Wesley Community Legal Service

Level 7, 133 Castlereagh Street Sydney NSW 2000
PO BOX A5555 Sydney South NSW 1235
communitylegal@wesleymission.org.au

Phone: (02) 9263 5577
Fax: (02) 9114 5683

Our Ref: RAB
Your Ref:

24th May 2012

General Manager
Retail Investor Division
The Treasury
Langton Crescent
PARKES ACT 2600

Dear sir/madam,

Strategies for reducing high-cost, short-term, small amount lending

The starting point for considering these loan products is to understand the profile of the typical borrower. These are people who have either poor money management skills or have mental health issues that prevent them making careful decisions with money management.

The most prevalent group of borrowers of high cost, short-term small amount loans are problem gamblers. Problem gamblers are secretive, so are not willing to identify themselves to researchers or lenders. These loans provide an alternative to pawnbrokers loans, as no security is required. Oddly, they are often more expensive than pawnbrokers (360% pa), despite being unsecured.

Problem gamblers frequently resort to small amount loans and form a significant proportion of customers of this industry. The Productivity Commission 2010 report “Gambling” found that between 80 000 and 160 000 Australian adults suffering significant problems from their gambling (0.5 to 1.0 per cent of adults), with a further 230 000 to 350 000 experiencing moderate risks that may make them vulnerable to problem gambling (1.4 to 2.1 per cent of adults).

The most commonly used tool for prevalence studies in Australia is the Canadian Problem Gambling Index (CPGI) which asks people to rate the frequency of nine behaviours/attitudes over the last year of gambling, with the options on any question being never, sometimes, most of the time or almost always. The questions are:

1. Have you bet more than you could really afford to lose?
2. Still thinking about the last 12 months, have you needed to gamble with larger amounts of money to get the same feeling of excitement?
3. When you gambled, did you go back another day to try to win back the money you lost?
4. **Have you borrowed money or sold anything to get money to gamble?**

5. Have you felt that you might have a problem with gambling?
6. Has gambling caused you any health problems, including stress or anxiety?
7. Have people criticized your betting or told you that you had a gambling problem, regardless of whether or not you thought it was true?
8. Has your gambling caused any financial problems for you or your household?
9. Have you felt guilty about the way you gamble or what happens when you gamble?

So borrowing money and financial problems are integral factors in problem gambling. Problem gamblers provide a major source of business for small amount lenders, and this is a topic that they are very quiet about. Gamblers are attracted to small amount lenders because:

- Marketing emphasises the quick and easy availability of cash
- Loan shops are often located nearby gambling venues
- Credit checks are minimal
- Lenders don't ask too many questions

Small amount lenders value problem gamblers as customers because:

- Gamblers don't think about the cost of the loan or shop around for a good deal
- Gamblers borrow frequently and for short periods, so loans can be periodically rolled over
- The loan default rate for gamblers is low as gamblers want to retain their good relationship with the lender

In NSW, some attempt has been made to restrict the activities of cheque cashing businesses (which are usually also operating as small amount lenders) from cashing gaming machine prize cheques immediately, enabling the problem gambler to lose their prize while in a gambling frenzy. Section 47 Gaming Machines Act 2001 prohibits any business other than a financial institution from knowingly cashing gaming machine prize cheques within 500 metres of a gambling venue. The NSW government has made some efforts to enforce this law. This was implemented in line with recommendations of a 2004 report of the NSW Independent Pricing and Regulatory Tribunal.

Financial Exclusion

The Discussion Paper is misleading in asserting that financial exclusion "can result in or contribute to a range of broader problems, such as relationship breakdown and a decreased standard of living." Whilst true in a few cases, the opposite is more commonly the situation – debt is frequently a cause of relationship breakdown and a decreased standard of living. Look at some of the research into relationship breakdown. Debt is a common factor. Inability to get credit is never cited as the reason why a couple broke up. It would be better to say that financial exclusion may be associated with a range of broader problems.

Reasons for borrowing

All of the "research" into the reasons for borrowing should be treated cautiously because it doesn't identify gambling as a reason for borrowing. Borrowing to pay an unexpected bill is a simplistic answer – the real reason is why the individual had no money available to pay the unexpected bill.

Gamblers will not reveal their gambling to a casual enquirer or researcher. Gamblers are highly secretive and prone to dishonesty. Instead of admitting that gambling has caused their real financial problems they provide a glib answer such as bills, utilities, food or car repairs.

Consider that Australia is the world leader in gambling expenditure – about $1500 per capita is spent on gambling each year. This is a demographic average. Actual expenditure is much higher for low income Australians – the group that most commonly use this sort of loan product, and much lower for wealthy Australians. Small amount lenders locate their shopfronts in low income suburbs, usually in close proximity to gambling venues.

It requires a more detailed look into the person's finances to identify gambling as being the real cause of the financial crisis that leads the gambler to the lender's door. Even financial counsellors have difficulty in working out whether a person has a gambling problem, because gamblers won't necessarily admit it to their counsellor. It may take a detailed look at the actual transactions and financial records to identify a secretive person as having a gambling problem.

The research also does not identify other mental health issues among borrowers such as depression and post traumatic stress disorder, which cloud the ability of the individual to make rational borrowing decisions.

Alternatives to borrowing

It is unfortunate that the Discussion Paper asserts that "In a modern society such as Australia, the need for small amounts of short-term credit to help manage cash flow and lumpy expenditure should be accepted as a universal element of financial inclusion." We would refute this assertion:

- Short-term, high interest borrowing exacerbates and entrenches poverty
- All of the reasons given for such borrowing do not justify the assertion. There are better and cheaper alternatives. This is evidenced by the work of financial counsellors, who <u>never</u> see a need to refer their clients to short-term lenders. There is <u>always</u> a better solution.
- All utilities offer instalment plans and have hardship teams so there is never a justification for high interest borrowing.
- Most other businesses will agree to instalment or hardship arrangements for consumers in financial distress, often with no interest charged.
- Landlords will usually allow renters time to catch up on arrears when an unexpected financial crisis arises, such as sickness or loss of employment – also at no cost.
- NILS schemes are nationally available.
- Centrepay allows welfare recipients to spread out their recurring payments to eliminate lumpiness.
- Centrelink loans can help.
- Welfare agencies such as the Salvation Army and St Vincent de Paul provide emergency assistance and are developing holistic nationwide programs to assist crisis payment claimants to develop basic money management skills and move out of the poverty cycle.

It is therefore misconceived to assert that lack of access to these high cost loan products is a bad thing. In fact, it is one of the reasons why the gap between rich and poor is widening. Small amount lending traps the poor in the poverty cycle.

One critical factor is the direct debit authority. This enables the small amount lender to withdraw funds from the debtor's bank account immediately following deposit by Centrelink and before it can be accessed by the debtor. The result is another cash crisis and a trip to the local welfare agency for emergency relief. Funds that are being doled out to emergency relief agencies for increased energy costs and the like are instead being used to pay off these loans.

It is critical that more reliable qualitative research be undertaken into the money management behaviours of people who borrow from these lenders. Research needs to track the actual cash flows, not just ask people what they borrow the money for. Yes, they may borrow the money to pay the rent, but the reason the rent money is gone is because it was gambled a couple of days ago at the local club. And no-one is going to admit that they gamble their welfare because they (rightly) expect to be condemned for that behaviour.

Centrepay

We support the extension of Centrepay to provide for advance payments in cases of financial hardship in addition to Centrelink loans. However it is essential that these advance payments be carefully monitored, as some Centrelink clients (e.g. problem gamblers) will use this money to feed their gambling expenditure. The most critical payment is housing – we have seen too many people lose their home because they gambled all their rent money. Once they are homeless it becomes a very costly (to the community) and time consuming process to help them return to some form of housing.

Utility debts

These are secondary to housing, but still important, particularly electricity and water. It would be appropriate to allow consumers to get advances on their Centrelink payment to pay arrears on these debts. Consumers should be given the option of authorising their utility provider at the time they sign up for their utiliy contract to access Centrelink monies in the event that payments are not made. If this is done in advance, it will avoid a crisis occurring for those with mental health issues who may be unable to make decisions at times.

Phone bills should be treated as a lesser priority as there are options available for those who may have their phone cut off.

The Enhancements Bill

The small loans people have a long and disreputable history of evading government regulation, and we would like to bring to your attention some of their favourite legal loopholes for bypassing regulators:

- The brokerage fee – which will be charged by a different legal entity for introducing the borrower to the lender and will be an additional cost to the establishment fee and the annual percentage rate;
- The multiple lenders trick – so if the borrower has already taken out a loan with lender A, they are signed up for their next loan with lender B – all separate companies, but conveniently located under the one roof;
- The associated purchase – see our article in Sharkwatch about the NSW Central Coast lender who sells money management CDs as part of the loan package – for hundreds of dollars;
- The just-ignore-the law approach – if you get caught out, you just shut down one company and start a new one;
- The jewellery switch – even we find this one hard to understand, but it gets them around the 48% interest rate in NSW.

The critical issue is a genuine commitment to enforcement of the laws; something that the States were too slow and underresourced to achieve. This is an area of lending that requires vigorous action by an active regulator, and frankly, our observations of ASIC to date do not give us a great deal of confidence.

One of the many problems is that consumers of these loan products do not know the actual cost of the credit. By using some of the scams outlined above, lenders don't have to disclose the true cost of the loan. Most of the customers know that they product is expensive, but if they knew just how expensive, they might think twice about it. Unfortunately a lot of the loan contracts are hard to read, and the borrowers are often not well educated. We would love to see the cost of credit in large letters in a Schumer box right above the place where the borrower signs. This should include all establishment fees, brokerage and extras.

NILS and Step Up loans
These are excellent products for consumers who are motivated to apply and are willing to put up with a slow process and a high degree of loan management. They are not popular with problem gamblers who are looking for a quick fix to a financial crisis and are not motivated to change their behaviour. We would like to see the availability of these loans widened and also the range of purposes. For example, few of these loan products are available to cover removal expenses, a major cost for those in the private rental market and one that is usually unavoidable.

Encourage mainstream lenders to support small amount lending?
Mainstream lenders would be encouraged to enter the market for small amount lending if they could have a simple method of lending and a reliable method of collection. At the moment, mainstream lenders are reluctant to enter this market because of the high cost of establishing and maintaining loans and the high default rate (perhaps 10%, instead of less than 1% for normal lending). The cost of establishing and maintaining loans would be greatly reduced if the responsible lending requirements were relaxed and if the loan administration was managed by an efficient structure. Moves in this direction have already been made by the supermarket chains, who issue credit cards. Being able to access cash or make payments at the same time and place as the weekly shopping trip has the potential to greatly reduce costs.

The problem for mainstream lenders is that they would not want their good reputations damaged by association with usurious lending practices. Worse, this approach simply makes more credit available to people who really cannot afford to get themselves in debt. A lot of people would borrow from both the mainstream lenders and the payday lenders and so get themselves into financial difficulty sooner.

One Stop Shop Hubs
We support the development of 'One Stop Shop' Hubs in throughout Australia. This will enable the seamless transfer of clients from one social service provider to another – which is particularly important for clients who may have mental health issues, CALD or other disadvantages. The loss of contact in the referral process now is very high, because each new provider has an intrusive intake process and clients simply give up when being shunted from one service to the next.

It is important to note that financial crises do not just occur in the low income areas of the country. Even wealthy areas have their pockets of disadvantage, and when financial disaster strikes, it is the One of the main reasons why consumers are slow to access financial counselling and other forms of financial assistance is lack of awareness of availability.

Debt Consolidation

We are not overly enthusiastic about the establishment of a low cost debt consolidation product. There would be a myriad of difficulties in assessing eligibility and processing these loans. At present there are a number of ways that consumers can access debt consolidation, such as personal loans or credit cards through mainstream lenders. These products are usually available at a rate of interest ranging between 15-30%. They are not widely successful because most of the consumers who get into trouble with small debts shouldn't have been granted the debts in the first place and the consolidation lender rejects the application on responsible lending grounds. Worse, consolidation loans are often taken out as an additional form of credit instead of a replacement, so the debtor retains the original debts as well as the consolidation debt. We would rather see an extension of the existing Centrelink loans for worthwhile reasons.

The need for effective enforcement of responsible lending laws

One of the problems with the current national credit law is that it is complaint driven. Although consumers of small high cost loans have the right to complain to COSL or FOS if they are unhappy with the product, very few complaints are actually made. This is because of the psychological profile of most borrowers of this product – gamblers, people with mental health issues, elderly, young, CALD and other vulnerable groups. They don't have the motivation to complain.

When a complaint is made, particularly when a lawyer or financial counsellor is representing the person, the small high cost lender quickly settles the claim, usually by waiving all outstanding interest and charges. But the actual number of these complaints is miniscule and the lack of disputes that proceed to a full investigation means that no systemic change is implemented.

What is needed is a strong regulator that takes the initiative to investigate the practices of these lenders by way of a review of their loans portfolio. This should focus on their general lending practices, compliance with responsible lending criteria etc and result in a system of warnings and penalties for those who don't comply. In our opinion, the majority of these lenders pay scant regard to the concept of responsible lending and they know that they can get away with it due to lack of government regulatory effort. We have been underwhelmed by the efforts of ASIC to complaints we have made regarding some of the worst offenders in this industry. Lack of enforcement leads to more brazen disregard of the law.

Yours faithfully,

Richard Brading

RICHARD BRADING
PRINCIPAL SOLICITOR
Liability limited by a scheme approved under Professional Standards Legislation