

REVIEW OF THE SMALL AMOUNT CREDIT CONTRACT LAWS

FINAL REPORT
MARCH 2016

Review of the small amount credit contract laws

Final report

March 2016

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The Hon Kelly O'Dwyer MP
Minister for Small Business and Assistant Treasurer
Parliament House
CANBERRA ACT 2600

Dear Minister

SMALL AMOUNT CREDIT CONTRACTS REVIEW FINAL REPORT

In accordance with the Terms of Reference, we are pleased to present the Final Report of the Review of Small Amount Credit Contracts (SACCs).

We have examined the effectiveness of the laws relating to SACCs, and whether any of the provisions which apply to SACCs should be extended to consumer leases.

Our starting point has been that the laws applying to SACCs and consumer lease providers should be designed in a way that promotes financial inclusion and attempts to protect consumers from descending into a spiral of financial exclusion. We are recommending refinements to the laws applying to SACCs and consumer leases to ensure they promote financial inclusion and that they are fit for purpose for the Australian economy now and into the future.

As part of the review, we undertook an extensive consultation process to gather information and to ensure that stakeholders were provided with an opportunity to engage with us. More than 70 submissions were received and a number of roundtables and separate meetings with stakeholders were held.

We made a conscious effort to ensure that small businesses had individual opportunities to engage with us and to provide their perspective. Many organisations and individuals gave considerable time and resources to assist this review for which we are grateful.

Finally, we wish to thank the Secretariat for their dedicated professionalism and excellent support.

Yours sincerely



Danielle Press
Chair



Catherine Walter AM
Panel member



Stephen Cavanagh
Panel member

RECOMMENDATIONS

Small Amount Credit Contracts (SACCs)

Recommendation 1 – Affordability

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.

Recommendation 2 – Suitability

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**.

Recommendation 3 – Short term credit contracts

Maintain the existing ban on credit contracts with terms less than 15 days.

Recommendation 4 – Direct debit fees

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

Recommendation 5 – Equal repayments and sanction

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 percent rate (APR) of 48 per cent.

Recommendation 6 – SACC database

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.

Recommendation 7 – Early repayment

No 4 per cent monthly fee can be charged for a month after the SACC is discharged by its early repayment. If a consumer repays a SACC early, the credit provider under the SACC cannot charge the monthly fee in respect of any outstanding months of the original term of the SACC after the consumer has repaid the outstanding balance and those amounts should be deducted from the outstanding balance at the time it is paid.

Recommendation 8 – Unsolicited offers

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

Recommendation 9 – Referrals to other SACC providers

SACC providers should not receive a payment or any other benefit for a referral made to another SACC provider.

Recommendation 10 – Default fees

SACC providers should only be permitted to charge a default fee that represents their actual costs arising from a consumer defaulting on a SACC up to a maximum of \$10 per week.

The existing limitation of the amount recoverable in the event of default to twice the adjusted credit amount should be retained.

Consumer Leases

Recommendation 11 – Cap on cost to consumers

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.

Recommendation 12 – Base Price of goods

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.

Recommendation 13 – Add-on services and features

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.

Recommendation 14 – Consumer leases to which the cap applies

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.

Recommendation 15 –Affordability

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.

Recommendation 16 – Centrepay implementation

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.

Recommendation 17 – Early termination fees

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.

Recommendation 18 – Ban on the unsolicited marketing of consumer leases

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

Combined recommendations

Recommendation 19 – Bank statements

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.

Recommendation 20 – Documenting suitability assessments

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.

Recommendation 21 – Warning statements

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.

Recommendation 22 – Disclosure

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.

Recommendation 23 – Penalties

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.

Recommendation 24 – Avoidance

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.

CHAPTER 1 — OVERVIEW AND BACKGROUND

On 7 August 2015, the Government announced a review of the small amount credit contract (SACC)¹ laws contained in the *National Consumer Credit Protection Act 2009* (the Credit Act) and regulated consumer leases.²

Jurisdiction for the regulation of consumer credit was transferred from the states and territories to the Commonwealth on 1 July 2010 with the commencement of the Credit Act. Enhancements to the Credit Act, which included specific provisions for SACCs and consumer leases, were enacted by the *Consumer Credit Legislation Amendment (Enhancements) Act 2012* (the Enhancements Act).

The Government asked the review panel (the Panel) to examine and report on the effectiveness of the law relating to SACCs, and to make recommendations on whether any of the provisions which apply to SACCs should be extended to regulated consumer leases.³

The terms of reference for the review (Appendix 1) require the Panel to consider a number of specific issues and in doing so to take into account:

- competition;
- fairness;
- innovation;

1 SACCs are loans to consumers, where the credit provider is not an Authorised Deposit-taking Institution (ADI), of up to \$2,000 where the term of the contract is between 16 days and 12 months, as per section 5 of the Credit Act. The Credit Act does not apply to any loans (including SACCs) to businesses including.

2 Regulated consumer leases are contracts for goods (hired wholly or predominantly for personal, domestic or household purposes) for longer than 4 months where: the consumer does not have a right or obligation to purchase the goods; and the total amount payable exceeds the cash price, as defined in sections 169, 170 of the National Credit Code. Note that the cash price is defined in subsection 204(1) of the National Credit Code. An example of a lease where the total amounts payable do not exceed the cash price, and therefore the lease is unregulated, is a rental car on a holiday. The focus of this review has been consumer leases which are comparable to SACCs. As such, the Panel's recommendations cover household and electronic goods but do not extend to motor vehicle leases.

3 Ms Danielle Press is the chair of the Panel. Mr Stephen Cavanagh and Ms Catherine Walter AM are the other Panel members.

- efficiency;
- access to finance;
- regulatory compliance costs;
- consumer protection; and
- whether the laws relating to SACCs and consumer leases are appropriate for the current economic climate and whether they will continue to meet Australia’s evolving needs.

In the interim report, the Panel discussed trends in the SACC and consumer leasing industries since the introduction of the Enhancements Act and outlined the key characteristics of consumers who utilise SACCs and consumer leases.⁴ The interim report also identified a number of problems which the Panel considered it necessary to be addressed. In this final report, the Panel has primarily focused on its recommendations and why they are needed. The Panel has not sought to restate all the material that was included in the interim report.

OVERVIEW OF FINDINGS

It is the Panel’s view that a key objective of the laws applying to SACCs and consumer leases should be to facilitate financial inclusion. The current exemption for SACC and consumer lease providers from the 48 per cent annual percentage rate (APR) cap that applies to all other credit products regulated by the Credit Act⁵ is a concession which should not continue to the extent that it produces outcomes which are inconsistent with that objective.⁶

SACC providers can currently charge a maximum establishment fee of 20 per cent of the adjusted credit amount (cash in hand to the consumer) and a monthly fee of a maximum of 4 per cent of the adjusted credit amount. The 4 per cent monthly fee is charged on the initial amount not on a diminishing balance as with an interest rate.

There is no limit to the price that can be charged under a consumer lease.

4 Interim report p. 5-6 and p21-22.

5 See section 32A of the National Credit Code.

6 The Panel notes that the cap does not apply to credit contracts provided by ADIs.

The Panel does not consider that access to finance, irrespective of the cost, means that a consumer is financially included. Financial inclusion is a broader and more complex concept that takes into account the relationship between high charges and broader social consequences, such as financial hardship, insecurity in housing tenure and adverse impacts on the consumer's health, and is concerned with improvement in the consumer's situation, rather than it deteriorating or remaining unchanged. This approach is consistent with the intent behind the SACC specific conduct obligations introduced in 2011 by the Enhancements Act.

The Panel's recommendations are designed to increase financial inclusion, particularly through the proposals to introduce a cap on costs for consumer leases of household goods, and to introduce a new protected earnings cap for both consumer leases for household goods and SACCs. The intention of these proposals is to reduce the risk that consumers may be unable to pay for basic needs or default on other necessary commitments. Mitigating these outcomes can be expected to improve a consumer's financial position through, for example, smoothing expenditure, limiting shortfalls in paying utilities or rent, creating a modest level of savings and reducing dependency on higher cost forms of finance.

The Panel is recommending refinements to the laws applying to SACCs to ensure they are fit for purpose for the Australian economy now and into the future. These proposals include:

- simplifying the responsible lending requirements by amending the protected earnings bright line test so that it applies to all consumers (not only Centrelink payment recipients) and is capped at 10 per cent of net income (rather than 20 per cent of gross income), and by removing the existing presumptions of unsuitability. This means that if the consumer makes fortnightly payments under a SACC then the total amount of all SACC repayments in the fortnightly period cannot exceed 10 per cent of their net income in each fortnightly repayment period;
- addressing some of the anomalies in consumer outcomes that have arisen since 2012 in response to the reforms in the Enhancements Act, including providing for greater consistency in the charges that can be imposed on early repayment and default by the consumer; and
- requiring the cost of a SACC to be expressed as an APR prior to the consumer entering into a contract.
- It is the Panel's view that these recommendations are consistent with the objectives of the reforms introduced in the Enhancements Act and seek to achieve similar consumer outcomes.

- The Panel considers that the existing concessional cap on costs for SACCs is appropriate provided that the responsible lending obligation changes are implemented, although the Panel would encourage industry to view it as a cap not a floor.

In relation to consumer leases of household goods, the Panel considers that the current regulatory framework is not effective in promoting financial inclusion. In particular, on the evidence presented to the Panel, the cost to consumers of such leases can be significant (see Table 1). There is no current restraint on what lessors can charge, resulting in high charges.

Table 1: Examples of high cost leases with a one year term – Centrelink recipients⁷

Product	Retail price	Fortnightly rental payment	Total cost	Equivalent interest rate
7 kg washing machine	\$700.00	\$83.69	\$2,175.94	292.18%
5 kg dryer	\$345.00	\$117.00	\$3,042.00	884.34%
253 L fridge	\$498.00	\$65.00	\$1,690.00	324.35%
145 L chest freezer	\$319.00	\$42.00	\$1,092.00	327.65%

The fact that the absence of a cap has permitted such high costs being charged in some cases to consumers who can least afford them dictates the need for reform and illustrates the unequal bargaining power in this market. Moreover, these costs are not readily visible to consumers. The Panel can see no justification as to why consumer leases should be the only product regulated by the Credit Act that is not subject to a cap on the amount that can be charged.

7 Australian Securities and Investments Commission (ASIC) report 447 Table 7 p.22. ASIC’s report used a comparison rate which accounted for leap years which achieves a marginally different interest rate from an APR.

The Panel is making a number of key recommendations for changes to the laws applying to consumer leases of household goods⁸ including:

- a cap on the amount that can be charged under a consumer lease, which would limit the amount lessors can charge to a multiple which is 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 (where the Base Price for new goods is the recommended retail price (RRP) or the price agreed in store, where this price is below the RRP for new goods or another amount for second hand goods which is yet to be determined, as discussed in *Recommendation 12*);
- the introduction of a protected earnings amount, 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, as with SACCs, the total amount of all rental payments cannot exceed 10 per cent of their net income in each payment period; and
- a requirement that, prior to the consumer entering into a lease contract, lessors disclose the Base Price and the cost of the lease expressed as an APR calculated by reference to that Base Price in addition to the current requirement to disclose the total cost of the lease.

The Panel notes that using RRP as the Base Price for new goods is a generous starting point from the perspective of the lessor, as the majority of lessors pay a lower price when they acquire the good.

These recommendations are discussed in detail in chapters 2 to 4.

The Panel considers that the recommended changes to the laws applying to SACCs and consumer leases of household goods are appropriate, given that the current cap for SACC providers and the proposed cap for consumer lessors provide a significant concession to these providers, allowing them to charge more than is permitted under the 48 per cent APR cap applying to other credit contracts. For example, allowing a lessor to charge a monthly fee of 4 per cent of the Base Price on a lease with a one-year term is equivalent to an APR of approximately 82 per cent. This is almost double the maximum permitted for other credit contracts.

8 This includes all regulated consumer leases of household goods including electronic goods. The recommendation does not extend to consumer leases for motor vehicles. The Panel has not had the opportunity to consult with car lease providers and other relevant stakeholders, and considers further work should be undertaken with key stakeholders before any reforms relevant to consumer leases for motor vehicle leases are considered.

The caps on amounts that can be charged should not be viewed in isolation but considered together with the other recommended changes. In particular, a limit on the total amount of payments under a SACC or consumer lease of household goods, so that the consumer is not required at any time to outlay more than the equivalent of 10 per cent of after tax income, is important in furthering financial inclusion. One consequence of this recommendation is to limit the ability of a credit provider or lessor to earn the maximum permitted charges payable in the shortest possible period of time. It should result in the provision of contracts with lower payments (either because the contract will have a longer term or because the amount of finance provided will be smaller). The recommendation should not prevent access to finance and will allow providers to continue to offer their products but on different terms.

The recommendations seek to strike an appropriate balance between enabling consumers to access emergency finance when required, optimising their opportunity to improve their financial situation over time, and the viability of an efficient industry. The Panel's view is that these recommendations should be expected to provide significantly better outcomes for vulnerable consumers.

Terminology in relation to the cost of SACCs and consumer lease

In this report, the Panel has referred to the cost to consumers of SACCs and consumer leases of household goods in the following ways:

- the total cost (the total payments under a SACC or lease over its term) as a dollar figure;
- the periodic cost – the amount of the fortnightly or monthly payments;
- an APR, using the formula set out in section 32B of the National Credit Code, which is a calculation based on a diminishing balance; and
- the total cost expressed as a multiple of the amount lent or Base Price of the leased goods.

Each method is helpful in different contexts in understanding the cost of SACCs and consumer leases both in themselves and relative to each other and their impact on consumers.

SACCS

When the cost of a SACC is expressed as a multiple, the total cost to the consumer is being compared with the amount lent. For example, if a consumer was lent \$500 for 12 weeks (or just less than three months) the maximum charges the credit provider could impose would be \$160 (\$100 establishment fee plus three monthly fees of \$20 each). The total amount payable by the consumer is \$660 which equates to a multiple of 1.32 times the amount of credit (\$500).

When the cost of a SACC is expressed as an APR, the Panel is referring to the cost of the SACC taking into account the 20 per cent establishment and the 4 per cent monthly fees and on the assumption the repayments are made fortnightly in arrears. Under the above example of a SACC of \$500 for 12 weeks, the consumer will repay a maximum of \$660. Assuming that the consumer makes six fortnightly payments of \$110, this transaction has an APR of 223 per cent.

Table 2: An example of a SACC expressed as an APR and a multiple of the amount lent

Amount lent	Total cost to consumer	Fortnightly cost	Term	APR	Multiple of amount lent
\$500	\$660	\$110	12 weeks	223%	1.32

Consumer leases

For consumer leases, the Panel has identified the charge under the lease as the difference between the total amount payable under the contract and the Base Price of the good. Where the cost of a consumer lease is expressed as a multiple of the Base Price of the goods, the Panel is comparing the total amount payable to the Base Price of the goods.

For example, Table 1 provides the example of a 7 kg washing machine with an RRP of \$700. Under this example, the total cost of the lease was \$2,175.94. This amount could be expressed as a multiple of 3.11 times the RRP.

Similarly, it is possible to determine an APR for this transaction using the following premises; the RRP (\$700) is treated as equivalent to the amount of credit provided under a credit contract; the total amount payable is \$2,175.94; and the consumer makes fortnightly payments of \$83.69 in arrears.

In this scenario the APR is 292 per cent.

Table 3: An example of a consumer lease expressed as an APR and a multiple of the Base Price

RRP	Total cost to lessee	Fortnightly cost	Term	APR	Multiple of Base Price
\$700	\$2,175.94	\$83.69	12 months	291%	3.11

The lease and SACC examples provided above are not directly comparable as the SACC is for a period of 12 weeks while the consumer lease is for a period of 12 months and the SACC is for \$500 and the lease \$700. It should be noted that the high APR reported in the SACC example in part reflects the short term of the SACC; this APR is not earned over a full 12 month period.

CONSULTATION PROCESS

The Panel undertook an extensive consultation process to gather information and to give stakeholders an opportunity to provide input.

The Panel released an initial consultation paper on 17 September 2015 and received more than 40 submissions. During the first consultation period, the Panel held four stakeholder roundtables that included a range of industry participants (from larger providers to smaller entities) as well as consumer groups.

The Panel released an interim report on 22 December 2015. The interim report set out the Panel’s initial observations in key areas and canvassed potential policy options. The consultation on the interim report was an opportunity for stakeholders to comment on the observations and provide additional information.

During the second consultation period, the Panel held a series of separate meetings with a wide variety of stakeholders. This too included both small and large industry participants as well as consumer groups. The Panel has made a conscious effort to ensure that small businesses had individual opportunities to engage with the Panel and provide their perspective.

In its meeting with stakeholders, the Panel also met with some consumers who provided first-hand insights into their experiences in using SACCs and consumer leases.

Data

The Panel was presented with a range of data during the review process from formal consumer and industry surveys to individual case studies and information provided by the Australian Securities and Investments Commission (ASIC) obtained from its surveillance. The Panel has drawn on both quantitative and qualitative information in forming its recommendations. This data provided valuable insights into the SACC and consumer leasing industries.

With regards to the SACCs industry, two major surveys were provided by stakeholders:

- Digital Finance Analytics (DFA) utilised their ongoing consumer survey, which is one of the largest of its type in Australia, to look at the SACC industry from the consumer's perspective. The DFA survey considers 500 consumers per week or 26,000 per year and is a broad survey of a consumer's financial position. The DFA survey is a branch survey, meaning that when a consumer notes that they have a SACC, a set of more detailed questions specifically relating to SACCs are asked. It is particularly relevant given that the timeframe for the survey covers the periods before and after the introduction of the reforms in the Enhancements Act.
- Coredata undertook a survey of SACC providers who are members of the National Credit Providers Association. A total of 23 submissions were received by Coredata, including Cash Converters, Money3 and Nimble, which together make up an estimated 77 per cent of the SACC industry's total revenue. This survey considered all loans with a value less than \$5,000 which includes both SACCs and medium amount credit contracts.

The Panel has taken account of the various concerns expressed regarding the data referred to in the interim report.⁹ While it does not consider that all of the concerns expressed are justified, the Panel is cognisant of the limitations of the data available and has taken these into account when drawing its conclusions.

9 For example, NCPA submission to the interim report p.1 and Min-it submission to the interim report p.2.

The Panel has benefited greatly from the evidence provided by industry participants regarding their own practices as well as their general observations on the industry. The Panel thanks, in particular, those stakeholders who provided responses to follow-on requests for additional information, sometimes at short notice.

CHAPTER 2 — SMALL AMOUNT CREDIT CONTRACTS

AFFORDABILITY

Recommendation 1 - Affordability

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.

Description

The Panel recommends that the existing protected earnings amount regulation applying to Centrelink recipients, where total SACC repayments cannot exceed 20 per cent of gross income, be extended to all consumers and that the cap on the total amount of all SACC repayments be amended to the relevant period equivalent of 10 per cent of the consumer's net income.

The repayments and the consumer's net income are to be compared using the period for payments under the contract. For example, if the consumer is required to make fortnightly payments, then the total amount of all payments, including under the proposed SACC, cannot exceed 10 per cent of the consumer's net income, assessed on a fortnightly basis. The lender should be required to make this assessment at the time the SACC is entered into.

Objectives

- Promote financial inclusion by ensuring that consumers do not enter into unaffordable SACCs that absorb too large a proportion of their net income.
- Limit the possibility of a debt spiral occurring, where an increasing percentage of the consumer's net income is used to meet repayments under each contract.

Discussion

In the interim report, the Panel considered the harm caused by repeat borrowing under SACCs.¹⁰ The Panel acknowledged that SACCs can be useful for consumers when they are used as an emergency source of funding for one-off expenses and that, while the cost of SACCs is high relative to alternate sources of finance, in emergency situations the benefits of having access to credit can justify the relatively high costs, provided the consumer can afford them.

However, the Panel also found that, when consumers engage in repeat borrowing, this can put them onto a path to financial exclusion. This is because when a consumer takes out more than one SACC, the repayments consume a greater portion of their income and can become increasingly unaffordable. With a large portion of the consumer's income being used to cover repayments, more credit may be needed to cover living expenses. This leads to the consumer becoming trapped in a debt spiral and inhibits the consumer's capacity to improve their financial situation over time.

Regulation 28S of the *National Consumer Credit Protection Regulations 2010* (NCCP Regulations) was introduced to address this harm for consumers who are dependent on Centrelink payments. It caps the amount of the repayments for consumers who receive at least 50 per cent of their gross income from payments under the *Social Security Act 1991* (Social Security Act).

When a consumer receiving at least 50 per cent of their gross income from payments under the Social Security Act applies for a new SACC, the SACC provider is prohibited from lending to that consumer in circumstances where the total amount of the repayments under all of the consumer's SACCs (including the proposed SACC for which application is made), during the term of that proposed SACC, would exceed 20 per cent of the consumer's gross income for each 'payment cycle of income'.¹¹ 'Payment cycle of income' refers to the period during which the consumer receives the predominant amount of his or her income payments under the Social Security Act.

The effect of this prohibition is that 80 per cent of the consumer's gross income is protected and cannot be used to repay SACCs. The protected proportion of the income is often referred to as the 'protected earnings amount'.

10 Interim report, p.11-12.

11 Regulation 28S of the NCCP Regulations.

The Panel recommends that this regulation be replaced with a new requirement which applies to all consumers, and restricts the total amount of SACC repayments under all SACCs to 10 per cent of the consumer's net income earned in the relevant period. The Panel is of the view that this strikes an appropriate balance between enabling consumers to access finance when required and enhancing their opportunity to improve their financial situation over time.

Options considered

1. Reduce the establishment fee for subsequent loans for a returning consumer from 20 per cent to 10 per cent.
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 a SACC to consumers who have had two or more SACCs in the past 90 days.
3. **Recommended:** Extend the protected earnings amount regulation to cover SACCs provided to all consumers and amend the cap on the total amount of SACC repayments to the relevant period equivalent of 10 per cent of the consumer's net income.

As identified in the interim report, there are high levels of repeat borrowing of SACCs in Australia.¹² For example:

- Research by DFA indicates that the average number of SACCs taken out by consumers during the 12 month period to 20 July 2015 was 3.64 and that 30 per cent of households with a SACC consumer had more than one SACC concurrently.
- One large SACC provider provided evidence that 64 per cent of applications they received were from consumers who had at least one other SACC in the previous 90 days. Five per cent of applications were from consumers who had had 10 or more SACCs in the past 90 days.¹³
- ASIC found that 54 per cent of SACCs reviewed triggered the multiple SACC assumption.

¹² Interim report p.9-10.

¹³ Credit Corp submission to the consultation paper p.49.

The repeated use of SACCs can result in debt spirals and put consumers on a path to financial exclusion. For example, during consultation one stakeholder provided evidence which demonstrated that 97 per cent of consumers with only one SACC spend less than 20 per cent of their income on repayments. However, once a consumer has three or more SACCs within 90 days, they are more likely to be spending large amounts of their income on SACCs. For example, 34 per cent of consumers with four SACCs and 48 per cent of consumers with five SACCs were spending more than 20 per cent of their income on SACC repayments.¹⁴

While capping SACC repayments as a proportion of income does not stop repeat borrowing, it is a simple and effective way to reduce the harm that can be caused by repeat borrowing as it limits the possibility of a debt spiral occurring.

The Panel is of the view that an income cap should apply to all consumers, and should be reduced from 20 per cent of gross income to 10 per cent of net income.

Extending the income cap to all consumers

In the submissions made in response to the consultation paper, there was general support across the SACC industry for protection for Centrelink recipients.¹⁵ There was also general support across both the SACC industry and consumer advocate groups to extend the protection to consumers who have a similar income to Centrelink recipients, such as those on Veterans' payments.¹⁶

14 Credit Corp submission to the consultation paper p.51.

15 For example, see NCPA submission to the consultation paper p.34, Finance Industry Delegation submission to the consultation paper p.58, Money Box Loans submission to the consultation paper p.49 and ASIC submission to the consultation paper p.35.

16 For example, see NCPA submission to the consultation paper p.35, Finance Industry Delegation submission to the consultation paper p.59, ASIC submission to the consultation paper p.35, Salvation Army submission to the consultation paper p.6, Good Shepherd Microfinance submission to the consultation paper p.5.

In the interim report, the Panel canvassed the option of extending the protection to all consumers and reducing the income cap to 10 per cent of net income. This was supported by ASIC and consumer advocate groups¹⁷ but opposed by SACC providers and industry bodies.¹⁸

Evidence presented to the Panel indicated that there is an increasing number of employed consumers obtaining SACCs, particularly from online-only lenders.¹⁹ The concerns associated with financial exclusion and the risks of being trapped in a debt spiral extend, therefore, beyond those consumers who receive Centrelink payments and apply to other consumers, in particular low income earners.

The percentage nature of the income cap means that, in practice, it will protect low income earners primarily. The greater a person's net income, the less relevance the proposed cap will have on that person.

Lowering the income cap to 10 per cent of net income

In the submissions, consumer advocate groups argued that the income cap for Centrelink recipients under Regulation 28S should be reduced to 10 per cent²⁰ or 5 per cent,²¹ or that lending to Centrelink recipients should be prohibited.²²

A 10 per cent cap is consistent with the Centrelink Code of Operation (the Centrelink Code).²³ The Centrelink Code is a non-legally binding statement of best practice made between the Department of Human Services, Department of Veterans' Affairs and the representative bodies on behalf of relevant members that are Authorised Deposit-taking Institutions (ADIs). It applies to the recovery of debts that arise from overdrawn accounts where no repayment arrangement already exists.

17 For example, see ASIC submission to the interim report p.8, Financial Rights Legal Centre submission to the interim report p.3, Good Shepherd Microfinance submission to the interim report p.5.

18 For example, see NCPA submission to the interim report p.17-19, IPF Digital Australia submission to the interim report p.4.

19 Results of Core Data Consulting 2015 "Consumer Credit Industry Survey for Loans of \$5,000 or less", referred to in NCPA submission to the submission to the interim report p.6, RMIT submission to the consultation paper p.7.

20 For example, see Consumer Action Law Centre submission to the consultation paper p.3.

21 For example see Financial Rights Legal Centre submission to the consultation paper p.33, The Salvation Army submission to the consultation paper p.6.

22 For example, see Good Shepherd Microfinance submission to the consultation paper p.15.

23 <https://www.humanservices.gov.au/corporate/publications-and-resources/code-operation>.

If a Centrelink customer overdraws their bank account, the ADI's system could automatically access their Centrelink payment to repay the full debt and the consumer would only be able to access the remaining amount (if any). However, under the Centrelink Code, the ADI agrees to take only 10 per cent of the Centrelink payments to repay the debt and to allow the consumer to access the balance.

The Panel considers that SACC repayments which consume more than 10 per cent of net income have the potential to be unaffordable or cause harm particularly for low income earners and can exacerbate financial exclusion.

The cap should apply to a consumer's net income as opposed to gross income as this is the amount of income that a consumer actually has available to spend each period. The current protected earnings amount regulation is based on a consumer's gross income, however, given that a person who receives 50 per cent or more of their income from Centrelink pays very little or no income tax, the distinction between net income and gross income has little relevance.

It is also simpler for lenders to determine a consumer's net income as this is what ordinarily appears in their bank statements.

The following tables illustrate the effect of the 10 per cent net income cap on various groups of consumers with different income sources and net income amounts.

Table 4: Percentage of net income used to repay a SACC of \$500 with a loan term from three month up to 12 months

	3 months	6 months	9 months	12 months
Total loan cost	\$660	\$720	\$780	\$840
Fortnightly repayment	\$110	\$55	\$41	\$32
Single adult receiving a Government allowance²⁴ (\$648 per fortnight)	17.0%	8.5%	6.3 %	5.0%
Single pensioner (\$989 per fortnight)	11.1%	5.6%	4.2%	3.3%
Average SACC consumer (DFA survey)²⁵ (\$1,219 per fortnight)	9.0%	4.5%	3.4%	2.7%
Minimum wage earner²⁶ (\$1,172 per fortnight)	9.4%	4.7%	3.5%	2.8%
Average weekly ordinary time earnings earner²⁷ (\$1,825 per fortnight)	6.0%	3.0%	2.2%	1.8%

24 Melbourne Institute Poverty Lines, September Quarter, a single person receiving an allowance is assumed to be receiving Newstart Allowance and rent Assistance and a single person receiving a pension is assumed to be receiving the Age Pension or Disability Support Pension as well as the Pension Supplement and Rent Assistance.

25 Financial Rights Legal Centre submission to the consultation paper p.8 states that the gross average income of a SACC borrower was \$35,702. Calculations in table done on net (cash in hand) income.

26 <https://www.fairwork.gov.au/how-we-will-help/templates-and-guides/fact-sheets/minimum-workplace-entitlements/minimum-wages>.

27 ABS cat.no. 6302.0 Original average weekly earnings for all persons, November 2015.

Table 5: Percentage of net income used to repay a SACC of \$1,000 with a loan term from three month up to 12 months

	3 months	6 months	9 months	12 months
Total loan cost	\$1,320	\$1,440	\$1,560	\$1,680
Fortnightly repayment	\$220	\$111	\$82	\$65
Single adult receiving a Government allowance²⁸ (\$648 per fortnight)	34.0%	17.1%	12.7%	10.0%
Single pensioner (\$989 per fortnight)	22.3%	11.2%	8.3%	6.5%
Average SACC consumer (DFA survey)²⁹ (\$1,219 per fortnight)	18.0%	9.1%	6.7%	5.3%
Minimum wage earner³⁰ (\$1,172 per fortnight)	18.8%	9.5%	7.0%	5.5%
Average weekly ordinary time earnings earner³¹ (\$1,825 per fortnight)	12.1%	6.1%	4.5%	3.5%

28 Melbourne Institute Poverty Lines, September Quarter, a single person receiving an allowance is assumed to be receiving Newstart Allowance and Rent Assistance and a single person receiving a pension is assumed to be receiving the Age Pension or Disability Support Pension as well as the Pension Supplement and Rent Assistance.

29 Financial Rights Legal Centre submission to the consultation paper p.8 states that the gross average income of a SACC borrower was \$35,702. Calculations in table done on net (cash in hand) income.

30 <https://www.fairwork.gov.au/how-we-will-help/templates-and-guides/fact-sheets/minimum-workplace-entitlements/minimum-wages>.

31 ABS cat.no. 6302.0 Original average weekly earnings for all persons Nov 2015.

Table 4 illustrates that a 10 per cent net income cap would still allow consumers, regardless of their source of income, to access at least one \$500 SACC during a 12 month period (and at least two concurrently if both were of 12 months duration). Those on average weekly earnings could access five \$500 SACC loans concurrently in a 12 month period, while someone on the minimum wage could have three concurrent 12 month SACCs or two concurrent six month SACCs.

Table 5 illustrates that all consumers would be able to access at least one \$1,000 SACC during a 12 month period.

Both tables also illustrate that a 10 per cent net income cap would necessarily encourage longer loan terms and, therefore, smaller and more affordable fortnightly repayments. This mitigates the risk of consumers becoming trapped in a debt spiral, as they are more likely to be able to make their fortnightly repayments and cover their other living expenses without accessing further credit.

The Panel, therefore, considers that lowering the cap on the amount of total SACC repayments to 10 per cent of the consumer's net income strikes an appropriate balance between enabling consumers to access emergency finance when required and enhancing their opportunity to improve their financial situation over time.

Other options

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

In the interim report, the Panel canvassed the option of reducing the establishment fee for a returning consumer from 20 per cent to 10 per cent. The Panel expressed the view that the rationale for granting SACC providers a concession from the 48 per cent cap breaks down for subsequent loans. This is because the upfront administrative costs for subsequent loans were considered to be lower.³²

32 Interim report p.12 -13.

While this option was supported by many consumer advocate groups,³³ it was largely opposed by SACC providers. They argued that the 20 per cent establishment fee covers general business and advertising costs (rather than just the administrative costs of each particular accepted loan) and that a 10 per cent cap for subsequent loans would not be viable for the industry. It was also argued that reducing the establishment fee for subsequent loans may encourage consumers to take out subsequent (and potentially larger) loans with the same SACC provider.³⁴

In light of the submissions and consultations on the interim report, the Panel considers that this option may not be viable for the industry and were it to encourage consumers to take out subsequent loans it may not efficiently address the issues associated with repeat borrowing and debt spiral.

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 a SACC to consumers who have had two or more SACCs in the past 90 days

In the interim report, the Panel canvassed the option of replacing the rebuttable presumption that a SACC is unsuitable if a consumer has had two or more SACCs in 90 days, with a bright line ban. The Panel expressed the view that replacing the rebuttable presumption with a bright line test would significantly reduce the incidence of repeat borrowing and would be easier for industry to comply with. However, in some instances, it may result in consumers taking out larger loans than needed.

This option was supported by consumer groups and by ASIC³⁵ but largely opposed by SACC providers. For example, SACC providers argued that an arbitrary number does not determine affordability³⁶ and that removing the ability to rebut the presumption may cause financial hardship for some consumers who may not have access to finance when required.³⁷

33 For example, see Consumer Action Law Centre submission to the interim report p.4, Financial Rights Legal Centre submission to the interim report p.6.

34 Oral consultations with the Panel.

35 For example, see Legal Aid NSW submission to the interim report p.4, Good Shepherd Microfinance submission to the interim report p.5, ASIC submission to the interim report p.7.

36 Oral consultations with the Panel.

37 IPF Digital Australia submission to the interim report p.4.

The Panel considers that a bright line test may result in circumstances where a consumer is unable to access finance when required, notwithstanding that they are able to afford the loan at that point in time and that it may also encourage consumers to take out larger loans than needed. Restricting the percentage of income that can be attributed to SACC repayments is a more appropriate method of addressing repeat borrowing and debt spiral, while still providing consumers with access to SACC loans.

Maintaining the existing 20 per cent establishment fee and 4 per cent monthly SACC fee

A SACC is an expensive product due to the fees which the SACC cap permits. This fact necessarily makes a SACC less affordable than other credit products but it is acknowledged that consumers of SACCs cannot readily access mainstream credit products.

Reducing the SACC cap should in principle make the product more affordable for its consumers, but the Panel considers that the reasons for setting the current level of the cap persist and does not therefore recommend that it be changed.

The panel nevertheless observed that the vast majority of SACC providers charge the maximum permitted fees. This might suggest an absence of market competition between SACC providers and it would be unfortunate if the existence of the present cap, which as previously stated is a concession from the 48 per cent APR cap which applies to other credit contracts, has discouraged competition or led to inefficiencies. While not recommending a change to the cap, the Panel reminds SACC providers that the cap is a maximum and encourages them to seek to look to ways which might allow them to reduce their fees below the cap and make their products more affordable for their consumers most of whom are vulnerable because they have no other credit options.

Implementation considerations

Consideration should be given to how a consumer's net income is determined for the purposes of *Recommendation 1*. While responsible lending obligations require a SACC provider to ascertain the income of a prospective consumer, and SACC providers are also required to obtain and consider 90 days of bank statements which will ordinarily disclose net income, flexibility may be required. This is particularly the case where a consumer does not receive a regular income (for example, casual employees).

Options that could be considered if net income is not readily ascertainable might include taking the consumer's average income over the past 90 days (from bank statements), their income based on a certain period's pay slips, or another amount if the consumer can prove this will be their income.

Recommendation 2 – Suitability

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**.

Description

The Panel recommends that the rebuttable presumptions under s131(3A) of the Credit Act be removed. Under this section, a SACC is presumed to be unsuitable if either of the following is satisfied, unless the contrary is proved:

- 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.
- The Panel makes this recommendation on the condition that it is implemented together with **Recommendation 1**.

The Panel has found that the rebuttable presumption has not been effective in addressing issues in relation to repeat borrowing and debt spiral (see earlier discussion in relation to repeat borrowing). It has resulted in uncertainty and complexity for SACC providers and increased compliance costs in circumstances where these issues can be more effectively dealt with by a bright line requirement in relation to protected earnings amounts, as set out in **Recommendation 1**.

If a consumer is in default under another SACC, it is likely that a lender would breach their responsible lending obligations by lending to them and therefore that limb of the rebuttable presumption is not necessary.

BAN ON SHORT TERM CREDIT CONTRACTS

Recommendation 3 – Short term credit contracts

Maintain the existing ban on credit contracts with terms less than 15 days.

Description

The Credit Act currently bans credit contracts of 15 days or less ('short term credit contracts'). More specifically, licensees are prohibited from:

- suggesting that a consumer apply, or assisting the consumer to apply, for a short term credit contract or an increase to the credit limit of a short term credit contract;
- entering into a short term credit contract; or
- increasing the credit limit of a short term credit contract.

The Panel recommends that these provisions should be retained in their current form.

Objective

- Prevent consumers from being trapped in a debt spiral by entering into contracts of short duration.

Discussion

Loans of less than 15 days consume a disproportionate amount of consumers' income due to large repayment amounts in a short period of time. These loans are more likely to trap consumers in a debt spiral than loans with longer durations.

In their submissions, the vast majority of stakeholders supported the ban on short term credit contracts.³⁸ For example, the NCPA stated that the prohibition has been effective and in the opinion of the Association, should remain.³⁹

SACC providers have also indicated that the outright prohibition has a low compliance cost and ASIC found that industry is generally complying with the requirement.

All of the available evidence suggests that the outright ban on short term credit is working as intended.

DIRECT DEBIT FEES

Recommendation 4 – Direct debit fees

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

Description

ASIC's class order 13/818 [CO 13/818] currently allows SACC providers to charge a consumer a separate fee for direct debit processing in some situations on top of any fees or charges permitted within the SACC cap. The Panel considers that SACC providers should recover any costs of direct debit arrangements from within the SACC cap.

Objective

- To ensure the integrity of the current SACC cap by ensuring that all amounts chargeable to consumers under a SACC arrangement are included within the one cap.

38 For example, see NCPA to the consultation paper p.24, Finance Industry Delegation submission to the consultation paper p.50, Nimble Australia submission to the consultation paper p.6, IPF Digital Australia submission to the consultation paper p.12, Redfern Legal Centre submission to the consultation paper p.6, Financial Rights Legal Centre submission to the consultation paper p.28, ASIC submission to the consultation paper p.36.

39 NCPA submission to the consultation paper p.24.

Discussion

CO 13/818 allows SACC providers to charge consumers a fee in relation to the costs incurred by a third party processing direct debit requests in relation to repayment of a SACC. Effectively this provides an exemption from the SACC cap for this particular cost.

Under the Credit Act the general position is that the maximum credit charge under a credit contract, where the credit provider is not an ADI, is limited to an amount calculated at an annual percentage rate of 48 per cent. Any credit fees or charges in relation to a credit contract are taken into account in determining the credit charge.⁴⁰

However, providers of SACCs and medium amount credit contracts are provided a concession to this annual cost rate and, in the case of SACCs, are able to charge a 20 per cent one-off establishment fee and a 4 per cent monthly fee, which is 4 per cent of the initial amount lent, and not on the outstanding diminishing amount owed by the consumer. If charged the maximum rate, as is the practice of most SACC providers, the SACC cap will always exceed a 48 per cent APR cap, and in many instances by a significant margin. The table below sets out how the SACC cap translates to an annual percentage rate when applied over various contract terms.

Table 6: Maximum SACC fees payable translated to an annual percentage rate (based on a \$500 loan repaid fortnightly)

SACC term	Maximum amount payable under a SACC	Annual percentage rate
6 weeks	\$640 (inc \$140 fees, which includes two monthly fees)	350%
3 months	\$660 (inc \$160 fees)	223%
12 months	\$840 (inc \$340 fees)	112%

40 Subsection 32B(3) of the National Credit Code.

The SACC cap concession already allows SACC providers to recoup substantially more benefit than that available under other types of credit contract. This concession was provided for SACCs ‘... given the higher establishment costs they may incur relative to the amount of the loan’⁴¹ and in consideration of the viability of the industry.⁴² The intention was ‘... to restrict the debtor’s liability under a small amount credit contract, by only allowing credit providers to charge those amounts specifically listed in subsection 31A(1).’

The Panel considers that, consistent with this intention, SACC providers should not be entitled to collect any fees and charges in excess of the existing SACC cap (except in relation to default fees and enforcement expenses), including the cost of processing direct debits. Nor should it be permissible for SACC providers to set up arrangements with subsidiaries or third parties under which SACC consumers incur fees or charges that exceed, if charged by the SACC provider, the SACC cap.

Similar to direct debit fees, a number of stakeholders suggested in submissions and in consultation that other costs, such as the costs of credit reporting and obtaining bank statements, should be able to be charged outside of the SACC cap.⁴³ The Panel does not see a reason to change the existing regulatory framework and considers that these costs should not be recoverable outside of the SACC cap.

The Panel notes that there are relevant and valid exemptions to this general policy position, subject to *Recommendation 10*, that apply in cases of default and in relation to enforcement expenses.⁴⁴

41 Revised Explanatory Memorandum to the Consumer Credit Legislation Amendment (Enhancements) Bill 2012, para 5.9.

42 See, for example, Revised Explanatory Memorandum to the Consumer Credit Legislation Amendment (Enhancements) Bill 2012, para 5.10.

43 For example, the NCPA in its submission to the consultation paper p.33 suggested that third party costs, such as credit reporting and obtaining bank statements, be recoverable outside of the cap.

44 Section 39B of the National Credit Code.

FRONT LOADING OF REPAYMENTS UNDER A SACC

Recommendation 5 – Equal repayments and sanction

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 APR of 48 per cent.

Description

The interim report identified a practice by which some SACC providers maximised revenue by ‘front-loading’ repayments (where the term of the contract is extended with lower repayments in the later months of the contract).⁴⁵ This practice should be specifically addressed.

Objective

- Address the consumer harm resulting from having to pay a higher cost for credit through an artificial lengthening in the term of the contract.

Discussion

ASIC provided an example of how a credit provider engaged in ‘front-loading’ of repayments in its submission to the consultation paper.⁴⁶ The consumer borrowed \$600 under a contract with a 12-month term and fortnightly repayments. The first 13 repayments were for \$58.15, followed by 13 repayments of \$19.38. By extending what may have previously been a six month term to one of 12 months, the SACC provider charges additional fees of \$144 (4 per cent of \$600 per month for six months).

The Panel’s view is that there is a significant financial disadvantage to the consumer from having the term extended to 12 months, with no corresponding benefit. Further, it would ordinarily be in the interests of both the consumer and the credit provider under a SACC to finalise the debt as quickly as possible.

45 Interim report p.17-19.

46 ASIC submission to the consultation paper p.38.

Given this potential harm, it is considered that the definition of a SACC should be amended to include a requirement that the contract must have equal repayments over the life of the loan. Credit providers who elect to offer contracts with unequal repayments would not be entitled to have the benefit of the concessional cap available to SACCs but would be subject to the 48 per cent APR cap applicable to other credit contracts, calculated in accordance with the formula in section 32B of the National Credit Code.

Implementation considerations

There may need to be limited exceptions to this rule, such as allowing for the final repayment to be smaller, given that the amount payable by the consumer may not be able to be divided into equal repayments.

SACC DATABASE

Recommendation 6 – SACC database

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.

Description

The Panel recommends that a national database for SACCs not be introduced at this stage. Although a database may assist SACC providers to comply with their responsible lending obligations under the Credit Act, there are other less costly options available.

Objectives

- Provide additional time for the comprehensive credit reporting regime to be fully implemented by the majority of credit providers.
- Avoid costs for the SACC industry associated with a national database and instead consider other, less costly, options.

Discussion

The Panel was required to consider whether a national database of SACCs should be established.⁴⁷ The Credit Act currently imposes responsible lending obligations on SACC providers to consider:

- whether the consumer can afford to meet the repayments under a SACC without suffering substantial hardship;
- whether the consumer has been a party to two or more other SACCs in the previous 90 days;
- whether the consumer is in default under another SACC; and
- if the consumer is receiving at least 50 per cent of their gross income from Centrelink, whether the total repayments from all SACCs exceed 20 per cent of the consumer's gross income.

As part of this review, the Panel has made several recommendations which amend some of these obligations.

A national SACC database could improve the capacity of SACC providers to comply with these responsible lending obligations. A SACC database may also improve ASIC's capacity to monitor trends and practices in the SACC market. However, these benefits will come at a cost to the industry, in relation to both implementation and ongoing access (for example, enquiry fees).

In their submissions, the majority of credit providers did not support the introduction of a national SACC database,⁴⁸ arguing that it would be expensive and that sufficient information was already available (for example, through the collection of bank statements). However there was support by some credit providers, consumer advocates and ASIC.⁴⁹

47 Terms of Reference 2.1.

48 For example, see NCPA submission to the consultation paper p.36, Moneybox Loans submission to the consultation paper p.50-56, IPF Digital Australia submission to the consultation paper p.17-21, Credit Corp submission to the consultation paper p.24-25.

49 For example, see Consumer Action Law Centre submission to the consultation paper p.3, Consumer Credit Legal Service (WA) Inc. submission to the consultation paper p.11-13, ASIC submission to the consultation paper p.44-47.

Comprehensive credit reporting

The comprehensive credit reporting (CCR) regime provides an alternative source of information for SACC providers. Prior to the introduction of CCR in March 2014, the credit reporting regime was focused on sharing ‘negative’ credit events, such as individuals’ history of defaults. The CCR regime introduced a voluntary ‘positive’ credit regime where positive information, such as loan repayment history could be shared.⁵⁰

The views of the SACC industry were mixed in relation to the use of CCR by SACC providers. Some SACC providers argued that CCR would not be suitable due to the cost of lender participation⁵¹ and inaccurate and untimely data.⁵² However, there was some support from stakeholders, primarily by consumer advocates.⁵³

The Panel considers that the CCR regime could be a suitable alternative to a national SACC database, but appreciates further time is required for this regime to be implemented.

The CCR regime has only been in place for a relatively short period of time and the major banks are still in the process of deciding whether to participate in the regime. The Panel is of the view that the major banks should be encouraged to participate in this regime by the earliest date as the value of the regime is necessarily diminished in the absence of the information they could provide.

50 See Financial System Inquiry report (2014), p.190.

51 For example, see Financial Industry Delegation submission to the consultation paper p.60 and Money Box Loans submission to the consultation paper p.52-53.

52 For example, see Min-it Software submission to the consultation paper p.21.

53 For example, see Nimble Australia submission to the consultation paper p.7, The Salvation Army submission to the consultation paper p.6-7, Financial Rights Legal Centre submission to the consultation paper p.35, Good Shepherd Microfinance submission to the consultation paper p.15.

Unique identifiers for SACC repayments

During consultation, some SACC providers raised the option of introducing a unique identifier for SACC repayments made through the direct debit system. This would allow SACC repayments to be easily identified on bank statements, and would assist SACC providers in complying with their responsible lending obligations.⁵⁴

The Panel understands that this proposal could be implemented by the direct debit system as there is currently space available to add new identifiers in the appropriate file.

The Panel is of the view that the use of unique identifiers for SACC repayments could be a suitable non-database option for assisting SACC providers to comply with their responsible lending obligations. Further consultation should be undertaken by the Government on this option.

EARLY REPAYMENT

Recommendation 7 – Early repayment

No 4 per cent monthly fee can be charged for a month once the SACC is discharged by its early repayment. If a consumer repays a SACC early, the credit provider under the SACC cannot charge the monthly fee in respect of any outstanding months of the original term of the SACC after the consumer has repaid the outstanding balance and those amounts should be deducted from the outstanding balance at the time it is paid.

Description

The Panel recommends that the legislation be amended to expressly state that each 4 per cent monthly fee can only be charged for a month where the consumer is still liable to make payments to the credit provider. In circumstances where a consumer repays a SACC early, the credit provider under that SACC cannot charge the 4 per cent monthly fee for any of the remaining months of the original loan term.

54 For example, see NCPA submission to the consultation paper p.37 and Finance Industry Delegation submission to the consultation paper p.66.

Objective

- Provide the consumer with a benefit for early repayment of a SACC by ensuring that the consumer is not charged a 4 per cent monthly fee for the full loan term in circumstances where the consumer repays the SACC early.

Discussion

Under the Credit Act, SACC providers are subject to a cap on fees of 20 per cent upfront fee and a 4 per cent per month ongoing fee for the loan term. Submissions identified that some SACC providers appear to be charging monthly fees in a way that allows the lender to earn all of the fees for the loan term, even if the SACC is repaid early.⁵⁵

In the interim report, the Panel canvassed whether consumers should not be liable to pay the 4 per cent monthly fee in respect of any outstanding months of the original loan term after they have repaid the outstanding balance.⁵⁶

Under section 29 of the National Credit Code, a credit provider is prohibited from requiring the payment of an interest charge at any time before the end of the day to which the interest charge applies. The SACC cap is based on a fee and not an interest rate and this means that the prohibition under section 29 does not apply. Notwithstanding this, the same policy should apply and SACC providers should be prohibited from charging the 4 per cent monthly fee in a month after the SACC is discharged.

The majority of submissions from SACC providers and consumer advocates supported the approach set out in the interim report. Several SACC providers stated that they waived the monthly fee for any unused portion of the original loan term.⁵⁷ This approach should in substance be required. Credit providers should be required to deduct from the outstanding balance the 4 per cent monthly fee otherwise relevant to any part of the original term which remains at the time of early repayment.

55 For example, see Min-It Software submission to the consultation paper p.30.

56 Interim report p.18-19.

57 For example, see Credit Corp submission to the interim report p.7, IPF Digital Australia submission to the interim report p.6.

Implementation considerations

The change may be able to be implemented by an amendment to section 82 of the National Credit Code, which specifies the way in which the amount required to pay out a credit contract is to be calculated. This would have the consequential effect that any written statement of the payout figure under section 83 of the National Credit Code, provided in response to a consumer request, would need to be calculated in the same way.

UNSOLICITED SACC OFFERS

Recommendation 8 – Unsolicited SACC offers

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

Description

The Panel recommends that SACC providers be prohibited from making unsolicited SACC offers to current or previous consumers. This includes in writing, such as via letter, email, SMS text message, or orally, such as via a phone call to the consumer.

Objectives

- To ensure that applications for SACCs result from unsolicited decisions made by the consumer and not made in response to the consumer being prompted to apply.
- To prevent consumers being repeatedly contacted in relation to obtaining a SACC.

Discussion

During consultations a number of stakeholders raised concerns about approaches made by SACC providers to entice consumers to apply for a SACC. For example, one submission provided a case study of a SACC consumer with a gambling problem who entered into SACCs regularly for short periods. Just before the consumer paid off a current SACC the consumer was sent an SMS offering a further SACC.⁵⁸

58 Consumer Action Law Centre submission to the consultation paper p.31.

One submission also suggested that SACC consumers are sent repeated SMS messages prompting them to take out further SACCs and that these messages are often timed towards the end of the term for a current SACC, or at other times, such as around Christmas.⁵⁹ This submission also noted concerns with other forms of SACC advertising on television, radio and online, with online advertising offering a targeted method of reaching consumers.⁶⁰

The particular concern with SACC advertising raised by stakeholders appeared to focus on the vulnerability and susceptibility of SACC consumers to such advertising. *Recommendation 21* of this report, which relates to warning statements, is intended to address some aspects of the concerns about SACC advertising. For example, in considering and consulting on warning statements for SACCs, including where to place them, ASIC may decide that warning statements should accompany any SACC advertising.

However, it is acknowledged that disclosures and warnings may not always be effective or adequate.

The Credit Act currently includes a provision that prohibits credit providers from sending unsolicited credit card limit increase offers unless the consumer has provided consent to receive such offers.⁶¹ This prohibition was introduced ‘...to assist consumers to actively choose whether to increase their credit limit, rather than being prompted to do so by written letters from their credit provider. A consumer who accepts these types of offers can, over time, have a high credit limit and find they are unable to repay the debt in full within a relatively short period of time.’⁶²

The Panel considers that a similar concern arises in relation to invitations or offers to consumers to apply for a SACC.

It was suggested by some stakeholders that this prohibition be extended to SACC offers.⁶³

59 Financial Rights Legal Centre submission to the consultation paper p.39.

60 Financial Rights Legal Centre submission to the consultation paper p.37-40.

61 Division 4, Pt 3-2B of the Credit Act.

62 The National Consumer Credit Protection Amendment (Home Loans and Credit Cards) Bill 2011 Revised Explanatory Memorandum, para 3.23.

63 Good Shepherd Microfinance submission to the consultation paper p.17.

In particular, consistent with the position for credit cards, a decision by a consumer to apply for a SACC should be one actively made by the consumer with reference to their own requirements and circumstances (that is, their need for a SACC), and not in response to prompting from a SACC provider. The Panel has previously noted the harm suffered by consumers in relation to entering into multiple repeat SACCs. A prohibition on unsolicited offers would help to reduce the frequency of consumers entering into repeat loans.

Implementation considerations

The Panel does not consider that, as is the case for credit card limit increase invitations, there should be an option for consumers to provide their consent to receive SACC offers. If a consumer wants a SACC they can approach a SACC provider directly.

If consumers were able to provide consent, the Panel is concerned that there would be a risk that consumers might be pressured to provide their consent to receive further offers when applying for a SACC. If consent were provided on an ad hoc basis it would also diminish the effectiveness of any prohibition. Further, a consent option would increase compliance costs for SACC providers who would be required to set up and maintain databases to record consents.

Although the unsolicited credit card offers prohibition only applies to written offers there is potential for the current SACC SMS offers to be replaced by phone calls or other unsolicited contact from SACC providers. Any prohibition should therefore be drafted in broad terms to capture any unsolicited contact from a SACC provider directly with a consumer, whether or not that contact offers or invites a consumer to apply for a SACC. This is consistent with the view of some consumer groups.⁶⁴

REFERRALS TO OTHER SACC PROVIDERS

Recommendation 9 – Referrals to other SACC providers

SACC providers should not receive a payment or any other benefit for a referral made to another SACC provider.

64 Financial Rights Legal Centre submission to the consultation paper p.39.

Description

The Panel recommends that SACC providers should not be able to sell, or receive a benefit for, a referral made to another SACC provider.

Objectives

- To prevent SACC providers referring applicants they reject onto other SACC providers.
- To reduce the ability of consumers already in financial difficulty to access further SACCs that may further disadvantage them.
- Ensure the cost of ‘buying a lead’ is not borne by the consumer.

Discussion

During consultations some stakeholders raised concerns about the practice of some SACC providers on-selling as referrals the details of consumers whose applications they have rejected.

For example, the Financial Rights Legal Centre said in its submission to the consultation paper:

Financial Rights also notes that the data that is by online lenders in rejected applications is on-sold to other lenders willing to take on the risk. According to the Trends in the Australia small loan market report: “One leading online industry stakeholder estimates that the lead-generation market is now larger in Australia than the small loan market.”⁶⁵

The Panel raised this issue with a number of SACC providers, none of whom disclosed they participated in such conduct. However, a number of SACC providers indicated they were aware of the practice.

65 Financial Rights Legal Centre submission to the consultation paper p.22, reference for the quote cited as Banks, Marcus, De Silva, Ashton & Russel, Roslyn ‘Trends in the Australian small loan market’ *Australian Centre for Financial Studies, School of Economics, Finance and Marketing, RMIT University, October 2015, pp. 36-37.*

In circumstances where a consumer has had a SACC application rejected by a SACC provider, because that SACC provider has assessed the consumer as unsuitable for a SACC or for other reasons, it seems inappropriate that the SACC provider give the consumer's details to another SACC provider, whether directly or through an intermediary. In particular, because the consumer is likely to already be experiencing difficulty meeting financial obligations and expenses and is therefore likely to be in hardship. Providing the consumer's details to another SACC provider, with or without the consumer's consent, is an inappropriate mechanism to deal with the consumer's situation.

It may, however, be appropriate for the SACC provider, with the consumer's consent, to provide the consumer's details to a financial counsellor or other similar assistance provider.

The Panel notes that it has not consulted on whether lead generators should be included in such a prohibition and considers further work should be undertaken on this issue. Lead generators here refer to comparison websites, and other-like services, that allow consumers to compare product features from a variety of product providers and then link directly to the SACC provider of their choice, or have their details passed on. Lead generators usually receive scaled remuneration on the basis of referrals and leads referred and the result of these referrals (for example, whether consumers acquire a product).

DEFAULT FEES

Recommendation 10 – Default fees

SACC providers only be permitted to charge a default fee that represents their actual costs arising from a consumer defaulting on a SACC up to a maximum of \$10 per week.

The existing limitation of the amount recoverable in the event of default to twice the adjusted credit amount should be retained.

Description

This recommendation limits the amount of a default fee that a SACC provider can charge by reference to both the SACC provider's loss arising out of the default and the duration of the default. SACC providers should be prohibited from charging a default fee that exceeds its actual costs arising from the default but, regardless of a SACC providers' costs, total default fees should be limited to a maximum of \$10 a week while the consumer remains in default under a SACC, regardless of how many payments are missed.

Further, the National Credit Code currently limits the maximum amount that a SACC provider can recover (whether by repayments under the contract or otherwise) in the event of a SACC default to twice the adjusted credit amount of the contract⁶⁶ (that is, a maximum of twice the first amount of credit provided under a SACC).⁶⁷ The Panel is recommending this limitation be retained.

Objectives

- To prevent the quick escalation of default fees incurred by SACC consumers.
- To continue to provide SACC providers with the ability to recoup reasonable costs incurred on default.

Discussion

Some submissions to the Panel's consultation paper called for a further cap on overall default fees and the amount that could be charged in each instance of default. In particular, there were concerns from consumer advocate groups that SACC borrowers were being charged inappropriately high amounts and, in some cases, multiple default fees per month.⁶⁸

These concerns were subsequently reiterated by consumer groups during roundtable discussions.

ASIC's second submission, in response to the interim report, detailed some of the fees charged by SACC providers on default.

66 See s204 of the National Credit Code for the definition of 'adjusted credit amount'.

67 See s39B of National Credit Code. The Consumer Credit Legislation Amendment (Enhancements) Bill 2012 Revised Explanatory Memorandum at para 5.70 explains: The effect of this provision is that the total of the permitted establishment and monthly fees and the default fees can, at most, only be equal to twice the adjusted credit amount. For example, in relation to a small amount credit contract where the adjusted credit amount was \$1,000 and the period of the contract was four months, the total of the establishment and monthly fees would be \$180. If the debtor then defaulted the total amount the credit provider could recover would be \$1,000, or a maximum of \$820 in default fees.

68 Care Inc. Financial Counselling Service & The Consumer Law Centre of the ACT submission to the consultation paper p.7 and Consumer Action Law Centre submission to the consultation paper p.33.

Table 7: Example of SACC default fees provided by ASIC⁶⁹

	Lender 1	Lender 2	Lender 3	Lender 4
Direct debit dishonour or missed payment fee	\$35	\$15	\$38.50 (missed payment fee charged once)	\$3
Periodic fee while account in arrears	\$30 (weekly, after original completion date)	\$5 (daily)	-	-
Rescheduling fee	\$35	-	-	-
Collection transfer fee	-	-	\$47 (charged once)	-
Default notice/letter fee	-	-	\$10 applied at 7, 14, 21 and 30 days)	-
Debt management fee	-	-	\$50 (charged once)	-
Late payment fee	-	-	-	\$15 (monthly)

Some industry submissions highlighted the high costs associated with default⁷⁰ while others suggested that any further cap should be set at a level that covers reasonable costs.⁷¹

Options considered

The Panel considered a number of options in relation to this requirement:

1. Introduce a default window, where no default fees can be charged until the consumer has missed a payment by one payment cycle;
2. **Recommended:** Maintain the current maximum amount recoverable for default of a SACC but introduce a supplementary cap to limit how quickly fees can be charged (\$10 per week); and

69 ASIC's submission to the interim report p.10.

70 For example, MoneyBox's submission to the interim report p.20.

71 NCPA submission to the interim report p.21.

3. Cap default fees as a percentage of the amount outstanding on the SACC or the amount of the missed repayment.

From information presented to the Panel it appears that the current limit on the maximum amount recoverable by a SACC provider (that is, twice the adjusted credit amount) that applies when a consumer has defaulted on a SACC is working and should be maintained. However, some of the fees being charged to consumers on default appear excessive, in particular where the default is not prolonged. The Panel is therefore recommending a simple and transparent supplementary periodic cap on default fees.

Analysis of options

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

There was some support for introducing a default window. For example, some industry participants supported, or were not opposed to, the introduction of a three day default window.⁷² However, some stakeholders noted that some default costs are incurred immediately on default, even if the default is rectified within a short period of time.

Concerns were also raised that providing a default window, or other options that prevent the recovery of actual costs, may mean that SACC providers are forced to recoup unrecovered costs, such as the costs of defaults of short duration, from other consumers through inflated default fees.⁷³ For example, if a default window of three business days was introduced, and there was no supplementary periodic limit on default fees, SACC providers may seek to claim unrecovered costs incurred for defaults that were rectified in 1, 2 or 3 days from consumers whose defaults took longer to rectify.

72 See, for example, NCPA submission to the interim report p.20-21.

73 IPF Digital Australia submission to the interim report p.4 noted this general concern.

Further, an introduction of a default window for SACCs would be inconsistent with other types of credit contracts, noting that SACC providers may provide other types of credit.⁷⁴ Consultations with industry suggested that the compliance costs associated with adjusting systems and processes to allow for a default window would be significant.⁷⁵

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

A number of submissions supported the introduction of a supplementary default cap. Of industry participants who supported a cap, the general view was that the number of default fees payable within a period should be limited, rather than the amount of any fee. The common position was that SACC providers should be limited to one default fee payable per failed payment event (rather than limiting the amount of any default fee), regardless of how late a payment is.⁷⁶

However, the Panel was concerned that this approach would not cap the quantum of the fee and that any current problematic fee arrangements could be wrapped into a single periodic default fee, the amount of which was unrestricted.

Other submissions suggested that a supplementary fee cap amount be introduced, with some submissions suggesting a default fee cap of \$10 a week⁷⁷ or \$10 a repayment cycle.⁷⁸ Discussions with some stakeholders following the interim report indicated some SACC providers currently charged default fees of around \$30-\$35.⁷⁹ The Financial Industry Delegation suggested that SACC providers average *default costs* were around \$35 and 86 per cent of the SACC providers surveyed charge *default fees* of less than \$35.⁸⁰ However, the Financiers Association of Australia suggested that SACC providers generally charge a one-off default administration fee of \$30-\$35, a \$10 letter fee plus \$1.50 postage.⁸¹

74 See, for example, NCPA's submission to the interim report p.21.

75 Min-It Software discussion with the Secretariat.

76 NCPA submission to the interim report p.20.

77 For example, Consumer Action Law Centre submission to the interim report p.8 and Legal Aid NSW submission to the interim report p.6.

78 Credit Corp submission to the interim report p.7.

79 Oral consultations with the Panel.

80 Financial Industry Delegation's supplementary submission to the interim report p.35.

81 Financiers Association of Australia oral consultations with the Secretariat.

It was not controversial across consultations that SACC providers should be able to recover their reasonable costs of default. There was, however, some deviation as to what a reasonable cost of default is. This assumes that action is in fact taken in respect of the default.

Few submissions provided specific evidence of a SACC providers' reasonable default costs. However, from submissions and discussions the following types of default costs would in principle appear reasonable for a SACC provider to recoup:

- the cost, if any, incurred by the SACC provider when a customer defaults on a direct debit payment. It is not clear whether this cost is always, or even commonly, incurred by SACC providers, noting that the borrower will generally be separately charged for default by the direct debit service provider;
- costs for services or actions taken by the credit provider in response to the default, such as sending letters or SMS messages. However, this should not allow costs for these services to be recovered that exceed the credit provider's actual expenses or that are incurred unnecessarily (for example, sending a SMS every day); and
- the SACC provider's loss from not receiving a payment when due.
- It must be noted however that while a SACC is in default, SACC providers can continue to charge the 4 per cent monthly fee, until the overall default cap is reached, and thereby recoup some of their costs. This fee is calculated on the initial amount of credit and not simply the outstanding balance. This is very different from other credit providers who, in the case of default, are limited to recovering interest on the outstanding balance (including the missed payment). To some extent, some of the costs arising out of default under a SACC are addressed within the existing cap.

The Panel considers that the period that applies to any cap should be a week. Too long a period for the supplementary cap would allow a SACC provider to charge up to a month's default fee for a relatively short default. For example, if the supplementary cap was set at \$40 a month, a SACC provider may charge a \$40 default fee irrespective of whether the default persisted for 1 or 2 days or the entire month. Charging relatively high default fees for defaults of short duration is inappropriate. By setting one week as the relevant period, the fees charged for default will only be able to be increased as the length, and therefore costs incurred by the SACC provider, increase.

Further, the limit on default fees is to cover to all missed payments / default events on a single SACC. That is, the \$10 weekly cap continues to be the maximum default fee payable on a SACC default even if more than one payment is missed for that SACC.

Although industry was generally not supportive of a dollar cap on default fees the Panel considers that this cap strikes the right balance of allowing SACC providers' to recoup their reasonable costs while preventing the quick escalation of fees.

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

This option may not allow SACC providers to recoup reasonable costs associated with default in particular where recovery steps are taken. This approach would potentially limit recovery to the economic loss of not receiving the repayment on time. Some submissions and consultations suggested that this option may be complex and cause confusion, in particular where customers are charged different default fees dependent on when they defaulted during the SACC term.

The Panel considers that option 2 would adequately deal with the issues raised in relation to default fees while providing a simpler outcome for consumers and industry and ensuring that SACC providers can recover reasonable default costs.

Implementation considerations

The Panel considers that the failure to pay a default fee should not constitute a default that accrues further default fees.

CHAPTER 3 — CONSUMER LEASES

The Panel considers that the consumer leasing laws have largely been ineffective at promoting financial inclusion. The very high cost leases (equivalent return of more than 880 per cent APR in one instance) identified during consultation has highlighted the problems associated with excluding consumer leases from the caps that apply to all other forms of finance.⁸² It is for this reason that the Panel is recommending substantial changes to the regulatory framework, including a cap on the cost of consumer leases of household goods and a cap on the portion of income that can be devoted to such lease payments.

CAP ON COSTS

Recommendation 11 – Cap on cost to consumers

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.

Description

The Panel recommends that a cap on the total payments under a lease for household goods 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 (where the Base Price for new goods is the RRP or the price agreed in store, where this price is below the RRP for new goods or another amount for second hand goods which is yet to be determined, as discussed in *Recommendation 12*). For a lease with a term greater than 48 months, the term should be deemed to be 48 months for the purposes of the calculation of the cap.

82 ASIC report 447 p.22.

This would provide, for example, a cap of 1.48 times of the Base Price of the goods for a 12 month lease, a cap of 1.6 for a 15 month lease, and a multiple of 1.96 times the Base Price of the goods for a two year lease. Leases of four years or more would be subject to a cap of 2.92 times the Base Price of the goods.

A one year lease for \$500 worth of goods would be limited to total payments of $\$500 + (\$500 \times 12 \text{ (months)} \times 0.04 \text{ (4 per cent monthly)})$.

Table 8: Examples of the recommended cap for leases

Length of lease	Cap multiple	Annual percentage rate
12 months	1.48	82%
24 months	1.96	76%
36 months	2.44	72%
48 months (or greater)	2.92	68% (for 48 months but APR will differ for longer lease terms)

Objectives

- To prevent high cost leases which can result in consumers being financially excluded; and
- To ensure consumers are able to access the goods that they need through leases.

Discussion

As a starting point for consideration, the interim report provided an option that consumer leases be subject to the 48 per cent cap that applies to credit contracts under the Credit Act (other than SACCs and medium amount credit contracts (MACCs)).

As discussed in the interim report, evidence provided to the Panel showed that the high cost of consumer leases of household goods is causing financial harm to some consumers.⁸³ Leases are currently being provided that are very expensive, and which can result in lease payments taking up a large portion of a consumer's income. These high lease payments can limit a household's ability to improve the financial position by reducing the capacity to access other forms of finance (as the income is tied up with long term lease payments).

The Panel called for evidence and arguments which might justify the provision of a concession for consumer leases of household goods from the 48 per cent cap.

Industry participants argued that leases typically embody services or features that mean they can be a higher cost product to provide than a traditional credit contract.

However, few of the sample loan contracts reviewed detailed these services and features and no evidence was provided as to the value. Nevertheless, the Panel acknowledges that consumer leases of household goods necessarily involve delivery costs and may involve servicing costs for the lessor. The Panel considers that delivery costs should be viewed separately (see below).

The Panel has decided to recommend a higher cap than that allowed in general for credit products to ensure a viable continuing consumer lease of household goods market. The Panel acknowledges this cap may result in changes to the leasing market as businesses adapt to the new environment.

Vulnerable consumer base

A large portion of consumer leases of household goods are provided to financially vulnerable consumers through Centrepay which accounts for more than half of the Australian consumer leasing market. Centrepay is a voluntary deduction service for Centrelink recipients. It deducts certain payments, such as payments for consumer leases of household goods, prior to the consumer receiving their Centrelink income.

Access to the Centrepay system reduces credit risk for lessors by providing them with priority over other payments which may subsequently be debited from the consumer's bank account after their Centrelink income has entered their bank account.

83 Interim report p.22.

Centrepay deductions for consumer leases of household goods in the period July – December 2015 were equal to around \$160 million or \$320 million on an annualised basis.⁸⁴ IBISWorld estimates that the size of the Australian consumer leasing market in 2015-16 is around \$596 million.⁸⁵

While Centrepay deductions account for approximately half of the consumer lease of household goods market, other lower income households, such as persons on the minimum wage or persons on Centrelink benefits who choose not to use Centrepay, also utilise consumer leases of household goods. Rent4Keeps suggested that their typical consumer has a fortnightly income of \$1,165 or 35 per cent below average weekly ordinary time earnings.⁸⁶

Leases are often long term arrangements. Given their long duration, especially compared to SACCs, it is important that all consumers are protected from locking in high portions of their income for extended periods as a consequence of an unduly high priced lease.

High cost of leases to consumers

Information provided to the Panel shows that in almost all instances lessors charge in excess of the equivalent of the 48 per cent APR cap that applies to credit contracts more generally. It is the view of the Panel that the caps on costs proposed to the Panel by lessors, ranging from multiples of 1.8 to 2.5 times the Base Price of the goods for a 12 month lease, or 129 to 220 per cent as an annual percentage rate, are excessively high and would result in poor consumer outcomes.

ASIC's 2015 report found that lessors were charging amounts equivalent to interest rates ranging from 292 per cent to 884 per cent.⁸⁷

84 Data provided to the Panel by the Department of Human Services.

85 IBISWorld Industry report OD5467: Home Appliance Rental in Australia (August 2015), p.3.

86 Rent4Keeps submission to the interim report Appendix 3 and ABS Cat.no 6302.0

87 ASIC's Report 447, Table 7. Calculated as APRs, these costs would be 291% and 881%. See footnote 6.

It is noted that a number of submissions criticised the ASIC report as being unrepresentative of the industry, and that the reported findings only addressed the costs charged by two lessors in remote Australia. However, there were several consumer groups who stated that ASIC's reports of some providers charging exorbitant amounts accords with the experiences of their clients.⁸⁸

In addition to the data presented in its report in relation to the rental payments charged by two lessors in regional Australia, ASIC advised that it saw leases where the lessor had charged more than three times the value of the goods on leases with a one-year term. These lessors operated in a broad range of locations across Australia including suburbs in capital cities and regional areas.

Cost to lessors of providing a lease

Lessors advised the Panel that they are the first point of call for lessees when something goes wrong with a leased product. As such, even if a product is still under a statutory warranty, some lessors said that they incurred staffing costs for organising repairs on behalf of the consumer. Some providers offer replacement goods to a consumer when the leased goods are being repaired during the statutory warranty period, meaning that lessors incur costs despite the statutory warranty.⁸⁹

Lessors also advised the Panel of instances where they provide particular services for leased goods, such as helplines in respect of equipment, or pest control for certain vulnerable products. The evidence for these services was at best limited.

Submissions further noted that some lease providers have much higher funding costs relative to more mainstream credit providers, and that most of the larger banks will not finance consumer lease providers. For example, estimates of funding costs for smaller lessors from wholesale financiers ranged from the high teens to over 25 per cent.⁹⁰ Funding was generally cheaper for those lessors who accessed finance secured against their home or provided by their franchisor.

88 For example, Salvation Army's submission to the interim report p.7.

89 CHERPA submission to the interim report p.16.

90 Oral consultations with the Panel.

However, the Panel notes that many smaller lessors have no or very little establishment costs or overheads as they operate out of their home. These businesses also tend to have no inventory or storage costs, as they purchase the goods after the consumer enters into a lease contract.

The recommended cap provides a concession to the standard credit contract cap to cover these additional costs, similar to the concession provided to SACC providers to recover the costs of establishing a SACC over a relatively short time period.

Level of the cap

While reiterating that consumer leases and SACCs are functionally different products, there was general agreement from stakeholders that consumer leases should be subject to a cap on costs to remove the extremely high cost leases from the industry and protect vulnerable consumers.⁹¹

There was almost unanimous agreement that a cap, if applied, should be expressed as a multiple of the price of the goods and not as an annual percentage rate.

Various submissions provided alternative approaches to how a cap on costs could apply to the leasing sector. Recommended caps provided via public submissions, the Panel's recommended cap, a SACC like cap, and examples of the impact of these caps are below:

91 For example, CHERPA submission to the interim report p.6, Australian Finance Conference additional submission p.1.

Table 9: Comparison of cap, multiples of the Base Price (percentage rates are the APRs)⁹²

Term	48% APR	0.04 per month (Panel's recommended cap)	SACC cap (20% establishment fee and 4% per month)	Australian Finance Conference proposed	CHERPA proposed	Rent4Keeps proposed*	MakeltMine proposed	Sir Rentalot proposed	Local Appliance Rentals proposed
1 year	1.27 (48%)	1.48 (82%)	1.68 (112%)	1.8 (129%)	2 (156%)	2.5 (220%)	2.5 (220%)	2.4 (207%)	—
1.5 years	1.41 (48%)	1.72 (79%)	1.92 (98%)	—	—	3.0 (187%)	2.5 (147%)	3.3 (209%)	—
2 years	1.56 (48%)	1.96 (76%)	2.16 (89%)	3.0 (140%)	3.0 (140%)	3.5 (168%)	2.5 (111%)	3.9 (190%)	3.6 (174%)
3 years	1.89 (48%)	2.44 (72%)	2.64 (80%)	3.0 (94%)	3.5 (112%)	4.0 (130%)	2.5 (74%)	4.5 (148%)	—
4 years	2.25 (48%)	2.92 (68%)	3.12 (74%)	4 (98%)	4 (98%)	—	2.5 (56%)	—	—

* Based on gross product cost (RRP + add on costs)

92 Rent4Keeps submission to the interim report p.5, Australian Finance Conference additional submission p.4, CHERPA (Consumer Household Equipment Rental Association) submission to the interim report p.6, MakeltMine submission to the interim report p.17, Local Appliance Rentals submission to the interim report p.5, Sir Rentalot submission to the consultation paper p.5, Legal Aid NSW submission to the interim report p.8, Consumer Action Law Centre submission to the interim report p.13, Financial Rights Legal Centre submission to the interim report p.3.

Table 10: Proposed caps, cost for a lease of a \$500 good based on the multiples in Table 9

Term	48% APR	0.04 per month (Panel's recommended cap)	SACC cap (20% establishment fee and 4% per month)	Australian Finance Conference proposed	CHERPA proposed	Rent4Keeps proposed	MakeltMine proposed	Sir Rentalot proposed	Local Appliance Rentals proposed
1 year	\$635	\$740	\$840	\$900	\$1,000	\$1,250	\$1,250	\$1,200	—
1.5 years	\$705	\$860	\$960	—	—	\$1,500	\$1,250	\$1,650	—
2 years	\$780	\$980	\$1,080	\$1,500	\$1,500	\$1,750	\$1,250	\$1,950	\$1,800
3 years	\$945	\$1,220	\$1,320	\$1,500	\$1,750	\$2,000	\$1,250	\$2,250	—
4 years	\$1,125	\$1,460	\$1,560	\$2,000	\$2,000	—	\$1,250	—	—

Table 11: Proposed caps, cost for a lease of a \$1,000 good based on the multiples in Table 9

Term	48 % APR	0.04 per month (Panel's recommended cap)	SACC cap (20% establishment fee and 4% per month)	Australian Finance Conference proposed	CHERPA proposed	Rent4Keeps proposed	MakeltMine proposed	Sir Rentalot proposed	Local Appliance Rentals proposed
1 year	\$1,270	\$1,480	\$1,680	\$1,800	\$2,000	\$2,500	\$2,500	\$2,400	—
1.5 years	\$1,410	\$1,720	\$1,920	—	—	\$3,000	\$2,500	\$3,300	—
2 years	\$1,560	\$1,960	\$2,160	\$3,000	\$3,000	\$3,500	\$2,500	\$3,900	\$3,600
3 years	\$1,890	\$2,440	\$2,640	\$3,000	\$3,500	\$4,000	\$2,500	\$4,500	—
4 years	\$2,250	\$2,920	\$3,120	\$4,000	\$4,000	—	\$2,500	—	—

Consumer groups supported a 48 per cent APR cap and noted that one benefit of applying a such a cap to consumer leases would be to remove the incentive for a credit provider to offer a lease over a sale by instalment. These groups were concerned that consumers with a preference to own a good at the end of the term, and hence seeking a sales by instalment, were instead offered a lease, in order for the lessor to avoid the 48 per cent APR cap.⁹³

However, as already noted, the fact that consumer leases may involve costs for the lessor should the lessor provide services in respect of the leased goods distinguishes a consumer lease from a credit contract and justifies a different cap.

The Panel has considered the various caps suggested by industry but, in its view, these have been set at levels above what is appropriate and would likely allow instances of egregious pricing to continue in cases where lessors are unconstrained from effective competition. In addition, any cap set without reference to the term of the lease would allow significant leeway for shorter term unaffordable leases.

While the Panel has recommended that the cap be determined by a formula which allows a return of 4 per cent of the Base Price of the goods per month of the lease, akin to the 4 per cent monthly fee allowed for SACCs, the Panel has not proposed mirroring the 20 per cent establishment fee allowed for SACCs.

The SACC cap includes a 20 per cent establishment fee because SACCs are for short term and low amounts. For example, if a lease is for \$500 for 90 days the fixed business costs associated with the loan application (including credit checks and to meet responsible lending requirements) could not be recouped if only three 4 per cent monthly fees of \$20 could be charged.

Consumer leases however are for longer terms. Information provided to the Panel suggests 12-36 months are currently the most common lease terms.

While the Panel does not wish to restrict the maximum length of a lease, allowing the price cap to increase month by month without constraint could lead to excessively long term leases being offered. As such, the Panel recommends that the payment cap does not increase for lease terms that extend beyond four years. In the Panel's view, a lessee with a consumer lease should never be required to pay more than 2.92 times the Base Price of the goods to lease them.

93 Consumer Credit Legal Service WA submission to the consultation paper p.16, Top End Women's Legal Service Inc p.4.

The Panel notes that some lessors are already operating inside the recommended cap.⁹⁴

Differences in leases provided in the market

Some submissions proposed that there be a distinction between:

- operating leases, where a range of add-on services are provided under the lease, and the good is returned to the lessor at the end of the lease; and
- finance leases, where the lessor is likely not to assume the responsibility for any maintenance and purely finances a good which is often not returned at the end of the lease.

The Panel recommends that these different types of consumer lease not be distinguished under any cap. It would be difficult to define and enforce any distinction in practice and any distinction is not relevant to the issue of the cap.

The Panel also notes that under the law a lessor under a consumer lease retains ownership of a good and cannot guarantee ownership to the consumer at the end of the agreed lease period. However, in practice, many consumer lease providers have mechanisms to allow ownership at the conclusion of the term to pass to the lessee or their nominee. This practice highlights the artificiality of the distinction under the National Credit Code between sales by instalment (including hire purchase) which currently are subject to the 48 per cent APR cap and consumer leases which currently escape any cap. The distinction, which is based on form rather than substance, provides no reason not seek to achieve similar consumer protection, whether through appropriate caps or otherwise, for both categories of products.

Recommendation 12 – Base Price of goods

The Base Price for new goods 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.

94 See for example Walker Stores online lease calculator at <http://www.inrent.com.au/calculator/>.

For new goods, setting the Base Price equal to the recommended retail price or the price agreed in store (where this is below the RRP) ensures a clear value is assigned from which to calculate the cap. The Panel notes that using the RRP as the value to which the cap applies is a generous starting point from the perspective of the lessor. It was apparent from consultation, that the majority of lessors receive a discount on the recommended retail price when purchasing goods, however, it was also clear that there was no consistency regarding the amount of the discount received by lessors when purchasing goods.⁹⁵

While larger lessors with greater bargaining power will be able to negotiate a larger discount on the price of goods and, therefore, have the opportunity to earn a greater margin, the Panel considers that the recommended retail price is still the best proxy for the Base Price given the difficulties associated with identifying another point of reference for the Base Price.

Most industry stakeholders supported using the RRP as the Base Price for the goods.⁹⁶ However, lessors should use a lower price when determining the Base Price if that is the price agreed in store with the consumer, for example, when lessors provide leases through a third party retailer.

The Base Price will be the price that will be required to be disclosed in the consumer lease of household goods contract (see *Recommendation 22*).

Implementation considerations

Consideration should be given to the calculation of the Base Price where the lessor leases their own branded goods. For example, Radio Rentals offer ‘Thorn’ branded goods for lease. It is possible that it may be more difficult to determine a Base Price in these circumstances or that the Base Price should be calculated in a different way.

Further consideration should be given to determining a reasonable value for second hand goods where there is no readily identifiable Base Price for such a good.

To improve visibility, ASIC may wish to investigate the prices that lessors pay to acquire their goods, to determine whether using the RRP as the Base Price is overly generous.

95 Oral consultation with the Panel.

96 CHERPA submission to the interim report p.6, Australian Finance Conference additional submission p.4, Rent4Keeps submission to the interim report p.18, MakeItMine submission to the interim report p.12.

Recommendation 13 – Add-on services and features

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.

Add-on services are those services provided by a lessor in addition to the provision of the good which relate to the leased good. Examples referred to by some lessors included a replacement good if the leased product requires repair.

Some submissions suggested that servicing and repairs are benefits heavily utilised by consumers.⁹⁷ However, other stakeholders noted that they almost never see consumers utilising add-on services and features.⁹⁸

Additional services or bundled items (for example, a broadband package leased with a laptop or a DVD player leased with a TV) are not what the Panel considers to be add-on services. Where relevant, these would be considered separate leases subject to the cap.

There were mixed views in the submissions on the level of add-on services provided in the market and whether or not charges for these services should be included in the cap.

Some stakeholders argued that if a cap was applied, it should exclude all add-on services.⁹⁹ Others argued that an all-inclusive cap would be easier to apply and simpler for consumers to understand.¹⁰⁰

97 Rentorilla submission to the interim report p.4, CHERPA submission to the interim report p.5.

98 Financial Rights legal Centre submission to the interim report p.16.

99 Rent4Keeps submission to the interim report p.19 and oral consultation with the Panel.

100 Legal Aid NSW submission to the interim report p.10, Consumer Action Law Centre submission to the interim report p.14, CHERPA submission to the interim report p.19.

Some submissions stated that these services were hard to quantify and no specific value could be given to them. These submissions stated that these features are generally expected of a lease, form part of the lease, and should not be considered separately but rather included in a cap.¹⁰¹ Sample lease contracts provided to the Panel were generally silent regarding these additional features and no evidence was presented to the Panel regarding their cost.

Some add-on features do, however, attract separate charges. Some lessors charge an additional amount on top of the lease payment for damage liability reduction insurance which provides cover to replace or repair the leased item in the event of a defined event.

The Panel accepts the broad view of industry stakeholders that separate pricing of these add-on services and features could be difficult, and notes that it would also be open to abuse. More particularly, given the uncertainty about the true nature and availability of the services and the absence of contractual obligations to provide them, the Panel considers that any costs incurred by lessors for their provision should be included in the cap.

As previously noted, the potential for the provision of such services persuaded the Panel to recommend a cap for consumer leases of household goods which departs from the 48 per cent APR cap for other credit contracts. The proposed cap is nevertheless a maximum and lessors who do not provide add-on services should be able to set lease payments well below the cap.

Cost of delivery

Particular concerns were raised that the cost of delivery can vary widely with the type of good leased as well as the location of the consumer. In particular, delivery costs to remote areas can often be much greater.

To prevent the cap from causing lessors to no longer to offer goods (particularly, large costly to move goods such as fridges) to individuals living in remote areas, the Panel recommends that a reasonable one-off delivery fee be allowed outside the cap. This delivery fee should be limited, capped at a maximum amount appropriate for delivery to a remote area or for delivery over a certain distance, to prevent abuse or an overestimation of the reasonable cost of the delivery.

101 MakeItMine submission to the interim report p.13.

In determining the reasonable cost, there should also be a discount where there is a bulk delivery. For example, when a truck delivers a number of goods to a remote area, the cost of delivery should be spread amongst the consumers, rather than each consumer paying the full cost otherwise payable for the delivery of a single item.

Recommendation 14 – Consumer leases to which the cap applies

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.

The Panel considers that the application of the cap should be as broad as possible to prevent avoidance. Stakeholders suggested a range of proposals during consultation:

- Some submissions suggested a cap should apply to all consumer leases of household goods;¹⁰²
- Other submissions noted that the cap should apply to a limited category of lessees in order to focus the additional consumer protection on vulnerable consumers without impacting other segments of the market. For example, it was suggested that the cap apply only to those consumers who receive more than 50 per cent of their income from Centrelink;¹⁰³ and
- Others suggested the cap should only apply to leases of goods of a value of \$2,000 or less.¹⁰⁴

The Panel has considered the harm being caused to consumers through the high cost of leases, and considers that the harm is not restricted to Centrelink recipients. Similar to the 48 per cent cap that applies to credit contracts more generally, all consumers should be afforded the protection of the recommended cap.

The Panel recommends that the cap apply to consumer leases of household goods including electronic goods.

102 CHERPA submission to the interim report p.7, Thorn submission to the interim report p.4, Australian Finance Conference additional submission p.4.

103 Walker Stores submission to the interim report p.5.

104 Redfern Legal Centre submission to the interim report p.7.

The recommendation does not extend to consumer leases for motor vehicles. The Panel has not had the opportunity to consult with car lease providers and other relevant stakeholders, and considers further work should be undertaken with key stakeholders before any reforms relevant to consumer leases for motor vehicle leases are considered. Consideration should also be given to extending to regulated consumer leases of motor vehicle the other recommendations that apply to consumer leases of household goods.

AFFORDABILITY

Recommendation 15 – Affordability

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.

Description

The Panel recommends that a protected earnings amount be introduced for leases of household goods, whereby lessors cannot cause lessees to pay more than 10 per cent of their net income in lease payments. This would apply to all of the lessee's lease payments under leases of this nature.

The payments and the consumer's net income are to be compared using the period for payments under the contract. For example, if the consumer is required to make fortnightly payments, then the total amount of all payments, including under the proposed lease, cannot exceed 10 per cent of the consumer's net income, assessed on a fortnightly basis. The lessor should be required to make this assessment at the time the lease is entered into.

Objectives

- Promote financial inclusion by ensuring that consumers do not enter into unaffordable consumer lease contracts that expend a large portion of their income.
- Continue to enable consumers to access goods that they need through leases.

Discussion

Some lessors are failing to undertake a robust assessment of a consumer's living expenses. In its submission, ASIC noted particular concerns about the inquiries lessors are making into consumer income and expenditure and the steps taken to verify those amounts. ASIC's surveillance has identified a number of potential issues including:

- the lack of any steps taken to verify a consumer's income;
- the use of the consumer's self-assessment to identify the amount of living expenses, even when the assessment seems unrealistically low; and
- the use of a benchmark for consumer expenses instead of considering the consumer's actual spending patterns.¹⁰⁵

In its submission, ASIC reproduced the findings from a recent survey of 53 consumer lease files from two lessors. ASIC found that in the majority of the files, the lessors assessed the affordability of the lease on the basis of unrealistically low estimates of consumer expenditure (see table 12 below).¹⁰⁶

Table 12: Living expenses and the Henderson Poverty Index (HPI)

Number of Dependents	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.

105 ASIC submission to the interim report p.18-19.

106 This finding relies on using the HPI, the usefulness of which in this context was questioned by some stakeholders.

ASIC has also recently succeeded in taking action against lessors in response to concerns regarding lessors' compliance with the responsible lending obligations (see Appendix to ASIC's first submission for further information).¹⁰⁷

Legal Aid New South Wales and other consumer advocate groups highlighted that they 'consistently assist consumers who cannot meet their basic living expenses as a result of consumer lease payments and whose financial situation was not properly assessed when entering into a contract.'¹⁰⁸

Case study¹⁰⁹

The Financial Rights Legal Centre provided an example of a consumer who entered into a number of leases, resulting in financial hardship:

Ms A is a single mother with eight children all living with her. She grew up in a rural environment, and until now has never lived in an urban area. She has very low financial literacy and receives Centrelink payments as her sole source of income.

Ms A agreed to rent household goods from a man in a local rental company and she told Financial Rights that "everyone in the aboriginal community was using him." She ended up renting nearly every item in her house from him. He told her that she could only pay for her rentals through Centrepay, and he would arrange for all of the payments himself on the phone after Ms A put the call through to Centrepay. Ms A said she felt like she had no control over the payments, and that the salesman controlled all of the transactions.

Ms A believed that she was renting to own the items in her house as she had been directed by the rental company to go to a particular furniture shop and to choose all her goods. Mrs A had multiple contracts with the same rental company. After the time she believed a contract had finished she was then advised by the rental company that it was a rental contract but if she wanted to purchase the goods she would need to come into the store and pay \$100 cash per contract after each contract had expired. If she stopped any Centrepay deductions then they would come and take the goods.

107 See for example, the ASIC actions described in 15-141MR ASIC accepts EU from Amazing Rentals, and 15-093MR Rental company found to have breached consumer credit laws and in 15-349MR Consumer leasing company to pay \$1.25 million in penalties.

108 Legal Aid NSW submission to the interim report p.13.

109 Financial Rights Legal Centre submission to the consultation paper p.20-21.

Case study (continued)

Ms A never had the \$100 cash so she continued with the Centrepay deductions indefinitely to keep all her goods (most of which had depreciated to be of very little value). Almost all of Ms A's Centrelink benefits were going through Centrepay, and she was left with almost no money each fortnight to pay for food, electricity and clothing. She had incurred rent arrears and an eviction hearing was pending. She was being assisted by local charities.

During consultation, a number of lessors indicated that while formal hardship application rates are relatively low,¹¹⁰ approximately 25-35 per cent of lease consumers are behind on their consumer lease payments.¹¹¹ This suggests that a large portion of consumer lease consumers routinely encounter difficulties meeting their consumer lease payments.

The size of Centrepay deductions for consumer leases also indicates that a significant number of consumers are entering into leases which absorb a large portion of their income, with 28 per cent of consumer leases on Centrepay having deductions greater than \$100 per fortnight (for a single lease provider).

110 CHERPA submission to the interim report p.24.

111 Oral consultation with the Panel.

Table 13: Fortnightly Centrepay deductions for consumer leases*

Centrepay deduction size	Proportion of total deductions	Proportion of allowance ¹	Proportion of pension*	Proportion of parenting payment for a single parent with two children ^{1^}
\$200+	3.6	n/a	n/a	n/a
\$180 to \$200	2.0	29.3	19.2	14.2
\$160 to \$180	2.9	26.3	17.2	12.7
\$140 to \$160	4.6	23.2	15.2	11.2
\$120 to \$140	6.3	20.1	13.1	9.7
\$100 to \$120	8.6	17.0	11.1	8.2
\$80 to \$100	12.9	13.9	9.1	6.7
\$60 to \$80	17.8	10.8	7.1	5.2
\$40 to \$60	21.9	7.7	5.1	3.7
\$20 to \$40	15.9	4.6	3.0	2.2
\$0 to \$20	3.6	1.5	1.0	0.7

Note: The proportion of pension, allowance and parenting payment are based on: a single person; and the midpoint of the deduction size (for example, the calculation for the \$180 to \$200 deduction size is based on \$190).

* The Department of Human Services do not have data linking each deduction to the type of income support payment paid to that individual. The proportion of pension and allowance are provided for illustrative purposes only.

¹ Figures from the September Quarter Melbourne Institute Poverty Lines report.

^{1^} Includes Family Tax Benefit Part A and B.

The Panel is of the view that, in light of the vulnerable consumer base for consumer leases and concerns regarding the way industry is complying with the responsible lending obligations, further protection regarding affordability is warranted.

Options considered

1. **Recommended:** introduce a protected earnings amount for consumer leases of household goods for all consumers, with a cap on lease payments under all such leases of the lessee of 10 per cent of their net income.
2. Only apply the protected earnings amount to persons who receive 50 per cent or more of their income from Centrelink.

3. Introduce a cap on the amount of income that can be devoted to both SACC payments and consumer lease payments.

The Panel considered two main questions when considering the protected earnings recommendation:

- Would the proposed cap enable consumers to continue accessing essential items?
- Would the proposed cap promote financial inclusion by helping to ensure that the consumer has sufficient income remaining, after making the consumer lease payments, to improve their financial situation over time while still meeting living expenses?

In regard to continued access to goods, a number of submissions noted that if a 10 per cent income cap was introduced, consumers' access to goods would diminish, exacerbating financial exclusion.¹¹² For example, CHERPA stated that a 10 per cent income cap would result in 33 to 50 per cent of consumers on low incomes, who currently lease goods, losing access to those goods.¹¹³

However, it is the Panel's view that, in combination, the 10 per cent net income cap and the recommended cap on the costs of leases would enable low income households continued access to a broad range of goods. Table 14 identifies the value of goods that could be leased concurrently by consumers with various levels of fortnightly income, under three year leases, assuming that the caps in *Recommendations 11* and *15* are implemented. For example, a person with a fortnightly income of \$648 could devote \$64.80 per fortnight to lease repayments under the cap in *Recommendation 15*. Assuming that the lessor charges the maximum amount allowed under *Recommendation 11* for a three year lease, or a multiple of 2.44, the consumer will be able to lease goods with a Base Price of up to \$2,071 (see Table 14 below).¹¹⁴

112 CHERPA submission to the interim report p.5, Rent4Keeps submission to the interim report p.6.

113 CHERPA submission to the interim report p.5.

114 This is based on the following formula: (Maximum Base Price x Multiple)/(number of fortnights) = (Fortnightly Income * 0.1), which results in Cash price = (Fortnightly Income * 0.1 * number of fortnights)/ multiple.

Table 14: Value of goods that can be leased over three years under the caps in Recommendations 11 and 15

	Fortnightly income	Value of goods that can be leased ¹
Single adult receiving a Government allowance²	\$648	Up to \$2,071
Single pensioner²	\$989	Up to \$3,161
Minimum wage earner*	\$1,172	Up to \$3,746
Single parent with two children receiving a parenting payment^{1^}	\$1,342	Up to \$4,289
Average weekly ordinary time earnings earner³	\$1,825	Up to \$5,834

Note: This table assumes equal fortnightly consumer lease rental payments and that lessors charge up to the maximum allowable rate.

[^] Includes Family Tax Benefit Part A and B

* These payments are after tax and exclude superannuation.

¹ Figures are the maximum value of goods that could be leased by a person for each fortnightly income amount based on the caps in **Recommendations 11 and 15**.

² Figures from the September Quarter Melbourne Institute Poverty Lines report.

³ ABS cat.no. 6302.0 Original average weekly earnings for all persons November 2015.

These caps would enable consumers continued access to essential goods. As an example of what a consumer could afford under the Panel's preferred approach, a single person on a Government allowance would be able to lease a 436L fridge, a 5.5kg top lop load washing machine, a 14 place setting dishwasher, a 750W microwave and 4kg clothes dryer concurrently over a three year period.¹¹⁵

The introduction of a protected earnings amount for consumer leases may encourage lessors to provide longer term leases in order to ensure that the consumer's periodic payments do not exceed the 10 per cent cap. The 10 per cent protected earnings amount is also consistent with the Centrelink Code.¹¹⁶

115 Example based on a \$747 Hisense Top Mount 436L fridge (HR6TFF437), a \$399 Haier 5.5kg Top Load Washing Machine (HWMP55918), a \$496 Beko 14 Place setting dishwasher (DSFN4630W), a \$99 Sharp 750W Compact microwave (R20A0W) and a \$329 Simpson 4kg clothes dryer (39P400M) from JB HI-FI on 2 March 2016.

116 See discussion under **Recommendation 1**.

In regards to financial inclusion, as discussed previously, a large portion of consumer lease consumers are financially vulnerable with around half the consumer lease market serviced through Centrepay.

By a standard measure of poverty, the Henderson Poverty Line, most consumers who receive all of their income from government welfare payments are already considered to be below the poverty line.¹¹⁷ On this measure the consumers who account for at least 50 per cent of the leasing market are unlikely to have much (if any) surplus income remaining after meeting their essential needs such as heating, clothes, food and transportation.

The Panel received a range of proposals from stakeholders in response to the interim report regarding what protected earnings amount would be the most likely to lead to financial inclusion:

- most industry stakeholders supported an income cap of 20 per cent,¹¹⁸ with some stakeholders suggesting it should only apply to consumers who receive 50 per cent or more of their income from Centrelink,¹¹⁹ and
- most consumer advocate groups supported an income cap of 5 per cent for all consumers.¹²⁰

Evidence presented to the Panel by a lessor with around 4 per cent of the Australian consumer lease market,¹²¹ suggested that a 10 per cent income cap would be consistent with the amount of income a typical consumer devotes to consumer lease payments.¹²²

It is the view of the Panel that a cap on total lease payments of 10 per cent of a consumer's net income strikes the right balance between enabling consumers to continue accessing essential items via consumer leases and ensuring that they have the opportunity to improve their financial situation over time by avoiding over commitment to leased household goods.

117 University of Melbourne, *Poverty Lines: Australia*, September Quarter 2015.

118 CHERPA submission to the interim report p.7.

119 Australian Finance Conference additional submission p.5.

120 Consumer Action Law Centre submission to the interim report p.16, Legal Aid NSW submission to the interim report p.5.

121 IBISWorld estimates that Rent4Keeps makes up 4 per cent of the market in its Industry report OD5467: Home Appliance Rental in Australia (August 2015), p.22.

122 Rent4Keeps submission to the interim report Appendix 3.

Other options

Only apply the protected earnings amount to persons who receive 50 per cent or more of their income from Centrelink

While a large portion of vulnerable consumers receive 50 per cent or more of their income from Centrelink, the Panel considers that other vulnerable consumers who may be employed should also be protected by a cap on the portion of income that can be used to service consumer lease payments.

In practice, the protected earnings amount will have less relevance the higher a consumer's net income. As such, while the protected earnings amount applies to all consumers, the nature of the cap is such that it primarily targets low income consumers.

Introduce a cap on the amount of income that can be devoted to both SACC payments and consumer lease rental payments

The interim report canvassed the option of introducing a combined SACC/consumer lease protected earnings amount. Under this approach, the portion of income devoted to both SACC and consumer lease payments would be capped as a portion of net income.

A range of stakeholders flagged concerns with this approach noting that the purpose and timeframe of each product is different, with SACCs being relatively short term while consumer leases tend to be longer term.¹²³

A combined cap would also have the impact of limiting a consumer's access to SACCs for the term of the lease if they have a consumer lease(s) with payments close to or equal to the cap.

Reflecting these concerns, the Panel considers that the protected earnings amounts for consumer leases and SACCs should be separate.

123 Rent4Keeps submission to the interim report p.20, Thorn submission to the interim report p.5 and MakeItMine submission to the interim report p.15.

Implementation considerations

Consideration should be given to how a consumer's net income is determined. While responsible lending obligations already require lessors to ascertain the income of a prospective consumer, and the Panel is recommending a requirement to require lessors to consider 90 days of bank statements, flexibility may be required.

Options that could be considered if net income is not readily ascertainable might include taking the consumer's average income over the past 90 days (from bank statements), their income based on a certain period's pay slips, or another amount if the consumer can prove this will be their income.

CENTREPAY

Recommendation 16 – Centrepay implementation

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.

Objectives

- Ensure that the most vulnerable consumers are protected by the caps as soon as practicable and prior to any legislative changes giving effect to *Recommendations 11* and *15*.

Discussion

While the cap on the maximum cost of consumer leases of household goods and the cap on the maximum payments are designed to protect all consumers, they are particularly important for consumers on Centrepay who are the most financially vulnerable.

The evidence referred to in discussing *Recommendation 11* above shows that the costs of some consumer leases of household goods are high. Further, ASIC identified in report 447 that in some instances Centrelink recipients are paying more than other consumers.¹²⁴ Given that Centrelink recipients are the least able to afford high cost leases and are at risk of financial hardship, prompt action should be taken to ensure that lessors who receive payments through the Centrepay system comply with the caps.

While it may take some time for the Government to draft and pass the legislation to implement the recommended caps, if agreed to, changes to the Centrepay system do not require legislation and can be progressed quickly. It is for this reason that the Panel recommends that the Department of Human Services consider making the caps in *Recommendations 11* and *15* mandatory for lessors who utilise Centrepay as soon as practicable.

EARLY TERMINATION FEES

Recommendation 17 – Early termination fees

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

Objective

- Ensure that consumers receive a benefit if they end a consumer lease early by returning the goods.

Discussion

There is significant variation among lessors in relation to both the amount of fees they are entitled to charge on early termination of a lease contract, and the amount which they may charge in practice. For example, some lessors currently charge the consumer all outstanding consumer lease of household goods payments on early termination without any discount, while others charge minimal fees or waive a certain percentage of the term of the lease has elapsed under the contract. During consultation, many lessors informed the

¹²⁴ See discussion at p.23 of the interim report.

Panel that, while their contracts allowed them to charge early termination amounts, this rarely happened in practice.¹²⁵

It is a well-established principle that a financier or lessor should only be able to charge an amount on early termination that, in summary, is a reasonable estimate of their losses from the early termination. In relation to credit providers, this is specifically recognised in subsection 78(4) of the National Credit Code, which states that this is a requirement for a consumer challenging such a fee as unconscionable under that provision.

It is, therefore, considered desirable to specify the maximum amount that can be charged to address the disparity in current practices and to restrict recovery by those lessors who seek to recover all unpaid rental payments on early termination without discount (a practice that would appear to be inconsistent with the common law).

Subsection 179(2) of the National Credit Code recognises that the amount to be paid on an early termination by the lessee is a matter for agreement under the lease but only in the absence of something less being prescribed by regulation. There is currently no such regulation.

The introduction of a regulation prescribing a formula or principles for the calculation of a maximum amount payable on early termination would provide greater consistency of outcomes for consumers and would still enable lessors, should they so choose, to charge smaller amounts or impose no charge at all.

The Panel considers that any formula or principles should give recognition to the value of receiving payments before their due date, and also give recognition to any ability of the lessor to mitigate losses which might otherwise arise, should the goods be returned in a reasonable condition or be available to be re-leased.

Some stakeholders proposed introducing a maximum early termination fee which would effectively allow a consumer to return the goods at no cost after a set period of time (such as 90 days).¹²⁶ While such a cap would be beneficial to consumers, it would not be consistent with all business models in the industry and may result in some lessors making considerable losses.

125 Oral consultation with the Panel.

126 CHERPA submission to the interim report p.7.

The Panel, therefore, considers that lessors should be entitled to recover their loss if a contract is terminated early. They may choose not to exercise that right in practice.

Accordingly, a formula should be developed which provides a discount for the early repayment of the outstanding consumer lease payments based on their net present value and which also includes principles to enable a benefit to be provided to consumers with regard to the fact that there is likely to be a difference between the value of the goods at the end of the lease and the value at the time of their early return.

The Panel considers that further work should be done to develop a formula and/or principles that provides an appropriate and reasonable estimate of the lessor's losses from early termination.¹²⁷

BAN THE UNSOLICITED MARKETING OF CONSUMER LEASES

Recommendation 18 – Ban on the unsolicited marketing of consumer leases

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

Objective

- Reduce the adverse financial consequences from unsolicited selling practices.

Discussion

Lessors offering consumer leases of household goods should be prohibited from engaging in unfair sales practices where this includes making unsolicited approaches to consumers, including at their place of residence, for the purposes of inducing the consumer to enter into a consumer lease.

¹²⁷ Consequential changes may also need to be made to section 179A of the National Credit Code and regulation 105G of *the National Consumer Credit Protection Regulations 2010*.

The issue of unsolicited sales (of any products or services) in Indigenous communities has been long recognised as causing significant harm, with these communities targeted as suppliers can make multiple sales in a short period of time with little effort or outlay of capital.¹²⁸

Officers from ASIC's Indigenous Outreach Program advise that they regularly hear of businesses, including rental companies, offering inducements to a senior or respected community member to obtain introductions to individuals in the community so that they can make as many sales as possible. They have heard of regular instances of this practice being used in the last six years, both first-hand, when visiting a community, and second-hand, through financial counsellors or consumer advocates, in numerous communities around Australia.

The Panel's view is that the sales through unsolicited approaches are unfair and have the capacity to cause financial harm irrespective of the target market. A number of unfair practices have been identified in relation to the unsolicited selling and marketing of consumer leases. These practices include:

- a lessor driving a van through an Indigenous community, and honking the horn to attract customers (as illustrated in case study below);¹²⁹
- a lessor offering free goods, cash, vouchers or other benefits to a member of an Indigenous community, in return for being introduced by them to other community members;
- hosting a barbeque in Indigenous communities to attract consumers; and
- offering consumers rewards (including small cash payments) to provide the names of other people who the lessor can approach.

128 See, for example, 'Taking action, gaining trust: A National Indigenous Consumer Strategy, National Action Plan 2014-2016' Council of Australian Governments Legislative and Governance Forum on Consumer Affairs, p.4.

129 While the approach is unsolicited it would fall outside traditional definitions of door-to-door sales that include a requirement that the consumer is visited in their home.

Case Study – Unsolicited selling from rental company van

In July 2013, ASIC's officers from its Indigenous Outreach Program were in a large regional community, with a significant Indigenous population, when they witnessed the sale practice of a rental company first-hand.

A person was driving a van with the rental company's logo on it through the community. The van would stop in a street and the driver would honk the car's horn. People came out of a house and walked up to the van. They were then shown items in the back of the van.

After a short while, the people who had been looking in the van went back into their house and returned with documents which they showed to the driver. They then appeared to sign some paperwork. They were not provided with any goods from the back of the van. They then walked back to their house. This process took about 10 minutes. The driver then drove the van about another 20 metres up the road and honked its horn in front of another house, where the same events occurred again. The ASIC officers watched the driver do this four times.

The Panel considers that unsolicited selling practices create a significant risk of adverse outcomes. The reasons for this include:

- these practices can induce people to make impulsive decisions to obtain leases for goods which they may not require, or where there is no capacity to bargain about the type of goods being offered;
- the lessor can take advantage of introductions or referrals to make unsolicited approaches to consumers, and have an unwarranted degree of credibility when making those approaches; and
- the transaction needs to be arranged during the unsolicited visit or the consumer may change their mind. This can mean that there are minimal responsible lending inquiries into the consumer's financial circumstances, based on the documents, if any, the consumer has at hand when they are approached by the lessor.

The Panel considers the banning of such canvassing should be broader however than visiting a place of residence. It should also extend to the situation where canvassing is done from vehicles outside or in proximity to a person's place of residence.

Door-to-door canvassing of credit products is prohibited by the Credit Act as it has the potential to induce people to apply for credit that they do not require.¹³⁰ However, this prohibition does not apply to consumer lease providers. Further, section 12DM of the *ASIC Act 2001* prevents a person from asserting a right for payment for unsolicited financial products, including consumer leases, and section 12DMA provides that a consumer is not liable to make payments where they have been provided with an unsolicited financial product. However, these provisions would not prevent a lessor from providing unsolicited consumer leases, and, in practice, seeking and receiving payments until the consumer asserts their right not to have to make payments. The lessor would also be able to obtain payments if the consumer wanted to retain possession of the goods, as they remain the owner, which may dissuade some consumers from asserting this right. These are significant limitations in the effectiveness of these remedies in respect of leases.

Consumer advocate groups and consumer lease providers generally supported a prohibition on door-to-door sales and similar canvassing and agreed that it was not an appropriate sales tactic.¹³¹

The Panel's preference is to introduce a prohibition which would prevent this conduct from occurring. The Panel considers the banning of such canvassing should be broader than visiting a place of residence, and should also extend to the situation where canvassing is done from vehicles outside or in proximity to a person's place of residence. The penalty needs to be sufficient to act as an effective deterrent, with consideration to be given to providing for the automatic loss of any amount payable above the Base Price (as discussed in detail in *Recommendation 23*).

Implementation considerations

Further inquiries should be undertaken to clearly identify the range of unsolicited selling practices used by lessors.

130 Section 156 of the Code.

131 Australian Finance Conference additional submission p.7.

CHAPTER 4 — COMBINED RECOMMENDATIONS

BANK STATEMENTS

Recommendation 19 – Bank statements

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 to 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.

Description

The current obligation for SACC providers to obtain and consider bank account statements that cover at least the immediately preceding period of 90 days should be retained. Further, this obligation should be extended to apply to lessors under consumer leases of household goods. This obligation complements the principles-based general responsible lending obligations applicable to all credit providers.

Objective

- Ensure SACC providers and lessors under consumer leases of household goods have obtained and considered information about a consumer's income and expenses at least as demonstrated in bank account statements.

Discussion

The obligation to obtain and consider bank account statements operates in conjunction with the responsible lending obligations imposed on all credit providers. The responsible lending obligations require credit providers to make reasonable inquiries into the consumer's financial circumstances including their income and expenditure. Bank statements are one way of obtaining this information, although there may be others. In many circumstances, it is likely that obtaining bank statements alone will not be sufficient to discharge the obligation to make reasonable inquiries and further inquiries will be necessary.¹³²

There was general support from stakeholders to retain the obligation to collect and use bank statements in relation to SACCs.¹³³

However, some stakeholders raised concerns with how statements were collected, and how the information was used. That is, whether it was actually being used by the SACC provider as part of the assessment of unsuitability¹³⁴ or whether that information was also being used for purposes unrelated to the assessment.¹³⁵

Collection of bank account statements

Submissions, and other consultation undertaken by the Panel identified that consumers are providing their bank statements by supplying their internet banking log-in details to a third party account aggregation software provider. The third party is able to scrape the relevant information from the consumer's online banking portal for use by the SACC provider. Concerns were raised that in handing over log-in details consumers may be voiding their unauthorised transaction protection that is available via either the account's terms and conditions or the ePayments Code.

132 This obligation does not set a minimum inquiry obligation but rather complements the other inquiries SACC providers will need to make.

133 For example, see submissions to the consultation paper: NCPA p.13, Finance Industry Delegation p.41, Moneybox Loans p.16-17, Consumer Action Law Centre p.14 and Financial Rights Legal Centre p.20.

134 Consumer Action Law Centre submission to the consultation paper p.13 and Financial Rights Legal Centre submission to the consultation paper p.20.

135 Financial Rights Legal Centre submission to the consultation paper p.22.

Whilst acknowledging these risks and concerns, the Panel accepts that there are advantages to both consumers and SACC providers in using third party providers to obtain bank statement information including ease and speed of providing bank statement information and compliance costs.

The Panel considers that a restriction on the use of such third party account aggregation software is likely to stifle innovation and reduce the industry's ability to maximise efficiencies (and minimise costs) and may affect consumers' ability to access finance. This, however, needs to be balanced with consumer protection.

Some solutions provided to the Panel included:

- a prohibition on SACC providers obtaining or using consumer log-in details;¹³⁶
- a requirement that consumers retrieve their own bank account statements;¹³⁷
- a requirement that SACC providers offer an alternate service to access bank statements;¹³⁸
- disclosure or warnings about the risks of providing log-in details;¹³⁹ and
- a removal of the obligation to obtain bank statements and relying instead on comprehensive credit reporting.¹⁴⁰

The Panel recommends that safeguards be put in place to ensure that consumers do not lose unauthorised transaction protection when giving access to their account information for responsible lending purposes. The concerns raised by stakeholders are likely to extend beyond the terms of this review, for example, to other credit and non-credit products and services, and consideration may be given to extending any such protections more broadly.

136 Legal Aid Queensland submission to the consultation paper p.6.

137 Foresters Community Finance submission to the consultation paper p.3.

138 Financial Rights Legal Centre submission to the consultation paper p.23.

139 Financial Rights Legal Centre submission to the consultation paper p.23.

140 Australian Retail Credit Association submission to the consultation paper p3-4.

ASIC stated in its submission that it has ‘... held discussions with software providers and banking institutions about account aggregation products, their use by payday lenders and implications for protection under the ePayments Code.’ ASIC indicated that it would continue to liaise with stakeholders while it considers its approach.¹⁴¹

The Panel considers that ASIC, as administrator of the ePayments Code, is best placed to lead work on resolving these issues. Further, options to address related concerns about third party account aggregation software providers holding consumer bank statement information and log-in details can also be canvassed.

Further, the Panel recommends (*Recommendation 21*) that ASIC be given the power to mandate and modify the use of consumer warnings in relation to SACCs. With this warning statement power, ASIC could potentially consider mandating a warning to highlight to consumers any risks associated with providing bank log-in details.

Use of bank account statement information for purposes other than responsible lending

The use of information collected from bank statements by SACC providers for purposes other than complying with responsible lending obligations was also raised by stakeholders. Some stakeholders suggested that this information was used to market further SACCs by the SACC provider. There were also suggestions of the on-selling of this information.¹⁴²

While some submissions suggested information could be used for purposes other than responsible lending obligations if consumers provided consent,¹⁴³ most submissions indicated that this should be an outright prohibition.¹⁴⁴ The NCPA submitted that any restriction on how information in bank statements should be used should be extended generally, and not just for SACC providers.¹⁴⁵

141 ASIC submission to the consultation paper p.25.

142 Financial Rights Legal Centre submission to the consultation paper p.22.

143 Finance Industry Delegation submission to consultation paper p.42 and Moneybox Loans Pty Ltd submission to the consultation paper p.17

144 Submissions to the consultation paper including IPF Digital Australia Pty Ltd p.7, Consumer Action Law Centre p.14, Salvation Army Australia p.3, Legal Aid Queensland p.6-7, Redfern Legal Centre p.6, ASIC p.25-26.

145 NCPA submission to the consultation paper p.14-15.

Consistent with the majority of submissions, the Panel considers that the use of information in bank statements should be restricted to compliance with responsible lending obligations by SACC providers. Recommending that this restriction be applied to other credit providers is outside the scope of this review. However, in implementing a restriction it would be prudent to consider its scope and whether there are similar concerns in other contexts.

Consistently, persons other than credit providers who obtain access to consumers' bank statements, such as third party software providers, should be similarly restricted in their use of bank statement information and bank log-in details.

Implementing an obligation for lessors to collect and use bank account statements

There was mixed support for an obligation for lessors to obtain and use bank account statements. Some stakeholders were opposed to the obligation, while others indicated support, albeit with some questions about its practicality.¹⁴⁶ Some lessors are already obtaining bank statements.

Some of the concern around implementing this obligation seemed to be about the time and logistics required to obtain bank statements, for example, in a retail store environment.¹⁴⁷ However, as has been shown in the SACC industry, consumers generally come to terms with providing bank statements and there are methods to obtain statements cheaply and quickly.

During the course of consultation, concerns were raised about the consistency and robustness of responsible lending by lessors. The Panel considers, consistently with the position in relation to SACCs, that lessors should be required to obtain and use bank account statements. This will assist lessors who are not currently obtaining bank statements to comply with their responsible lending obligations in a more consistent manner.

The Panel's views on the issues raised above in relation to the collection and use of bank statements in the SACC context apply equally to consumer leases of household goods should the recommendation that they be required to obtain and consider bank statements be implemented.

146 Thorn Group Limited submission to the consultation paper p.23.

147 Thorn Group Limited submission to the consultation paper p.23.

SUITABILITY ASSESSMENTS

Recommendation 20 – Documenting suitability assessments

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

Description

SACC providers and lessors are currently under an obligation to provide credit contracts and consumer leases of household goods that are suitable, as tested against the consumer's requirements and objectives, and their capacity to afford the payments under the proposed contract, either at all or without financial hardship. The recommendation would provide for consistency in the way in which these providers comply with that obligation by specifying both the time at which the assessment is to be made and the key matters that should be addressed in the assessment in order to demonstrate that the proposed contract is suitable.

Objective

- Improve the transparency and accountability of decisions by SACC providers and lessors that the proposed contract is suitable.

Discussion

As discussed previously, the Panel's view is that it is desirable that there is substantive and robust compliance by SACC providers and lessors with their obligation to provide contracts that are suitable. This level of compliance will encourage greater financial inclusion by consumers.

Some submissions provided examples of transactions that raised questions as to the adequacy of the assessment undertaken by the SACC providers and lessors.¹⁴⁸ For consumers on low incomes (including Centrelink recipients) a failure to conduct a reasonable suitability assessment creates a risk they will have difficulty meeting living expenses, default on other commitments or find it harder to save. In other words, where the consumer has limited or hardly any discretionary spending, the consequences of a SACC provider or lessor understating their expenses can have greater adverse financial impact than on a consumer with higher levels of discretionary expenditure.

Two examples can be provided. First, ASIC provided a summary, in its second submission (Table 12 in the discussion under *Recommendation 15*), of the extent to which two lessors were consistently assessing consumers as having living expenses less than the HPI.

Secondly, the Consumer Action Law Centre provided an example of a SACC provider who used an internal formula to calculate the consumer's living expenses (excluding rent) at 15 per cent of their income rather than their actual expenses. Where those expenses of the consumer are more than 15 per cent the inference from this approach is that the credit provider assumes the consumer will reduce their expenditure in order to meet the repayments.¹⁴⁹

No view is expressed as to whether these are examples of contracts where the assessment that the contract was suitable was correct or flawed. However, it is considered that they demonstrate the desirability of having greater accountability and transparency as to the assessment.

Although a requirement to document suitability assessments was not widely supported by industry in their submissions, the Panel does not expect the cost of compliance with this requirement to be significant. In their submission to the consultation paper, the NCPA advised that most SACC providers use software packages to manage database activities, and these software packages record the decision-making process electronically. The SACC providers who do not use electronic systems record the decision-making process manually.¹⁵⁰

148 For further examples see the case studies in the submissions to the consultation paper from Financial Rights Legal Centre at p.6-7 and in the Appendix, and Legal Aid NSW pp. 41-42 (particularly Case Study 2).

149 Consumer Action Law Centre submission to the consultation paper p.34.

150 NCPA submission to the consultation paper p.50.

Other submissions received from SACC providers and lessors indicated that compliance with a documentation requirement could be demonstrated using a robust technology framework,¹⁵¹ and that using customer relationship management software would be an efficient way to document assessments.¹⁵²

The recommendation therefore would introduce a clear statement of the matters to be included in a suitability assessment at a level of detail to inform the existing requirement in section 132 and section 155 of the Credit Act. The Panel considers this is appropriate given that in this market sector clarity in the requirements applying to SACC providers and lessors can be expected to result in better compliance.

Implementation considerations

It is proposed that SACC providers and lessors under consumer leases of household goods be required to complete and document the suitability assessment before the consumer enters into a proposed contract.

SACC providers and lessors could be required to record the assessment in a way that is broadly consistent with current practices, by requiring them to specify the information they have relied on and to set out the way in which they have considered this information (including resolving any anomalies in it).

It is expected that the record would include the following matters (although it may also need to cover other matters):

- the consumer's income – and whether this was verified or not, and, if it was verified, the documents relied on to do so;
- the consumer's living expenses – and whether they were verified or not, and, if they were verified, the documents relied on to do so; and
- the consumer's other liabilities – and whether they were verified or not, and, if they were verified, the documents relied on to do so.

151 Credit Corp submission to the consultation paper p.26.

152 Make It Mine submission to the consultation paper p.21.

The two examples discussed above are helpful in illustrating the matters that might arise where more details are needed to support the assessment of suitability:

- Where the lessor regularly assesses consumers as having living expenses below HPI – an explanation as to why the consumer can be expected to have such low expenses, and why it is reasonable not to verify those expenses.
- Where the living expenses attributed to the consumer for the purposes of assessing suitability were less than the consumer’s actual expenses – the basis on which it is concluded that the consumer could reduce their expenditure below their current spending.

It is considered that this assessment could be undertaken and documented in a standardised way that is largely consistent with existing practices.

WARNING STATEMENTS

Recommendation 21 – Warning statements

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.

Description

The recommendation allows a more nuanced and effective approach to be taken to warning statements by allowing ASIC the flexibility to mandate requirements which take into account different media for delivery of warnings (including addressing any new media that develop) and the behavioural biases of consumers.

The application of the requirement to lessors offering consumer leases would maximise the extent to which consumers become informed of, and seek out alternatives to, high-cost leases.

Objectives

- Maximise the effectiveness of the warning statements in relation to SACCs and consumer leases.
- Ensure that consumers have appropriate information, particularly in respect of the cost, to make a more informed decision before entering into a consumer lease of household goods contract or SACC.
- Increase the use by consumers of low-cost alternatives to SACCs or consumer leases of household goods.

Discussion

SACC providers are currently required to display a warning statement to prospective consumers. In general, the intention of the warning statement is to encourage consumers to make greater use of financial counsellors and to promote awareness of alternatives to high cost short term loans such as utility hardship programs or No Interest Loans schemes.

Particulars of the warning statements, including content and format, are detailed in the *National Consumer Credit Regulations 2010*. Warnings are required online, at the premises and over the phone of licensees who represent that they enter into SACCs with consumers.

Submissions generally agreed that the warning could be more effective. Issues and suggestions raised included:

- mandating hyperlinks on the website version of the warning, in particular to link through to ASIC's MoneySmart website;
- more information should be provided about alternatives to SACCs, such as in relation to No Interest Loan schemes, potentially with examples outlining the comparative costs of SACCs;¹⁵³
- the positioning of warnings on websites not being sufficiently prominent early in the application process;¹⁵⁴ and

153 Redfern Legal Centre submission to the consultation paper p.7, Consumer Action Law Centre submission to the consultation paper p.22, Anglicare Sydney submission to the consultation paper p.6, Care Inc submission to the consultation paper p.7 and National Australia Bank submission to the consultation paper p.3.

154 The Salvation Army Australia submission to the consultation paper p.5.

- the warning should be consumer tested to ensure it encourages positive behaviour and is useful.¹⁵⁵

Others submissions considered the warning to be ineffective.¹⁵⁶

Consumers are often unaware of the high cost of consumer leases and the alternative options that are available. Warning statements, similar to the mandatory warnings required for SACCs, will ensure that consumers using consumer leases also have appropriate information available to make informed decisions.

ASIC noted that there has been increased referral traffic to its MoneySmart website from SACC providers' websites as a result of the warning.¹⁵⁷ However, its submission identified that the impact of current warnings may be diluted given that a consumer may only view or hear the warning after they have already decided to apply for a SACC.

The Panel considers that the effectiveness of the warning statement could be improved, consistent with its original intention, by better utilising the insights from the way in which behavioural biases influence consumer decisions. Further, there is potential for different warnings to be used depending on a consumer's characteristics, how they seek to access a SACC or how many SACCs they have entered into.

Consumers can be susceptible to these biases when making decisions in relation to SACCs or consumer leases of household goods (as with other financial products). Reasons for this include that:

- financial products are inherently complex and/or involve trade-offs between the present and future;
- financial decisions often require assessing risk and uncertainty; and
- in the context of low-income consumers, the decision may be based on an assessment of the amount of each payment rather than the total cost.

155 Consumer Action Law Centre submission to the consultation paper p.21 and Financial Rights Legal Centre submission to the consultation paper p.28-29.

156 Rob Bryant submission to the consultation paper p.7, Moneybox Loans submission to the consultation paper p.23, Finance Industry Delegation submission to the consultation paper p.50-51, Legal Aid QLD submission to the consultation paper p.10.

157 ASIC submission to Consultation Paper p.27.

The Panel considers that the extension of the requirement to display a warning statement to lessors offering consumer leases of household goods is important. Similar considerations apply in that there are a range of alternatives available to consumers, including investigating the availability of low-cost leases, short-term savings for low-value goods, Centrelink advances, No Interest Loans schemes, and not seeking a lease where the goods are not essential.

The Panel notes the Financial System Inquiry raised concerns regarding the efficacy of disclosure as a regulatory tool.¹⁵⁸ However, this was primarily in the context of disclosure being relied upon in isolation. In this case, it will be one of a number of regulatory tools used to protect consumers.

Implementation considerations

The change could be implemented through ASIC relying on its existing modification power in section 163 of the Credit Act or by a specific amendment of the Credit Act (as suggested in its submission). This would allow the warning to be modified to respond to changing business models, technology and consumer practices.

In general terms, it is expected that ASIC would seek to maximise the impact of warning statements by making changes, including with respect to content and appearance, based on considerations such as:

- specifically targeting the behavioural biases of consumers that render them susceptible to taking out a SACC or a consumer lease of household goods when it may not be in their best interests;
- selecting the most effective point in time to display the warning;
- providing personalised data that may resonate more effectively with consumers, such as using language along following lines: *Did you know – a typical consumer who borrows \$x takes y time to repay the loan and pays \$z in fees and interest;* and
- being presented in a manner that allows consumers to process the information without distraction.

158 See Financial System Inquiry final report p.9.

Further, the Panel considers that the infringement notice regime in the Credit Act, and associated regulations, should be extended to apply to the warning statement obligations. The ability to quickly and simply enforce breaches of warning statement obligations is particularly important in circumstances where ASIC will be able to modify the requirements for warning statements including for use in advertising.

DISCLOSURE

Recommendation 22 – Disclosure

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.

Description

The recommendation would require both SACC providers and lessors under consumer leases of household goods to disclose the cost of their products as an APR both in the contract document and at an earlier point in time (using the formula set out in section 32B of the National Credit Code, using the Base Price).

Lessors under a consumer lease of household goods should also 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 as a dollar amount, in the contract document.

The APR, the Base Price of the goods being leased, and the difference between the Base Price and the total payments under the lease are referred to collectively as the ‘pricing information’ in the discussion below.

Further consultation is recommended to determine whether the pricing information could be disclosed at an earlier point in time than when the consumer is presented with the contract document, and, if so, the way in which it should be displayed.

Objectives

- Enable consumers to better assess the cost of SACCs and consumer leases of household goods.
- Encourage consumers to seek cheaper alternatives (by increasing the visibility of high-cost transactions).

Discussion

The way in which the cost of both SACCs and consumer leases of household goods is currently disclosed does not provide consumers with an effective way of assessing their cost, whether relative to other SACCs or consumer leases of household goods, or across credit products more generally. In relation to SACCs, consumers are only advised of the cost in dollar terms, while lessors are only required to state the total rental payments, and do not need to give any information as to the Base Price of the goods or the cost expressed as an annual percentage rate.

Consumer groups have provided evidence that some consumers make purchasing decisions in relation to leases on the basis of the amount of the fortnightly payments, rather than the term of the lease and the total rental payments charged under the lease. As a result, they do not realise that they are paying multiple times the price of the good until after they have entered into the contract.¹⁵⁹

The Panel considers that disclosure of the Base Price of the goods (in itself and relative to the total amount payable) and the annual percentage rate will further support a consumer's decision-making, and provide them with clearer price signals, particularly for consumers who focus on the fortnightly payments rather than the total amount payable.

Many lessors operate models in which the consumer can effectively retain possession of the goods at the end of the lease, and where the amount they are paying will allow them to achieve this outcome (and not simply result in them renting the goods and then returning them). It is therefore desirable that consumers are advised, before making purchasing decisions, of the amount they will be paying in excess of the Base Price of the goods, and of the cost as an APR.

159 Consumer Action Law Centre submission to the consultation paper p.43.

Implementation considerations

The disclosure of the value of the goods raises one issue that will need further consideration. *Recommendation 12* proposes that the cap should be based on the Base Price. In some business models, the consumer will have the choice of purchasing the goods for cash, and a Base Price will be displayed that may be less than the RRP.

The way in which this recommendation is implemented needs to take into account the following matters:

- Disclosure of the pricing information rate to the consumer before they have applied for a SACC or consumer lease of household goods, and before they have made a purchasing decision, is likely to be more effective in influencing their choices. However, at this point in time, the exact terms of any contract will not be known so it will not be possible to, for example, disclose the annual percentage rate applicable to the transaction but only a typical or indicative rate. Further consideration needs to be given as to how the pricing information should be determined (for example, whether or not the annual percentage rate should be based on a rate commonly charged by the provider).
- It would assist to understand the points at which SACC providers and lessors send messages to their consumers and the delivery channels for those communications. This analysis may identify a common type of communication where the pricing information could most effectively be disclosed (in addition to it being included in the contract document).
- Any potential consumer confusion as to the nature of a lease that may arise from requiring disclosure of its cost as an APR.
- Additional changes to disclosure are proposed in *Recommendation 21* (changes to warning statements). It may be that the appropriate vehicle to disclose the pricing information is in the warning statement.

The method of calculating the cost of a lease as an annual percentage rate can utilise the existing formula in section 32B of the National Credit Code.

ENCOURAGING COMPLIANCE THROUGH EFFECTIVE PENALTIES

Recommendation 23 – Penalties

Encourage a rigorous approach to 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.

Description

This recommendation would result in changes intended to encourage a strict approach to compliance by SACC providers and providers of consumer leases of household goods by:

- for breaches of key or fundamental requirements of the Credit Act (as discussed below), providing for SACC providers and lessors to lose the right to their charges under the contract (the loss of the establishment or monthly fees in the case of a SACC, and the loss of the payments in excess of the Base Price in respect of a consumer lease of household goods); and
- extending the civil penalty regime in Part 6 of the National Credit Code to consumer leases of household goods and to SACCs.

Objective

- Create greater incentives for lessors and SACC providers to comply with the law by:
 - in relation to fundamental requirements of the Credit Act where contraventions are likely to result in adverse financial outcomes for consumers, encourage strict compliance by making the SACC provider or lessor at risk of losing their charges;
 - making the adequacy of their systems for complying with the Act relevant to the amount of any penalty; and
 - in relation to systemic breaches of key conduct requirements, providing for a significant penalty without the need for ASIC to take court action.

Discussion

The Panel's view is that it is important that the proposals in the other recommendations are complemented with a penalty regime that operates in a simple and effective way, and also encourages a high level of compliance by lessors and SACC providers. The Panel considers that there are a number of ways of meeting this objective.

The first is to provide that a breach by a SACC provider or lessor of certain requirements, as discussed below, would result in a loss of their charges under the contract (the loss of the establishment or monthly fees in the case of a SACC, and the loss of the payments in excess of the Base Price in respect of consumer lease of household goods). This amount becomes a debt payable to the consumer.¹⁶⁰ This is consistent with the approach already taken to SACCs, where a credit provider charges more than is permitted under the Credit Act, as a result of the operation of sections 23A and 31B of the National Credit Code.

This proposal would only apply to a small number of requirements, where a contravention would have significant adverse consequences for consumers, where the obligation is clear and can be clearly complied with, and where it is reasonable to expect that a diligent provider would be readily able to ensure compliance. The Panel's view therefore is that the penalty of automatic loss of charges should only apply to the following matters:

- a lessor who charges an amount in excess of the cap on costs (including charging higher delivery costs than are permitted);
- entering into a credit contract or consumer lease of household goods where the consumer is required to make payments in excess of the protected earnings amount; and
- entering into a credit contract or consumer lease of household goods in breach of a prohibition on unsolicited sales.

¹⁶⁰ The submission from Care Inc. to the consultation paper, at p. 4, noted that consumers can be reluctant to act as witnesses in criminal prosecutions against a provider, where they may continue to seek finance from that entity.

It is considered that the penalty of loss of charges is warranted, as otherwise the SACC provider or lessor may still be able to earn a significant amount of money from the consumer. By way of example, if a lessor charges an amount in excess of the proposed cap, a regime where the consumer can only recover the amount charged above the cap is an insufficient deterrent, as the lessor can still earn the maximum amount lawfully permitted.¹⁶¹ A lessor may therefore consider the financial benefits of exceeding the cap are sufficient to justify the risks resulting from such conduct, noting that ASIC has limited resources and cannot prosecute every breach of the law.

The second method of introducing stricter penalties for contraventions is to extend the civil penalty regime in Part 6 of the National Credit Code to SACC providers and lessors. The design of Part 6 was structured so as to encourage compliance as:

- the court is directed to consider the effectiveness of a credit provider's compliance systems in determining the size of any penalty (so that the penalty would be expected to be higher for a provider with poor compliance systems);¹⁶² and
- it is likely that the credit provider will be subject to a lower penalty where it commences court action itself in response to a contravention (compared to a situation where a debtor or guarantor takes it to court), as this will be an indicator of actively monitoring and responding to contraventions.

Part 6 currently applies to a number of requirements under the Credit Act, including disclosure of the cost of credit, and the repayments under the credit contracts, and, in relation to credit contracts that are not SACCs, entering into contracts where the credit provider has charged more than the maximum amount that is permitted under section 32A or section 32AA of the National Credit Code.

161 ASIC's submission to the consultation paper noted, at p. 61, that sanctions in Australia providing for redress through a provider having to disgorge their profits were not as widely available as in other countries.

162 The submission by IPF Digital Australia to the consultation paper, at p. 4, supported an approach to supervision of compliance procedures that motivates providers to continually improve their products and services.

It is proposed that other obligations applying to SACC providers and lessors be included within the existing civil penalty regime in Part 6, so that the amount of the penalty could be directly linked to the adequacy of their compliance systems. The types of obligations that could be included would be analogous to those already included in respect of other finance products (primarily disclosure obligations). Consideration could also be given to including in Part 6 other obligations introduced as a result of the Panel's recommendations.

Finally, an amendment is proposed to section 114 of the National Credit Code to allow a consumer to recover amounts calculated by reference to the credit fees and charges imposed under a SACC, or the payments under a consumer lease of household goods. Currently the section only allows a consumer to recover amounts based on the interest charges payable under a contract, and, therefore does not provide a remedy to a consumer who is a party to a SACC or a consumer lease of household goods, as interest is not charged under these contracts.

AVOIDANCE

Recommendation 24 – Avoidance

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.

Description

It is recommended the Government introduce provisions that deal broadly with avoidance activities using existing Commonwealth powers. While not within the Panel's terms of reference, the Government may also wish consider whether existing powers are sufficient for a broad anti-avoidance provision or whether a further referral of powers from the states is necessary.

The consultation paper identified two types of avoidance practices:

- ‘Business model avoidance’ where a provider structures the financial products it provides so that they are not regulated by the Credit Act and so not subject to any of the requirements of the Act.
 - An example of this type of avoidance would be a lessor offering indefinite term leases instead of consumer leases of household goods regulated by the Credit Act.
- ‘Internal avoidance’ of the Credit Act where the provider offers a regulated credit contract or a consumer lease of household goods but structures the contract, or includes certain terms, to avoid requirements of the Act.
 - An example may be lessors deliberately providing finance through leases rather than as a credit contract to avoid the caps that apply to credit contracts.

It is recommended that the Government introduce broad anti-avoidance provisions that deal with both types of avoidance.

Objectives

- Drive competition by ensuring that all providers are meeting the same obligations in relation to the costs they charge and their assessments of suitability of the proposed contract.
- Avoid a drift to non-compliance where providers who are complying with the Credit Act are losing business to those who are not complying and are, therefore, under financial pressure to lower their own standards.
- Minimise consumer detriment resulting from businesses which are avoiding compliance with cost caps and additional responsible lending and conduct requirements.

Discussion

The experience under the Uniform Consumer Credit Code (UCCC) and under the Credit Act has been that the introduction of a cap on the maximum amount that can be charged under a credit contract, and of other conduct obligations applying to SACCs, has resulted in some lenders seeking to avoid these obligations through a range of avoidance practices.¹⁶³

The submissions to the consultation paper identified a number of current or recent avoidance practices. For example, both ASIC and the Consumer Action Law Centre (CALC) referred to the ‘front-loading’ of payments to maximise fee revenue, where the term of the contract is extended with lower payments in the later months of the contract. This practice is an example of ‘internal avoidance’ in that it is engaged in by credit providers who are offering a product that is regulated by the Credit Act. It is considered preferable that this practice be specifically addressed (as discussed above at *Recommendation 5*).

ASIC’s submission also referred to a matter from October 2014 where it intervened to stop a business model where the consumer was provided with an amount of cash through an arrangement under which the consumer first sold a household good to the lender and subsequently leased that item back (paying more than the sale price they received and more than the maximum amount allowed to be charged under a SACC).¹⁶⁴ Similarly, the Consumer Action Law Centre provided a further example of an avoidance practice where the consumer was advanced funds by a cheque (rather than cash), and an associated business charged the consumer a cheque cashing fee of \$70 in order for the consumer to have immediate access to the funds.¹⁶⁵

163 Five different avoidance models developed in response to the cap on costs for credit contracts under the UCCC were discussed in the Regulation Impact Statement: ‘National Credit Reforms: Addressing Avoidance of the *National Consumer Credit Protection Act 2009*’ pp. 9-10. The Financial Rights Legal Centre submission to the consultation paper identified nine avoidance models used by providers while the UCCC was in force, p.40.

164 Media Release (14-278MR) ASIC continues crackdown on payday lending avoidance models.

165 Consumer Action Law Centre’s submission to the consultation paper p.35.

ASIC also identified a different category of avoidance where a credit provider offered loans that were for a term of more than 12 months, even though the repayments were such that the loan would be paid out within 12 months. In this case, the credit provider was seeking to avoid the conduct obligations applying to a SACC (such as the requirement to obtain bank statements) rather than the cap on the maximum amount that could be charged.¹⁶⁶

Avoidance can have a significant adverse impact on compliant industry participants. In particular, providers engaging in avoidance activity can obtain competitive advantages by being able to provide their products more quickly by not having to meet the responsible lending and other conduct obligations and by having reduced compliance costs.

The consequences of avoidance can be harmful to consumers as it results in outcomes such as the consumer paying amounts higher than the cap on costs, entering into arrangements that are unsuitable and having a more limited capacity to seek redress for any harm (as a result of the provider not being a member of an external dispute resolution scheme or having compensation arrangements).

A number of stakeholders, including ASIC, have pointed to the need for a broad anti-avoidance provision.¹⁶⁷ The purpose of an anti-avoidance provision would be to provide ASIC with a remedy to address conduct that attempts to avoid provisions that apply to SACCs and consumer leases of household goods.

ASIC's submission indicated that although it has taken action where it has seen conduct intended to avoid consumer credit obligations, such action is resource intensive.¹⁶⁸ Further, without a broad anti-avoidance provision outcomes do not have a broader deterrent effect. ASIC has indicated that in its experience once an avoidance scheme has been stopped, another scheme may be developed to take its place (including in some instances by the same provider).

166 ASIC submission to the consultation paper p.39. The practice was also referred to by IPF Digital Australia in its submission to the consultation paper p.23.

167 ASIC submission to the consultation paper p.40.

168 ASIC submission to the consultation paper p.6 and p.39.

Industry submissions varied in their support for an anti-avoidance provision, with some submissions indicating that an anti-avoidance provision is unnecessary and any issues can be dealt with via regulation.¹⁶⁹ However, many of submissions considered that a broad anti-avoidance provision was necessary,¹⁷⁰ although some submissions noted that there was a risk that an anti-avoidance provision that was too broad may inadvertently capture legitimate business models.¹⁷¹

Finally, it is noted that two business model avoidance practices that lessors could easily adopt or introduce would be to offer leases with an indefinite term or to offer leases with a four-month term that are regularly rolled over at the end of each four month term (as there are specific exemptions in relation to these two classes of leases under the Credit Act). Prima facie these two categories of lease should be regulated (rather than prohibited), given the risk of avoidance and that there may be circumstances where it is desirable to allow lessors to offer these products (but on a regulated basis).¹⁷²

Options considered

The Panel considered a number of options to deal with avoidance practices:

1. **Recommended:** Introduce a prohibition on persons engaging in anti-avoidance practices.
2. Introduce targeted provisions that address current or likely instances of avoidance practices identified through this review.

The recommendation provides a mechanism to address avoidance in the broadest possible way.

169 For example, NCPA submission to the consultation paper p.50, the Financiers Association of Australia submission to the consultation paper p.4, Moneybox Loans submission to the consultation paper p.63-65, and Min-It Software submission to the consultation paper p.22.

170 For example, see submissions to the consultation paper by the Consumer Action Law Centre p.37, Law Council of Australia p.9 and Good Shepherd Microfinance, p.18.

171 For example Australian Bankers' Association submission to the consultation paper p.3.

172 For an example of the high costs that can arise from the use of an indefinite lease see the case study in the Consumer Credit law Centre SA and Uniting Communities submission to the consultation paper at p.9.

Given the range of avoidance practices that have been utilised in response to changes to regulation under both the UCCC and the Credit Act, it is reasonable to expect that there will be continued avoidance of the Credit Act, both by some lessors (in response to a cap on the maximum amount that can be charged under a consumer lease of household goods, and other conduct obligations recommended by this review) and by some providers of small amount credit finance.

Avoidance practices can disadvantage both consumers and the regulated population. As a result, it is considered appropriate to introduce a broad prohibition on persons engaging in anti-avoidance practices.

The terms of reference for the review do not permit the Panel to recommend changes that are outside the Commonwealth's current jurisdiction. This means that:

- In relation to internal avoidance (where the financial product is regulated by the Credit Act, including SACCs and consumer leases) the Commonwealth could comprehensively address this conduct by amendment to the Credit Act (or through regulations) under the existing referral of legislative power from the states and territories.
- In relation to business model avoidance (through providing financial products structured so that they are not regulated by the Credit Act), the anti-avoidance prohibition could be enacted based on existing Commonwealth powers, such as the heads of power in respect of corporations, inter-state trade and commerce, and postal, telegraphic, telephonic, and other similar services. This would allow the Commonwealth to regulate most avoidance activity, although not conduct where it was engaged in by an individual operating within a single state, and without reliance on the communication methods listed above.

Some stakeholders suggested that any avoidance practices can be addressed by changes to the law through regulations. Implicit in this approach is that it is preferable to respond only to such practices after they have been identified, rather than seeking to discourage persons from engaging in avoidance at all. The Panel does not accept that this is desirable, and that the risk of financial harm to consumers should be minimised by anti-avoidance conduct being prohibited before it occurs.

However, it is considered appropriate to address the specific risk that the introduction of a cap on the maximum amount that can be charged under a consumer lease of household goods will create financial incentives for some lessors to offer unregulated products where there is no cap, as indefinite term leases or leases with a maximum term of four months.

In relation to these unregulated leases, there is a question as to whether they should be prohibited or regulated. This question is one that is not necessary for the Panel to comment on, given previous government consultation on this issue, and given that either approach would address the risk of non-compliance.

The Panel notes that in practice most leases with a term of four months or less will not meet the requirement, in paragraph 170(1)(b) of the Credit Act, that the charge for hiring the goods exceeds the cash price of the goods.¹⁷³ However, it would not be implausible that a lessor might offer leases of four months, and continually roll over the consumer to a new lease for the same goods.¹⁷⁴

The Panel also considers that the penalties for breaching any prohibition on anti-avoidance should be set at a level that acts as an effective deterrent. An entity which is prepared to engage in this type of conduct is unlikely to take a cooperative attitude towards providing compensation to consumers on a voluntary basis or without court action. Consideration could, therefore, be given to providing strict and automatic penalties to deter this type of conduct. For example, if a person has provided a consumer with an amount of money and requires them to repay a larger sum through instalments (through a contrived business model where the financial product is not regulated by the Credit Act), the penalty could be the loss of the sum payable in excess of the amount of money received by the consumer.

Implementation considerations

Some submissions raised concerns that a broad anti-avoidance provision may capture legitimate business models. The prohibitions on business model avoidance and internal avoidance should be as broad as possible while balancing the needs to avoid creating too much uncertainty for both credit providers and lessors.

173 The term 'cash price' is defined in subsection 204(1) of the National Credit Code.

174 See the discussion in 'Consumer Leases and Consumer Protection: Regulatory Arbitrage and Consumer Harm' by Paul Ali, Cosima McRae, Ian Ramsay and Tiong Tjin Saw (2013) Volume 41, Australian Business Law Review 240, especially at p. 265.

This issue should be considered in the design of the provision. One method of addressing this issue would be to ensure that ASIC has the power to exempt particular conduct. Another option would be to make the application of the prohibition dependent on the characteristics common to known avoidance practices, and specify that the existence of those characteristics makes it more likely that a business model or a practice has been adopted to avoid regulation under the Credit Act.

By way of example, some of the characteristics of avoidance practices could include:

- Artificiality or unnecessary complexity of the arrangements (for example, there are more parties to the arrangement than is reasonably necessary, noting that some avoidance practices rely on the use of third parties to charge additional fees or perform unnecessary services).
- Whether the entity has changed its practices in response to a change in the law (that is, the timing of the introduction of the practice creates an inference that it was a response to those changes, to allow the entity to continue operating in substantially the same way rather than changing its practices to comply with the changes to the law).
- It is reasonable to assume that the practice does not deliver any benefits to the consumer (with a consequent inference that the rationale for the practice is only to advantage the provider).
- In relation to business model avoidance – the provider promotes the products it offers on the basis that they provide the consumer with financial outcomes similar to those under a SACC or a consumer lease of household goods.

APPENDIX 1: TERMS OF REFERENCE

Terms of reference

1. The review will make recommendations about the effectiveness of, and, where necessary, recommend changes to the following:
 - 1.1 the requirement to obtain and consider a consumer's bank account statements in subsections 117(1A) and 130(1A) of the Credit Act;
 - 1.2 the rebuttable presumption that a loan is unsuitable where the consumer is in default under another SACC or has held two other SACCs in the past 90 days in subsections 118(3A), 123(3A), 131(3A) and 133(3A) of the Credit Act;
 - 1.3 the prohibition on entering into, or increasing the credit limit of, a loan contract that has a term of 15 days or less with a consumer, and on suggesting or assisting a consumer to do so in sections 124A, 133C and 133CA of the Credit Act;
 - 1.4 the requirement to display a warning statement about the alternatives available to SACCs in sections 124B, 133C and 133CB of the Credit Act;
 - 1.5 the cap on fees and charges (including the maximum of a 20 per cent establishment fee and of a monthly 4 per cent fee) in sections 23A, 31A, 31B and 39A of the National Credit Code;
 - 1.6 the requirement that consumers who default under a SACC must not be charged an amount that exceeds twice the amount of the relevant loan in section 39B of the National Credit Code; and
 - 1.7 the power to introduce specific protection for particular groups of consumers in sections 133C and 133CC of the Credit Act and the protection for consumers who receive 50 per cent or more of their income under the *Social Security Act 1991* in regulation 28S of the National Consumer Credit Protection Regulations 2010.

2. The review will make recommendations on:
 - 2.1 whether a national database of SACCs should be established and, if so, by whom and how it should be funded; and
 - 2.2 whether any additional provisions relating to SACCs should be included in the Credit Act, the accompanying regulations, or the National Credit Code.
3. The review will make recommendations on whether any of the provisions which apply to SACCs should be extended to regulated consumer leases.
4. The review will make recommendations that take into account:
 - competition;
 - fairness;
 - innovation;
 - efficiency;
 - access to finance;
 - regulatory compliance costs; and
 - consumer protection.
5. In examining the issues set out above, the review should also consider whether the laws relating to SACCs and regulated consumer leases are appropriate for the current economic climate and whether they will continue to meet Australia's evolving needs.
6. The review should conduct consultations with stakeholders and hold public meetings where appropriate.
7. The review will not recommend the establishment of an additional body or the establishment of a further review(s).
8. The review will not recommend changes to any area of the law that the Commonwealth does not have the direct power to regulate.

APPENDIX 2: LIST OF PUBLIC SUBMISSIONS RECEIVED ON THE INTERIM REPORT

Australian Bankers' Association	MakeItMine
Australian Securities and Investments Commission	Min-it Software
Care Inc	Moneybox Loans
Consumer Action Law Centre	National Credit Providers Association
Consumer Credit Legal Service (WA)	Nimble
Consumer Household Equipment Rental Association	Redfern Legal Centre
Credit Corp	Rent the Roo
Good Shepherd	Rent4Keeps
Familycare	Rentorilla
Financial Rights Legal Centre	Sir Rentalot
IPF Digital	Thorn
Legal Aid NSW	Uniting Church
Local Appliance Rentals	Walker Stores

APPENDIX 3: GLOSSARY OF ABBREVIATIONS

ADI	authorised deposit-taking institution
ASIC	Australian Securities and Investments Commission
ASIC report 426	ASIC's report 426 'Payday lenders and the new small amount lending provisions'
APR	Annual percentage rate, calculated using the formula in section 32A of the National Credit Code, which is a calculation based on a diminishing balance
CCR	comprehensive credit reporting
Centrelink Code	Centrelink Code of Operation
CHERPA	Consumer Household Equipment Rental Association
CIO	Credit and Investment Ombudsman
Credit Act	<i>National Consumer Credit Protection Act 2009</i>
DFA	Digital Finance Analytics
DSP	Disability Support Pension
Enhancements Act	<i>Consumer Credit Legislation Amendment (Enhancements) Act 2012</i>
HPI	Henderson Poverty Index
MACC	medium amount credit contract
National Credit Code	Schedule 1 to the <i>National Consumer Credit Protection Act 2009</i>
NCCP Regulations	National Consumer Credit Protection Regulations 2010
NCPA	National Credit Providers Association

Revised Explanatory Memorandum	Revised Explanatory Memorandum for the Consumer Credit Legislation Amendment (Enhancements) Bill 2012
RIS	Regulation Impact Statement
RMIT	RMIT University, Melbourne
RRP	recommended retail price
Social Security Act	<i>Social Security Act 1991</i>
SACC	small amount credit contract
UCCC	Uniform Consumer Credit Code

