FINLAYSONS

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May 21, 2012

The General Manager
Retail Investor Division
The Treasury

Attention: Mr Christian Mikula

Dear Sirs & Mesdames

Submission on Consumer Credit and Corporations Legislation Amendment (Enhancements) Bill 2011 (*Bill*)

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Super Nexus Pty Ltd (*Nexus*)

We act for Nexus, which operates a number of Cash Converters franchised stores in South Australia.

The caps proposed by the Bill prohibit lenders charging establishment fees that exceed 20% or monthly fees that exceed 4% on small amount credit contracts. The caps are designed to: "*reduce the amount borrowers can be charged to a more acceptable and controlled level*".

Nexus supports the Treasury's attempt to impose realistic limits on the fees for small account credit contracts.

However, **Nexus strongly objects** to the introduction of the proposed fixed rate caps for microfinance lenders and, for the reasons below, believes the caps imposed by the Bill are <u>unworkable</u>.

Summary

- The caps would prevent Nexus from charging more than 24% on its "*Cash Advance*" product, which is repaid over a one-month period.
- On the basis of those fees, Nexus would make a **<u>loss of $13.79</u>** on an average $320 Cash Advance.
- Clearly, it would not be commercially viable for Nexus to continue making credit available at the rates set by the proposed caps.
- Providers of such credit cannot recover their costs under the fee structure fees proposed by the Bill.
- A viable alternative is an "all inclusive" cap of fees, charges and interest which prohibits the finance cost to the consumer from exceeding the amount borrowed.

1. The objective of the caps is to: "*reduce the amount borrowers can be charged [under small amount credit contracts] to a more acceptable and controlled level*".[1]

2. Unfortunately, however, the caps introduced by the Bill remain unworkable for microfinance lenders.

3. That is because the 20% cap on establishment fees, and the 4% cap on monthly fees, are still below the costs incurred by Nexus when providing small amount loans.

4. Under the caps, the maximum fee Nexus can charge on its Cash Advance product, which is repaid over one-month, is 24%, and 28% on a Cash Advance repaid over two months.

5. On an average Cash Advance of $320, the **fee would be $76.80** or, at most, $89.60 over two months.

6. However, the **cost to Nexus** of making an **average Cash Advance** of $320 is **$96.67**.[2]

7. Compared with NAB, which incurred costs (excluding cost of funds) of $462 per loan,[3] Nexus is an efficient supplier of short-term, low-value credit. The proposed caps are set **below** the cost incurred by an efficient provider of short term credit.

8. The imposition of a 20% and 4% cap would therefore result in Nexus making a **loss of $19.87** per $320 loan as follows:

Total income	**$76.80**
less Expenses	
Administration	
Direct	$34.59
Indirect	$39.39
Other	
Bad debt	$14.71
Interest	$1.90
Income tax	$6.08
Total expenses	**$96.67**
Loss per Cash Advance	**$19.87**

[1] Treasury has indicated that the cost of such loans "can be very high, with effective interest rates of up to 1,000 per cent": Commonwealth Treasury, *Discussion Paper – Strategies for reducing reliance on high-cost, short-term, small amount lending*, April 2012, pp ix. Nexus submits this is not representative of all microfinance loans and, indeed, is not representative of the Cash Advance product.

[2] Super Nexus Pty Ltd, *Submission to the Parliamentary Joint Committee on Corporations & Financial Services re: Inquiry into Consumer Credit & Corporations Legislation Amendment (Enhancements) Bill 2011*, 14 October 2011: copy attached.

[3] National Australia Bank, *Do you really want to hurt me? Exploring the costs of fringe lending – a report on the NAB Small Loans Pilot* (2010), p 16.

9. Clearly, it would not be commercially viable for Nexus to continue making credit available at the proposed caps.

10. Treasury has indicated it should be viable for lenders to continue offering microfinance under the proposed caps.[4]

11. However, that contradicts submissions made by market participants to, and evidence given by them at, the Parliamentary Joint Committee hearing on 24 October 2011,[5] and is further supported by recent industry submissions including those from Cash Doctors, DollarsDirect and the National Financial Services Foundation.

12. We are aware that the Submission made by Cash Converters to the Senate Economics Committee (October 2011) referred (on page 9) to Cash Converters':

> ... current calculated costs for [a $320.00] loan [as being] $76.00.

13. However, **Nexus believes its cost calculations are more accurate than those in the Cash Converters' Submission and more correctly reflect actual costs** because:

    13.1 the calculations performed by Nexus include, quite properly, a substantial number of unavoidable indirect costs that are missing from the Cash Converters' Submission;

    13.2 the Cash Converters' Submission assumes income is received from *all* loans. In reality, a credit provider *does not receive income from customers who fail to repay their loans*. Cash Converters have written off the principal portion of bad debt, but assumed those customers still contribute to product income.

14. **Under the more accurate cost model prepared by Nexus, the proposed 20% and 4% caps remain <u>unviable</u>.**

15. Nexus would be pleased to provide Treasury with details of its costing.

16. Nexus therefore strongly believes the caps will result in lenders being unable to supply short term credit products such as the Cash Advance.

17. Without products such as those offered by Nexus, many consumers will have no access to an alternative source of legitimate finance.

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4 Commonwealth, *Official Committee Hansard – Parliamentary Joint Committee on Corporations and Financial Services*, 24 October 2011, pp 76-77 (Mr Christian Mikula, Manager of Consumer Credit Unit, Department of Treasury).

5 Ibid, pp 17-18 (Mr Robert James Bryant, CEO, Money3 Corporation Ltd and Mr Phillip Smiles, Consultant, Financiers Association Australia).

18. While there have been a number of proposals to introduce alternative sources of finance, Treasury acknowledges that many consumers would not qualify for such finance or would find it ill-suited to their needs.[6]

19. There is thus a **real risk** consumers be encouraged to enter into larger loans than they require, with longer repayment periods that allow the lender to recover its costs; or will turn to illegal operators.

20. Those outcomes clearly indicate the caps will <u>not</u> achieve the objective set by the Government (and referred to in 1. above). It was clearly never intended that the caps would reduce competition, outlaw payday lending or drive legitimate lenders out of the market.[7]

Recommendations

21. A key shortcoming of the proposed caps is that they do not recognise that the cost of providing microfinance does not usually vary as the term of the loan increases.

22. Microfinance lenders that provide credit of less than $1,000 for periods of around one-month have **larger costs relative to** the **amount loaned**, which they need to recover over a short period of time.

23. Such lenders **cannot** recover their costs under the fee structure proposed by the Bill.

24. A sensible approach might therefore be to impose a simple "all in" cap applying to loans of less than, say, $1,000, that prohibits the total cost to the consumer over the life of the loan, however described (including default fees and interest), from exceeding the amount loaned.

If the Treasury believes it would be useful to meet with our client to discuss in greater detail any of the issues raised above, or if we can be of any further assistance, please do not hesitate to let us know.

Yours faithfully

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6 Commonwealth Treasury, *Discussion Paper – Strategies for reducing reliance on high-cost, short-term, small amount lending*, April 2012, pp 19-20.

7 See Commonwealth, *Official Committee Hansard – Parliamentary Joint Committee on Corporations and Financial Services*, 24 October 2011, 77 (Ms Sue Vroombout, General Manager, Department of Treasury).