The Treasury of the Commonwealth of Australia

Discussion Paper - Strategies for Reducing Reliance on High-Cost, Short-Term, Small Amount Lending

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PREFACE

From the outset, the ambit of this discussion paper takes several sweeping generalisations and tries to invoke policy deliberation thereon. The very title of the discussion paper contains the first of these, in the form of "high-cost". There is no objective evidence given to support this allegation, and it relies on sentiments expressed by industry detractors. It also connotes the impression of "high profit" which is, likewise, unfounded. The falseness of these labels is no better evidenced than referring the cost of the credit back to the cost of the provision of the product. There is no empirical research available based on actual running costs to make such a reference. Because of this very absence, there is likewise no evidence upon which to make claims that the loans are "high cost". It is insulting to industry that they should have to continue to deal with these baseless claims.

Over the course of the past couple of years, industry has been forced to comply with an ever increasing amount of regulation. The majority of the businesses involved are not large, well funded corporations. The compliance requirements are generally not able to be sourced internally, and must be obtained at a cost from external service providers (at an obvious premium). This all means extra cost to the business, which must be covered from revenue or absorbed from profit. Combined with the downward pressure created by interest rate caps, this has squeezed many businesses out of the market[1] because the amount of revenue realisable is less than the cost of provision - something that is maintained by industry, disclaimed by consumer groups and still undetermined by any impartial party.

The paper is a rather pointed instrument. Financial exclusion is indentified as a culprit leading to the so-called problem of small amount lending - yet the paper is not styled in that manner. It is clear from the outset that, instead of trying to tackle the issue of financial exclusion which is the actual issue in question, it seeks to tackle the lending. This is analogous to focusing on the symptom while treating the disease as a secondary consideration.

There also exists a parallel consideration. On page 2 of the paper, it is acknowledged that the perceived reliance on the loans is "as a result of exclusion from mainstream credit providers." Instead of acknowledging, perhaps, that the conduct of the mainstream credit providers is the protagonist for the loan, the focus of the paper is skewed towards placing blame on the result. To use another analogy, that's a matter of putting the cart before the horse. The valid question could be asked - why is the paper titled the way it is, in that it does not give voice to the aim of fostering financial inclusion through mainstream credit providers?

These issues create a poor foundation for the deliberation that appears to be sought. They are unbalanced and prejudicial towards the small loans industry in much the same way as comments made in the media and by consumer groups, who have unfairly demonised the industry. Prudent thinking would expect that the administrative branch of government would remove itself from that and take a balanced, fair approach.

It is abundantly clear that this has not been done. Any argument to the contrary need only read the title of the paper, and realise that there has been no evidence offered to support the claim of "high-cost" beyond the false math of the annualised percentage rate.

ERRORS AND INCONSISTENCIES

It is necessary to draw attention to the following list of incorrect statements contained in the paper. The list is by no means exhaustive, and refrains from argument against external references:

[1] This includes lenders that have moved to alternate business models to escape the capping requirements.

- The references to annualised percentage rates throughout the paper are misleading and wrong - in accordance with the finding of the Parliamentary Joint Committee on Corporations and Financial Service[2]. They are also wrong from the standpoint of logic when discussing whether something is high-cost. Percentage rates in isolation never have, and never will, be indicative of cost. They are completely incapable of giving any idea of cost until they are related to actual, real figures.

  Extrapolating annual percentages in relation to short term loans is the single biggest disservice that the legislature has inflicted on the industry. The perpetual use of false, inflated figures has given industry detractors the ability to establish insurmountable arguments; because industry is forced to use such an incorrect notion and the majority of people do not understand its implications. To put the error simply: 1,000% is not high-cost. The cost of 1,000% cannot be determined UNTIL it becomes related to a number. For example, 1,000% of 0 is 0 – not a high cost at all.

- Page 2 of the paper makes a reference to "effective interest rates", a notion which is creeping in to publications used about the industry. Effective interest rates are a separate mechanism from annualised percentage rates, and the former does not necessarily equal the latter. There are incidences when the calculations can be equal, but there are also instances when they are not. Using the former term interchangeably with the latter (in any particular publication) can only cause a sense of confusion. The legislated requirement is for reference to be made to annualised percentage rates. Referencing "effective interest rates", which is not a supported term in the legislation, is plainly incorrect and should be avoided.

- Page 2 of the paper continues the false claim that direct debit facilities are a form of security for the lender. The simple fact is that they are quick and easy for the consumer to stop through a variety of means - often without any involvement through the lender. In contrast, they have benefits to both the lender and to the borrower. It would be trite to list them here.

- Pages 2 and 3 comment on an apparent lack of competition in the industry, by reference to cost. However, no consideration is given to any other possible factor that may have a bearing on the determination of those prices. The simple fact is that competition would be alive and well in the industry if it was simply allowed to get on with the job. The protracted period of changing regulation, coupled with the inherent unease this causes business, in addition to the divergent state regimes, means that many businesses are simply trying to ensure their survival. Making sure your doors are open to begin with is a secondary consideration to what your competition are doing.

- Page 19 makes comment regarding "fair and appropriate alternatives to high cost, small amount, short-term lending". This comment presupposes that the loans are unfair. It is, itself, "unfair" for the reasons set out in this document. The reality is that all proffered alternatives to commercial small amount, short term lending are either public based, not for profit organisations or revolve around requiring large corporate entities to provide such products[3]. The fact that there are no commercial alternatives available, and no realistic commercial alternatives identified, soundly indicates that either the regulatory regime makes the business cost prohibitive or the level of capping is below the cost of commercial provision. More likely, it is a combination of both.

- The section entitled "encourage mainstream lenders to support small amount lending", on page 21, is an acknowledgment that the small amount loan industry is (or at least will become) unprofitable. If encouragement is needed to entice mainstream lenders to provide the amounts contemplated, in an industry they not already have dominance in but for which they have an ever expanding product base, then it is clear that there is not the level of profit being represented. By requiring lenders with a range of products to take on an unprofitable one, the lender either has to bear the loss or offset the costs by increasing the price of their other products. Neither eventuality is economically responsible.

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[2] While it is acknowledged that rates must be expressed annually under the National Credit Code, this is not the same as the contemplation in the paper of taking the rate in isolation without reference to actual figures.

[3] Which, I would argue, is for the express reason that they would be lending at a loss and the cost of doing so would need to be covered by other revenue streams - something that could only be done due to the entity's inherent size, ie banks.

Reference is made to the situation in the United States. Aside from their finance industry bearing little relevance to Australia's , it is impossible to make direct comparisons without contemplation of the complete situation. For example, I attended a seminar from a visiting United States professor in which it was stated that the policy requirements of the government in extending services to the financially excluded (notably in the form of the so called "no income, no job" or "ninja" loans) had a direct bearing on the economic woes of the country. Whether this is correct or not, and the actual bearing that it may have had, is unknown it demonstrates that such a complex consideration cannot be taken lightly.

ANSWERS TO SPECIFIC QUESTIONS

1. The statement that Centrepay, advance payments and weekly payments are mechanisms for recipients to manage their money is a bit of a misnomer. These are forced, external methods of money management - they don't truly allow welfare recipients to manage their own money. Without intending to sound derogatory, one reason for the predicament requiring the monetary considerations is that the person is largely incapable of managing their money. If the consideration was that people could adequately manage their money, then the simple answer to the question is to provide welfare recipients with more money.

2. Individual circumstances warrant individual attention. It should not be the case that anyone is referred to the FMP as a matter of course. All cases should either be the subject of voluntary inclusion through active choice based on full information, or referral based upon consideration of the individual circumstances of the person.

3. Any requirement for lenders to undertake mandatory actions leads to increased running costs for the lender. The suggestion is better placed as being a requirement of the service providers - not the lenders (the lenders themselves already have their own hardship regimes to wrestle with). Further, the lender is not to know the applicant's history with the utility provider. Ascertaining a full history, which is the prudent way such an activity would be undertaken, would be objectively difficult and possibly invasive. This is not the function to which a lender should be put.

4. There are only two realistic ways to accomplish this aim: better awareness of the existence of such programs, and making the programs more palatable for the consumer. Ultimately, if the consumer is fully aware of the programs, it becomes a matter of personal choice as to whether they avail themselves.

5. This consideration is better left to other parties.

6. Apart from the services that generally fall under the auspices of financial counsellors, I am not aware of any services that would be of assistance. That aside, drawing a direct line of consequence between energy hardship and use of small amount loans fails to consider the likelihood that there are other factors to the equation.

7. The general lack of awareness of the existence of these programs is obviously the issue. Personally, I am not aware of any person outside of the small loans industry who was aware that utility providers have hardship programs available until I spoke to them about the issue - including a number of welfare recipients. From within the small loans industry, the people who are aware of their existence (myself included) found out only because of their mention in papers such as this one.

   Perhaps the most simple and effective way of making their promotion more wide spread would be a requirement for service providers to send a disclosure document with any arrears notice sent on a bill. That way, people who are able to meet their bills would not be inundated on a regular basis with unnecessary information, and the service providers would not bear unnecessary cost in sending information to recipients who had no use for it.

8. Whether or not these programs are an appropriate alternative depends on the factors to be considered. Simply increasing the amount of money people have could be considered appropriate if a sufficiently narrow set of criteria was established.

   These matters should be looked at wholly, however, because of the flow on effects in the economy. When done is such a manner the issue starts to verge on the question of political ideology - which would warrant more

consideration that this document proposes. My primary concern is that if the government seeks to make the provision of credit a public matter then it should truly do so by taking over and being the lender itself. It almost appears to be attempting to do so.

What is realistically happening is the creation of an anti-competitive marketplace. If the products are the same (apart from cost), then there is no way that an entity the needs to derive a profit for its continued existence can compete with an organisation that does not need to do so. This is clearly analogous to the considerations upon which the National Competition Policy was established, and could be viewed as an attempt to circumvent the policy considerations. In short, the programs should be viewed as appropriate adjuncts to commercial industry, not alternatives.

9. Not applicable.

10. This consideration can only be viewed as a direct acknowledgment of the cost necessary to operate in the industry. That financial institutions (ie mainstream lenders) are being partnered with community service organisations to provide NILS/LILS only shows that it is a commercially difficult industry.

    What is really set out in the proposition is that banks will provide money to charitable entities to lend, and those entities will provide all of the labour necessary to operate the lending. The amount of labour required for the undertaking, in both lending and managing repayment of the funds, is where a great amount of the cost resides. The amount of labour required to take an application, assess it, document a loan, undertake audit and compliance and so on is not fundamentally different from loan product to loan product in terms of quantum; and the amount of credit provided generally has little to no practical impact on the amount of work necessary.

    The falling down is that the amount of work necessary is able to be amortised more easily over a large principal figure than a smaller one. If it takes $300 worth of work to provide a loan, regardless of the amount of credit, then it is much more palatable to the uninformed to say that there is $300 worth of fees on a $300,000 loan than $300 worth of fees on a $300 loan - despite both loans requiring the same amount of work by legislation. By making the labour "free" in the case of charitable entities, the effect on the cost of the loan is obvious.

11. To be trite, the consideration here is how to force banks to give the loans. It's only window dressing to state that it is "encouragement". In that consideration, if the government feels that such an outcome is warranted it should just make it law and be done with it.

12. If the consideration in 11 is mandatory enforcement, then the reporting consideration could be called emotional blackmail. A voluntary reporting regime is simply another way of creating a method to shame lenders who do not participate.

13. As noted in the paper, CDFIs "grow up" and transform. None of those entities are undertaking the types of loans referred to, so there should be no expectation that any organisation allowed to be self-determinative would be any different in time. This then leads back to the enforced requirement argument.

14. It can, for people who don't mind being "on display". However, such an arrangement would still fall afoul of being anti-competitive.

15. Locality of services has never been a major consideration for consumers when it comes to a necessary product, in my experience. Added to that, many lenders operate from a partial or wholly online presence. This provides both convenience and relative anonymity to consumers.

16. This consideration is better left to other parties.

17. Debt consolidation simply replaces a number of loans with one loan. If the repayment circumstances aren't more favourable to the debtor, then it will be a case of that one loan falling over for the whole amount. There are benefits and disadvantages to having a number of loans or one combined loan, the mix of which depends on

the person and the repayment conditions. Drawing gross generalisations of what they are would not do the issue justice.

18. This consideration is better left to other parties.

19. From an ideological position, this suggestion is economic disaster. For it to be successful, many businesses would have to make losses in wiping debts. These businesses have to then either absorb the loss or pass the cost on to other consumers - neither of which is a good prospect. It is worthy to note that it is reasonable to assume in most cases part of the second option would be taken up, which would drive up costs. If undertaken on a wide scale, this would have the effect of falsely stimulating inflation.

    An indirect consequence would be the behavioural ramifications of allowing someone to accrue debts simply to walk away from them without detriment. It is arguable that the existing bankruptcy regime is too lenient; a debt reduction program of the sort contemplated would be a quasi-bankruptcy scheme without the level of stringent regulation. The ability to rort this type of system would destabilise social confidence. Enumerating the detriments that could cause is beyond the scope of this document.

Thank you for the opportunity to make this submission.

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