment to consumers and that this detriment is significant?

C1Q2 Do you consider that the short term lending model does or might cause detriment other than that identified by ASIC, or to a greater or lesser extent? If additional or greater, how should the proposed product intervention order be expanded to address this significant detriment?

C1Q3 Do you agree with our proposal to make an intervention order by way of legislative intervention prohibiting credit providers and their associates from providing short term credit and collateral services except in accordance with a condition which limits the total fees that can be charged? Please provide details of why, or why not.

C1Q4 What alternative approaches (including Options 2 and 3) could ASIC take that would achieve our objectives of preventing the consumer detriment identified in this paper?

Rationale

68 The proposed product intervention order (*Option 1*) is ASIC's preferred option for addressing the significant consumer detriment identified in relation to the current use of the short term lending model and to prevent any further significant detriment that may be caused by the use of the short term lending model, or similar models by short term credit providers and their associates.

69 We have also considered the following options:

(a) *Option 2*—Encourage use of alternative products or action through warning messages.

(b) *Option 3*—No change (status quo option).

Summary of options and impact analysis

Option 1: Use of product intervention power to prohibit specific short term lending models

70 Under Option 1, ASIC would use our product intervention power to:

(a) make an industry-wide product intervention order by legislative instrument under s1023D(3) of the Corporations Act to prohibit credit providers and their associates from providing short term credit and collateral services except in accordance with a condition which limits the total fees that can be charged; and

(b) if a new model, which seeks to circumvent the industry-wide product intervention order, evolves in response to the prohibition, amend the existing order or introduce a new order to address that model.

71 In ASIC's view, Option 1 is preferable because:

(a) the product intervention order will prevent the use of the short term lending model which is causing significant consumer detriment, including the model currently being used by Cigno and GSSF;

(b) it will prevent other credit and collateral services providers from adopting this model;

(c) it promotes protection for consumers who require small amount credit contracts but who are provided with short term credit (and services agreements) in reliance on the short term credit exemption; and

(d) it is a more comprehensive and timely response than the other options.

Regulatory and financial impact of Option 1

72 ASIC considers that the proposed use of the product intervention order is likely to result in Cigno and GSSF abandoning their short term lending model that relies on the short term credit exemption. The impact would be limited to these two companies; our inquiries have not identified any other businesses using this model.

73 It is likely that the proposed order would also:

(a) prevent credit and collateral services providers from providing unregulated credit outside the ambit of the short term credit exemption;

(b) prevent credit and collateral services providers from developing new models; and

(c) if Cigno and GSSF elect to continue providing credit under a model where they charge more than the maximum amount permitted under the short term exemption, require these providers to apply for a credit licence and, if granted, comply with the conduct obligations and prohibitions in the National Credit Act.

74 We consider that this intervention would not have any regulatory costs on credit and collateral services providers as:

(a) Cigno and GSSF would be prohibited from providing short term credit and collateral services using their current short term lending model, and therefore would not incur any compliance costs; and

(b) there are no other known credit providers in the market using this short term lending model, with the purpose of industry-wide product intervention order being to discourage future use of the short term lending model.

75 This intervention would be likely to have the following impact on consumers:

(a) *Increased use of small amount credit contracts*—Some consumers may obtain a small amount credit contract rather than using short term credit, where the credit provider considers the loan is not unsuitable under the National Credit Act. These consumers would benefit from being provided with finance with the statutory protections under the Act.

(b) *Reduced access to credit*—Some consumers may be unable to access small loans when they need credit, and may not be eligible for a small amount credit contract. These consumers may experience financial hardship. However, their overall level of debt will be lower as it will not include the amounts charged under the short term lending model which exceed the cost caps in the short term credit exemption. It should therefore be less difficult for some of these consumers to resolve their financial difficulties in other ways, rather than by seeking short term credit.

76 We will monitor the impact of the product intervention order. If other models are developed to circumvent the product intervention order, we will consider whether further action or amendments are necessary.

Option 2: Encourage consumers to use alternatives

77 Under this option, ASIC would seek to reduce the use of high-cost products such as the short term lending model used by Cigno/GSSF by encouraging consumers to visit financial counsellors and promoting awareness of alternatives like Centrelink advances, utility hardship programs, and No Interest Loan Schemes (NILS).

78 ASIC would use our product intervention power to impose specific obligations on providers of short term credit, requiring them to notify borrowers of these alternatives.

79 These credit providers would be subject to obligations that could include:

(a) providing a concise high impact notice about the alternatives that are available before the consumer enters into a contract; and

(b) where the consumer applies online, displaying similar information before an application can be started.

80 This would supplement existing financial literacy messages to consumers through ASIC's MoneySmart website.

Regulatory and financial impact of Option 2

81 ASIC considers that Option 2 would:

(a) have low compliance costs for providers of short term credit;

(b) result in a small decrease in the number of loans provided; and

(c) not deliver as comprehensive or effective a solution as Option 1.

82 We consider that providers of short term credit would incur regulatory costs in ensuring that their websites displayed the appropriate warnings and hyperlinks. These costs are minimal and would only apply on a one-off basis, rather than being continuing. It is likely that they could be absorbed within the existing budgets committed to website maintenance.

83 The impact on consumers who use alternatives to short term credit is likely to be:

(a) a reduction in their reliance on high-cost loans; and

(b) if they use a financial counsellor, better management of their income, changes to their spending habits and, overall, less reliance on all credit products.

84 We consider that Option 2 would not provide as effective a solution as Option 1. This is because warning statements are a form of disclosure, and there is significant empirical evidence demonstrating the limitations of disclosure as a tool to help consumers make good decisions. Disclosure is even less likely to be effective with the group of consumers who are affected by Cigno's conduct. Our view is that warning statements will not materially reduce the number of consumers who are harmed by Cigno's conduct.

Note: See, for example, ASIC's recent submission to Treasury discussing the limitations of disclosure,: Disclosure in general insurance: Improving consumer understanding, pp. 5–6.

85 Consumers who do not respond to the warning messages may find that their financial position is substantially worsened, as the amount of their debt quickly increases through the charges imposed by entities using the short term lending model, and they have a reduced ability to pay for other expenses, such as food, rent or utilities.

Option 3: Status quo

86 Under this option, ASIC would take no regulatory action to address the use of the short term lending model.

87 We consider that Option 3 would not address the significant consumer detriment we have identified that is caused by the use of the short term lending model:

(a) The current players in the market, Cigno and GSSF, would continue to conduct business under their current short term lending model, which causes significant consumer detriment.

(b) Other credit providers, related service providers, businesses and companies may adopt and use the short term lending model or similar models, causing further significant detriment to consumers.

(c) Consumers who take out a loan through the short term lending model, would find their financial position worsened, due to the high fees and being provided with loans where they cannot meet the repayments.

Key terms

Term	Meaning in this document
AFCA	Australian Financial Complaints Authority
AFS licence	An Australian financial services licence under s913B of the Corporations Act that authorises a person who carries on a financial services business to provide financial services Note: This is a definition contained in s761A.
ASIC	Australian Securities and Investments Commission
ASIC Act	*Australian Securities and Investments Commission Act 2001*
Cigno	Cigno Pty Ltd
collateral services	A service provided to a retail client in relation to an application by the retail client for the provision of credit by a short term credit provider under a short term credit facility
consumer	Means both a retail client for a financial product and a consumer for a credit product, unless otherwise specified
CP 313 (for example)	An ASIC consultation paper (in this example numbered 313)
credit	Credit to which the National Credit Code applies Note: See s3 and 5–6 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 an Australian credit licence under s35 of the National Credit Act
credit product	Means a credit contract, mortgage, guarantee or consumer lease Note: See s301D(a) of the National Credit Act.
credit provider	Has the meaning given in s5 of the National Credit Act
EDR	External dispute resolution
Enhancements Act	*Consumer Credit Legislation Amendment (Enhancements) Act 2012*
Enhancements Bill	Consumer Credit Legislation Amendment (Enhancements) Bill 2012
financial product	A facility through which, or through the acquisition of which, a person does one or more of the following: • makes a financial investment (see s763B); • manages financial risk (see s763C); • makes non-cash payments (see s763D) Note: This is a definition contained in s763A of the Corporations Act: see also s763B–765A.

Term	Meaning in this document
financial service	Has the meaning given in Div 4 of Pt 7.1 of the Corporations Act
financial services business	A business of providing financial services Note: This is a definition contained in s761A of the Corporations Act. The meaning of 'carry on a financial services business' is affected by s761C.
FLD	Finance & Loans Direct Pty Ltd
GSSF	Gold-Silver Standard Finance Pty Ltd
IDR	Internal dispute resolution
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 credit contracts
product	Means both financial products and credit products, unless otherwise specified
responsible lending obligations	The obligations under Ch 3 of the National Credit Act
retail client	A client as defined in s761G of the Corporations Act and Div 2 of Pt 7.1 of the Corporations Regulations 2001
s160F (for example)	A section of the National Credit Act (in this example numbered 160F), unless otherwise specified
short term credit	Has the meaning given in s6(1) of the National Credit Code
short term credit exemption	The exemption in s6(1) of the National Credit Code
short term credit facility	A financial product covered by both: • s12BAA(7)(k) of the ASIC Act; and • s6(1) of the National Credit Code
short term credit provider	A provider of short term credit
short term lending model	Means a lending model structured to benefit from the exemption in s6(1) of the National Credit Code to provide short term credit to consumers at high cost as described in paragraph 2 of this paper
small amount credit contract	Has the meaning given in s5 of the National Credit Act
Teleloans	Teleloans Pty Ltd