Griffith UNIVERSITY

Centre for Credit and Consumer Law

Interest Rate Caps: protection or paternalism?

CCCL Research Paper

December 2008

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Interest rate caps: protection or paternalism?
A Centre for Credit and Consumer Law Research Paper

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Acknowledgements

This research report was a collaborative effort. Thanks to the following individuals and organisations for assisting with the research and reporting for this project:

- Financial Services Federation Queensland assisted with the development and implementation of the industry survey.
- Dr Elena Marchetti, CCCL Acting Director, played a significant role in initiating the research and conducted many of the qualitative interviews.
- Rebecca Rimmer, former CCCL staff member, conducted some of the interviews and coded and analysed the qualitative data.
- Lauren Dancer, Griffith Law Student, provided general research assistance.

Most importantly, our sincere thanks are due to the regulators, consumer advocates and industry members who participated in the project by agreeing to be interviewed, surveyed, or by providing copies of documents. Their willingness to provide information and opinions has provided considerable insights. Without their participation, this research could not have happened.

Nicola Howell drafted chapters 2, 3, 8, 9, 11, and part of chapters 5 and 10; Therese Wilson wrote chapters 1, 4, 12 and part of chapter 10, and edited the entire report; and James Davidson drafted chapters 6 and 7, and part of chapter 5.

The Centre for Credit and Consumer Law is funded by the Queensland Government's Consumer Credit Fund (administered by the Office of Fair Trading), and Griffith University. This funding enabled this research to go ahead.

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1. Introduction

In a context where over-indebtedness and financial exclusion have been recognised as problems in Australia, it is undesirable that those who can least afford it, pay a high cost for short-term consumer credit.

Evidence points to an increase in consumer debt in Australia[1] and consequential over-indebtedness which has been shown to lead to a wide range of social problems.[2] There is also evidence of financial exclusion, where consumers suffer a lack of access to mainstream financial services, and in Australia this is particularly the case with regard to access to safe and affordable credit.[3] Financial exclusion can only exacerbate over-indebtedness, given that financially excluded, predominantly low income consumers[4] , have been shown to turn to high cost credit to meet their short term credit needs. This is a problem that has been explored most recently in the Victorian Consumer Credit Review.[5]

As part of the response to problems of over-indebtedness and financial exclusion, state governments have explored the possibility of imposing a 'cap' or 'ceiling' on interest rates, to ensure that credit products with exorbitant interest rates attached are not offered on the market. A number of government discussion papers and reports have been published exploring the benefits and disadvantages of such a regulatory response.[6] Although some governments have recently made decisions to introduce an interest rate cap, or expand an existing one, the issue is still a 'live' issue in the context of the recent decision to transfer responsibility for regulating consumer credit from the State and Territory Governments to the Commonwealth Government.[7] In its Action Plan for the transfer of responsibility, the Commonwealth Government has announced that 'an examination of State approaches to interest rate caps' will be conducted in phase two of the plan, and any legislation required in phase two is to be in place by mid-2010.[8]

This report will again explore the arguments for and against an interest rate cap, but will draw on survey results and qualitative stakeholder interviews in doing so. It will also present information about the nature of fringe lending products in Queensland based upon that empirical research.

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[1] See http://www.rba.gov.au/Statistics/Bulletin/D05hist.xls
[2] Department of Trade and Industry, UK (2003), pp74-78.
[3] Connolly & Hajaj (2001); Chant Link & Associates (2004)
[4] Connolly & Hajaj (2001), p 22.
[5] Consumer Affairs Victoria (2006)
[6] See for example QOFT (2000), QOFT (2006), Ministerial Council on Consumer Affairs (2003), Ministerial Council on Consumer Affairs (2006), Office of Consumer and Business Affairs (SA) (2006).
[7] See COAG (2008).
[8] See http://www.treasury.gov.au/consumercredit/content/default.asp?NavID=014&titl=Consumer%20Credit.

Chapter 2 provides some context for this discussion, while chapter 3 outlines the current regulatory framework pertaining to the regulation of short term credit in Australia. Chapter 4 summarises key arguments for and against an interest rate cap, drawing on the literature on the topic.

The research method, encompassing literature reviews as well as a survey and qualitative interviews, is explained in chapter 5.

For the sake of comparison, chapter 6 describes the finance options available in Queensland apart from micro or 'fringe' lending products. Chapter 7 then describes in some detail the characteristics of those micro or 'fringe' lending products, based upon information provided through the surveys.

Chapters 8 to 11 analyse the perspectives of consumer advocates, micro-lenders, mainstream financial institutions and regulators on the question of interest rate caps and their likely impacts. These perspectives are drawn from in depth, qualitative interviews conducted in 2006.

The report is concluded in chapter 12 with a discussion of the potential benefits and disadvantages of interest rate caps as a regulatory response. A key benefit of capping is the fact that (subject to effective enforcement of a cap) it will remove the possibility of consumers paying a high cost for credit. Conversely, however, there is a risk that this will result in an absence of short-term credit products from the market, or only more harmful, illegal short term credit products being available. Is capping merely a paternalistic exercise in depriving low income and other consumers of access to a product on the basis that "we now what is best for them", or is it likely to be an effective mechanism to protect consumers from harm?

The evidence as to whether the introduction of a cap automatically leads to a departure of fringe credit providers from the market is unclear. Even if this is the result, however, there is an argument that the absence of fringe credit products, which while desired and well-managed by some consumers are potentially harmful to others, is a good outcome. A point has been made by the Consumer Action Law Centre that just because there is a demand for a product in the marketplace, does not necessarily make it a good idea for that product to be supplied.[9]

In regulating to prevent the harms associated with high cost credit, is an interest rate cap going to be the answer? Should there be greater focus on the problems of rollovers and renewals of micro-loans, and the taking of security over household goods? Should the fringe credit industry be consulted to arrive at a cap and regulatory model that they are more likely to comply with and less likely to seek to avoid? There is considerable debate and

[9] Ashton (2008), p30.

disagreement amongst stakeholders as to the answers to such questions, which will be outlined in this report.

2. Context

In this part, we provide a brief context for a discussion of our research findings. Issues associated with high cost credit are complex, and cannot be considered in isolation from the broader picture of the consumer credit market in Australia.

At a national level, we are seeing increasing levels of household debt being carried by Australians, with Reserve Bank of Australia figures showing that consumers owed $800 billion to banks alone in April 2008, an increase from $566 billion in April 2005.[10] This figure has been showing an upward trend for at least the last 10 years.

At the same time, interest rates have been rising, and housing affordability is decreasing. Recent media reports on foreclosure levels in Sydney and Melbourne highlight the significant consequences of unsustainable levels of household debt for families.[11] Increasing housing costs are also rampant in the private rental sector, and there is simply not enough public housing to meet the demand for low-cost housing. [12] Other basic living expenses (petrol, basic food items, utilities, etc) are becoming more expensive over time, and individuals are expected to shoulder more in terms of education costs, medical costs, retirement savings, and other items that were previously funded largely by the state.

In this environment, some households are becoming overcommitted and burdened with unsustainable debt, and some lenders provide credit too readily. High debt burdens can particularly impact on households on low incomes. However, it is often low income households, those living in poverty, who have a great need for finance (at least in small amounts).

As a report by the Department of Trade and Industry in the UK notes:

> Households on very tight budgets are among those most likely to need to borrow, being less likely to have savings safety nets in a case of emergency or to be in a position to save towards essential services.[13]

According to a report prepared for the Queensland Council of Social Services, 'approximately 10 percent of Queenslanders live in circumstances where their basic needs

[10] See http://www.rba.gov.au/Statistics/Bulletin/D05hist.xls.
[11] See for example, 'RBA probes housing loan stress levels', *Australian Financial Review*, 7 February 2007, p 1.
[12] See for example, 'Rent spike hits families', *Courier Mail* 18 December 2006, at http://www.news.com.au/couriermail/story/0,23739,20947777-3102,00.html.
[13] Department of Trade and Industry, UK (2004), p 10

are not being met'[14] – a small loan can help to bridge the gap between income and basic expenses, at least on a temporary basis.

These consumers are often excluded from the mainstream consumer credit market because they are not seen as a good credit risk; their incomes are too low; and/or because small loans are not offered by mainstream institutions. Most mainstream lenders have minimum personal loan amounts of between $3000 and $5000, however, a person on a low income may want to borrow only $500 or $600 to, for example, pay for the car registration, or to replace a broken fridge or washing machine.[15] Chapters 7 and 8 of this report discuss in more detail some of the characteristics and situations of customers of fringe lenders.

These small amount loans *are* available in the fringe or micro-credit market but at a much higher cost of credit than is available in the mainstream market, as can be seen from our results in Chapter 7. The result is that those who are the most in need of affordable finance are paying the highest costs. In turn, the repayment obligations for high cost loans can impose even greater financial strain on households, and can increase their financial vulnerability.

These customers can be regarded as suffering from financial exclusion, in the sense of exclusion from the mainstream market. Financial exclusion in the Australian context has been defined as:

> 'the lack of access by certain consumers to appropriate low cost, fair and safe financial products and services from mainstream providers.'[16]

To date, however, there has not been an adequate assessment of the extent of financial exclusion in Australia, and there is criticism of an approach that assesses financial exclusion on the basis of ownership, or lack of ownership, of particular financial products.[17]

As can be seen in chapter 10 of this report, community and consumer advocates are concerned that financial exclusion is becoming a more significant problem,[18] and that there is a lack of public recognition or response to the issues raised. This contrasts with the situation in both the United Kingdom and the United States, where government agencies have implemented programs and policies designed to combat financial exclusion and its detrimental effects.[19]

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[14] University of Queensland Social Research Centre (2006), p 34.
[15] See for example, Wilson (2002), p 66-67.
[16] Chant Link (2004), p 58
[17] Howell & Wilson (2005), p 131-2
[18] See also Chant Link (2004), pp 82, 107.
[19] Eg in the UK a growth fund of £36 million was established in December 2004 to increase the availability of affordable personal loans through not-for-profit lenders such as Community Development Financial institutions (CDFIs), see Department for Work and Pensions (2007); the Community Investment Tax Relief Scheme offers tax relief to individuals or organisations that invest in CDFIs, see Parker and Lyons (2003); and in the USA the *Community Reinvestment Act* operates to encourage investment by banks in community development and the provision of loans to low income members of the communities in which they operate, see Squires (ed) (2003).

On the other hand, the MISC report suggests that the focus should be on consumers who are financially stressed, rather than those who are financially excluded.[20] Indicators of financial stress include asking for help from welfare, asking for help from family or friends, inability to pay bills on time, inability to pay rent/mortgage, inability to raise $2000 for something important.[21]

At the same time as a potential increase in overcommitment and financial exclusion, the capacity of services such as financial counsellors to respond to the need and assist those in debt and financial hardship are limited because of the lack of funding, even as the demand for their services is increasing.

There is little publicly available data on the market for fringe or micro-lending, including data on the number and frequency of loans made; the demographics of customers; and the reasons for using this form of lending. The consumer credit statistics published by the Reserve Bank of Australia and Australian Prudential Regulatory Authority do not cover this form of lending. The industry members and associations have not publicly disclosed comprehensive information about industry operations and scope, although some data about products from individual lenders has been made available in submissions (for example, to the Victorian Consumer Credit Review).[22] Media reports suggest that the sector is growing at a rapid rate, and this is certainly the trend that was predicted in early reviews of the fringe lending sector.[23]

The most comprehensive publicly available analysis of the industry to date is a report prepared by MISC Australia and commissioned by the Victorian Government ("the MISC Report").[24] This report reviews the available data and the estimates on the size and scope of the micro-credit industry in Australia, and in overseas jurisdictions. It highlights inconsistencies and lack of rigour in the existing estimates used by researchers and policy makers, and suggests an estimate of $10 billion as a potential domestic market flow (annual new credit commitments), if data from the United States can be accurately projected onto the Australian market.[25]

There has been some Australian research on the customers of fringe and micro-lenders, however, these have generally been on a small scale. For example, the Wilson research on payday lending involved short surveys with 78 customers and in-depth interviews with 12 customers,[26] and we are not aware of any other published studies of Australian payday lending customers. This study and other studies of fringe lending and micro-finance

[20] MISC Australia (2006), p 18.
[21] MISC Australia (2006), pp 21-22.
[22] See Consumer Affairs Victoria (2006), pp. 38, 106.

[23] See comments in Wilson (2002); QOFT (2000)
[24] MISC Australia (2006)
[25] MISC Australia (2006), pp 50-57.
[26] Wilson (2002) pp 15-16.

customers[27] are very important and have made a significant contribution to understanding many of the issues around fringe lending, and the circumstances of some fringe lending customers. The findings are also generally consistent with research on fringe lending in other countries.[28]

The MISC report also highlights the lack of detailed studies on customers of micro-lenders, and proposes an extensive research project, with a potential dataset of over 6,000 customer responses Australia-wide.[29] At the time of writing this report, it is not known whether this research has commenced.

It is hoped that, as governments increasingly recognise the importance of evidence-based policy making, additional resources will be allocated to research on issues around fringe lending and financial exclusion. This report itself hopes to contribute to the store of knowledge on this sector.

[27] For example, Scutella and Sheehan (2006).
[28] For example, Lott and Grant (2002)
[29] MISC Australia (2006),p 120-121.

3. Regulatory framework

In this part of the report, we summarise the regulatory framework governing the cost of consumer credit in Australia, including recent reviews and announcements by State and Territory Governments.

Uniform Consumer Credit Code

The primary regulatory instrument governing the consumer credit industry in Australia is the *Uniform Consumer Credit Code* (UCCC). The UCCC is implemented as a Schedule to the Consumer Credit (Queensland) Act 1994, and each of the other Australian States and Territories have passed legislation implementing the UCCC in their jurisdiction.[30]

Apart from interest rate caps imposed in some States as outlined below, the only direct constraint on the cost of consumer credit that is imposed by the UCCC is found in section 72. This section provides a remedy for some costs if they are unconscionable:

The Court may, if satisfied that ...

- a change in the annual percentage rate or rates ...; or
- an establishment fee or charge; or
- a fee or charge payable on early termination of a credit contract; or
- a fee or charge for prepayment of an amount under a credit contract;

is unconscionable, annul or reduce the change or fee or charge ...

Consumer advocates have questioned the effectiveness and practicality of this provision,[31] and we are aware of only one case that has considered the application of s 72. In 2005, in a case instituted against City Finance and Cash Solutions franchisees, the Victorian Civil and Administrative Tribunal found that establishment fees of between one-third and one-half of the principal were not unconscionable. In this case, the Director of Consumer Affairs had asked the Tribunal to find that the

> "effect of section 21(1)(b), combined with section 72(1)(a) and (3) of the Code, is that a credit contract must not impose fees that are unconscionable; and, in particular,

[30] Note that, in Tasmania and Western Australia, amendments to the template legislation do not come into force immediately. Instead, the proposed amendments must be the subject of a Governor's order, and the draft order must be approved by both Houses of Parliament.
[31] Niven and Gough (2004), pp 18-19 (re: establishment fees), p 21 (re: early termination fees).

must not impose an establishment fee which is greater than the credit provider's reasonable costs of determining an application for credit and the initial administrative costs of providing the credit, or the average of these costs in respect of a class of contract."[32]

The Tribunal found that the Code did not include an implied obligation to refrain from charging an unconscionable establishment fee; it simply means that a lender is at risk if it charges an unconscionable establishment fee.[33] The Tribunal also noted that the question of whether or not a fee was unconscionable would depend on the circumstances, and that the fact that a fee exceeded a credit provider's costs would only be one factor in considering unconscionability.[34] By implication, then, the Tribunal could not determine in the abstract whether a particular establishment fee, charged to all potential borrowers, was unconscionable.

The Tribunal also found that in this case, the application fee, establishment fee and loan maintenance fees, could not be characterised as interest,[35] and therefore were not required to be included in the calculation of whether the loan was consistent with the interest rate cap in Victoria.

As the Report of the Consumer Credit Review in Victoria notes:

> The result of this case demonstrates the practical difficulty and uncertainty surrounding one of the few provisions in the Code designed to place some restriction on what is often a significant credit charge.[36]

More broadly, the UCCC also prohibits unjust credit transactions (section 70). Again, however, this provision has had limited impact in practice on high cost credit. Section 70(2) provides that, in assessing whether a transaction is unjust, a court or tribunal may have regard to:

> (m) whether the terms of the transaction ... is justified in light of the risks undertaken by the credit provider; and
> (n) the terms of other comparable transactions involving other credit providers, and if the injustice is alleged to result from excessive interest charges, the annual percentage rate or rates payable in comparable cases.

However, cases decided under s 70 have tended to focus on issues of procedural injustice, and, until recently, there were no cases that found a transaction to be unjust because of excessive interest rates, fees or charges. A case decided in the Queensland District Court in

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[32] *Director of Consumer Affairs v City Finance Loans (Credit)* ("City Finance case") [2005] VCAT 1989 (30 September 2005), para 27.
[33] City Finance case Para 29
[34] City Finance case para 31, 32.
[35] City Finance case para 16-22.
[36] Consumer Affairs Victoria (2006), p 110.

early 2008, found that a transaction could be re-opened as unjust under s70, in part because of an interest rate described as “simply not justified” and “simply unjust”. The case [37] concerned a loan to a Mother and son as co-borrowers, for a total amount of $15,500 which was used for return airfares for a friend of the son’s, car repairs for the son’s car, and the purchase of Christmas presents. The applicable interest rate was 204% per annum. The son was described as a risky borrower with a poor credit record who could not obtain finance through mainstream lenders. Both the magistrate at first instance and the judge who heard the appeal, agreed that a higher than usual commercial rate of interest was justified to reflect the level of risk associated with this borrower. However they also agreed that a rate of 204% p.a. was not justified. The magistrate re-opened the transaction and fixed the interest rate at 30%. The District Court judge upheld the decision to re-open the transaction but fixed the interest rate at 48%, taking judicial notice of the fact that that was the interest rate cap adopted in other Australian jurisdictions and that was soon to be adopted in Queensland. It is important to note that the judgment makes it clear that a high interest rate in itself would not be sufficient to declare a transaction as unjust, and that other factors were important in this case, namely the unequal bargaining positions of the parties, the fact that there had been no negotiations with respect to the interest rate, and the fact that the loan was secured by a car and the borrower had in fact lost his car as a result of the transaction.

The Uniformity Agreement

The UCCC does not deal with all matters pertaining to consumer credit. An agreement between all States and Territories setting out the framework for uniform credit laws provides that a number of matters are to be treated as non-uniform matters, and each jurisdiction given the freedom to regulate or not regulate in relation to those matters.[38]

The non-uniform matters include ‘the fixing of maximum interest rates payable under consumer credit contracts’.[39] To date, only Victoria, New South Wales, and the ACT have introduced regulations fixing maximum interest rates. Queensland followed in mid-2008, when part 2 of the *Consumer Credit (Queensland) and Other Acts Amendment Bill 2008* commenced. Subject to the prohibition against unconscionable fees and charges (see above), all other States and Territories have left it to the market to determine the cost of consumer credit. However, as we discuss below, some jurisdictions are considering regulating in this area.

The Victorian, New South Wales and ACT regulations all differ slightly, and they are outlined below.

NSW Consumer Credit Act

[37] *Cash Solutions (Australia) Pty Ltd v Turner & Anor* [2008] QDC 108
[38] See clause 12 Australian Uniform Credit Laws Agreement 1993 (‘Uniform Agreement’), available at http://www.creditcode.gov.au/display.asp?file=/content/original_credit_code.htm.
[39] Clause 12, Uniform Agreement.

Under s 11 of the *Consumer Credit (New South Wales) Act 1994* ("the NSW Act"), the regulations may prescribe a maximum annual percentage rate (APR) for a credit contract or class of contracts. In reliance on this provision, the regulations provide that:

> the maximum annual percentage rate for a credit contract to which the Code applies is 48 per cent.[40]

The maximum APR is effectively an 'all-inclusive' APR, as interest charges and all other credit fees and charges under a credit contract must be taken into account in calculating the APR.[41]

In 2002, when the 'all-inclusive' APR was first introduced, it applied only to short-term consumer credit contracts; that is, contracts with terms not exceeding 62 days.[42] However, in March 2006, further amendments to the Act came into force, extending the requirement to include all fees and charges in the calculation of the APR to all credit contracts covered by the Consumer Credit Code, regardless of their term.[43] The relevant NSW Minister described the changes as necessary because:

> There is recent evidence that the fringe lending market—a term used to describe credit providers who offer relatively small high-cost loans—has reinvented itself from "payday lending" by increasing the term of loan products to a period greater than 62 days. This has allowed fringe lenders to continue to impose fees and charges far in excess of reasonable costs. ... This bill will address those predatory lending practices by closing a loophole and requiring all consumer credit loans regulated by the Consumer Credit Code, with the exception of certain products offered by authorised deposit-taking institutions, to include fees and charges in the calculation of the maximum annual percentage rate, regardless of the term of the loan.[44]

A contract is void to the extent that it imposes an annual percentage rate in excess of the prescribed amount, and any amount paid under the contract may be recovered.[45] In addition, it is an offence for a credit provider to enter such a contract.[46]

Australian Capital Territory Consumer Credit Act

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[40] *Consumer Credit (New South Wales) Special Provisions Regulation 2002*, regulation 7(1).
[41] Consumer Credit (New South Wales) Act 1995 s 11(2); Consumer Credit *Consumer Credit (New South Wales) Special Provisions Regulation 2002*, regulation 7(2).
[42] Consumer Credit (New South Wales) Amendment (Pay-day Lenders) Act 2001, schedule 1, amendment to s 11.
[43] Consumer Credit (New South Wales) Amendment (Maximum Annual Percentage Rate) Act 2005, schedule 2, amendment to regulation 7.
[44] NSW Parliament Hansard, Legislative Assembly, Second Reading Speech, The Hon Diane Beamer, Minister for Fair Trading, 19/10/2005, p 18907, at http://www.parliament.nsw.gov.au/prod/parlment/hansart.nsf/8bd91bc90780f150ca256e630010302c/858e002428d0f1fcca2570a80007a52f!OpenDocument, viewed 12/02/2007.
[45] Consumer Credit Code s 21(2).
[46] Consumer Credit Code s 22; Consumer Credit (New South Wales) Act 1994, s 11(2).

The ACT approach to regulating interest rate caps is similar to that in NSW. Section 8B(1) of the Consumer Credit Act 1995 (ACT) provides that the regulations may prescribe a maximum APR, and the relevant regulation sets the maximum APR at 48%.[47] In calculating the APR, all interest charges and other fees and charges must be taken into account.[48]

As with NSW, the all-inclusive APR originally applied only to short-term credit contracts, but in 2005, the requirement was extended to all credit contracts covered by the Code, irrespective of their term.[49] Again, the explanation given for the 2005 change was to plug a gap exploited by short-term credit providers:

> This ensures a fairer system where hidden fees and charges do not enable credit providers to charge their customers extortionate amounts. The act has also been amended to remove references to short-term credit contracts as the section now applies to both short and long-term credit. This is to ensure that short-term credit providers do not evade the operation of the section by providing credit outside the short-term time lines.[50]

A provision of a credit contract that seeks to impose an APR of more than 48% (including fees and charges) is void, and it is offence to require payment of the prohibited amount.[51]

Victorian Consumer Credit Act

Although Victoria also imposes an interest rate cap, the approach differs from that taken in NSW and the ACT.

In Victoria, there is a maximum interest rate of 48% on unsecured loans;[52] and a maximum interest rate of 30% on loans secured by a mortgage.[53] A credit contract that is covered by the Code and exceeds the 48% limit is not enforceable, and must not be entered into by a credit provider,[54] and a mortgage that secures a loan that exceeds the 30% limit is void.[55] However, the cap is on interest rates only, and the legislation does not require fees and charges to be included when determining the interest rate.

The recent Consumer Credit Review in Victoria noted that:

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[47] Consumer Credit Regulation 1996 (ACT), regulation 5(1).
[48] Consumer Credit Regulation 1996 (ACT), regulation 5(2).
[49] See Justice and Community Safety Legislation Amendment Act 2005 (No 4) (ACT), Schedule 1, Part 1.8, amending section 5 of the Consumer Credit Regulation 1996.
[50] Legislative Assembly for the ACT, Hansard, 20 October 2005, p 3912, The Hon John Stanhope, Chief Minister and Attorney General, at http://www.hansard.act.gov.au/hansard/2005/week12/3912.htm, viewed 12/02/2007.
[51] Consumer Credit Act 1995 (ACT), s 8B(3).
[52] Consumer Credit (Victoria) Act 1995 s 39(1).
[53] Consumer Credit (Victoria) Act 1995 s 40.
[54] Consumer Credit Act (Victoria) Act 1995 ss 39(1), 39(3).
[55] Consumer Credit (Victoria) Act 1995 s 40.

> The annual interest rate charged for small amount credit is often as high as the law permits – 48 per cent for unsecured credit and 30 per cent for secured credit (the security usually being a car or household goods). While the rates substantially exceed the market rates for fixed term credit (currently less than 10 per cent) or indeed for credit cards (currently most non-store credit card interest rates are below 20 per cent), the fact that the term of small amount loans tends to be fairly short means that the actual dollar amount of interest payable does not form a major part of the cost.
>
> Usually, the main cost component for the consumer is in the form of fixed fees and charges, such as establishment fees, or simply a dollar amount on a sliding scale, depending on how much is borrowed ...[56]

Later the report notes that:

> the effective rate of interest can lawfully exceed the ceiling because fees and charges are not part of the interest calculation.[57]

As we discuss later, stakeholders view this as a major limitation on the effectiveness of the interest rate ceiling in Victoria.

Recent amendments to the Queensland Consumer Credit Act

Under the *Consumer Credit (Queensland) and Other Acts Amendment Act* 2008, and the *Consumer Credit (Queensland) Special Provisions Regulation* 2008, Queensland has followed the NSW model, in that the interest rate cap is set at 48% per annum. The legislation provides that:

> for calculating the annual percentage rate of a credit contract....not only interest charges but all credit fees and charges under the credit contract are to be included.

The legislation came into effect on 31 July 2008.

Review processes in other jurisdictions

At the time of writing (and subsequent to the empirical research conducted for this report), South Australia has commenced review processes on the merits or otherwise of introducing controls on the cost of credit.[58] In the case of South Australia, this discussion is being examined in the context of a broader review of payday lending.

[56] Consumer Affairs Victoria (2006), p 106.
[57] Consumer Affairs Victoria (2006), p 110.
[58] See QOFT (2006); Office of Consumer and Business Affairs (SA) (2006) .

In South Australia, the Parliamentary Economic and Finance Committee initiated an inquiry into the provision of consumer credit and investment scheme. Relevant to this report, the Committee examined:

> 5. Fringe credit providers and the emergence of "payday lenders" and other forms of short-term credit; ...
> 8. The current consumer credit and finance regulatory regime.[59]

In its final report, the Committee recommended to the Minister:

> Consideration of capping annualised interest rates and fees/charges. The Committee does not necessarily endorse the 48% cap, but is of the opinion further research is needed of cap or restraint mechanisms in use nationally and internationally.[60]

On 21 October 2007, the Minister for Consumer Affairs announced that the Government would introduce new legislation 'designed to crackdown on unscrupulous operators in the payday lending industry', and that would include introducing a maximum interest rate cap that encompasses fees and charges.[61] At the time of writing, the proposed legislative amendments do not appear to have been released for comment or introduced in Parliament. (An earlier Bill designed to cap interest rates was introduced into the SA Parliament by an Opposition member in November 2006, but the Bill appears to have lapsed.[62])

It has also been reported that the Western Australian government intends to introduce an interest rate ceiling, inclusive of fees and charges,[63] although it does not appear that the Government has publicly announced such an intention.

At the national level, the Uniform Consumer Credit Code Management Committee (which includes representatives from all states and territories) has a current project on fringe lending. A discussion paper was released in August 2003, and it noted that an interest rate cap was one policy option, but that 'At this stage a national interest rate caps is not supported and it is up to individual jurisdictions to determine the issue'.[64]

A Regulatory Impact Statement has subsequently been released, and this expresses a similar view that the issue should not be considered at the national level at this time:

> As interest rate caps are specifically excluded from the uniformity agreement, there is no regulatory power to implement them at a national level. National implementation of interest rate caps would need to be by amendment of the

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[59] Economic and Finance Committee, SA Parliament (2007), p 7.
[60] Economic and Finance Committee, SA Parliament (2007), p 103.
[61] Rankine (2007).
[62] Consumer Credit (South Australia) (Maximum Annual Percentage Rate) Amendment Bill 2006.
[63] Consumer Affairs Victoria (2006), p 111.
[64] Ministerial Council on Consumer Affairs (2003), p 43.

> uniformity agreement at a ministerial level. It is therefore not appropriate to conduct a regulatory impact analysis of this option. For those States and Territories that have not implemented interest rate caps, consideration of the impact of such proposals will need to be undertaken at a State level.
>
> Given the exclusion of interest rate caps from the uniformity agreement, further analysis of this option has not been undertaken.[65]

Consequently, the Consultation Package (including draft legislation) released in August 2007 does not include any amendments that would introduce an interest rate ceiling.[66]

General Fair Trading Legislation

In addition to the UCCC, each State and Territory's Fair Trading legislation prohibits misleading or deceptive conduct, unconscionable conduct and other unfair trading practices.[67]

Similarly, at the Commonwealth level, the *Australian Securities and Investments Commission Act 2001* (Cth) ("the ASIC Act") regulates consumer credit. The ASIC Act prohibits various unfair practices, including misleading or deceptive conduct and unconscionable conduct,[68] but it does not impose any specific controls on the cost of credit.

While the prohibitions against unconscionable conduct could theoretically be relied upon to address issues of high cost credit, in practice, successful cases have focused on procedural unconscionability. Courts have tended to shy away from determining that a credit contract (or other consumer contract) is unconscionable simply because the price might be considered excessive.[69] As the Queensland discussion paper notes, these provisions:

> ... have been of minimal practical assistance to consumers in the area of high interest loans.[70]

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[65] Ministerial Council on Consumer Affairs, (2006).
[66] Ministerial Council on Consumer Affairs, (2007).
[67] See for example, sections Fair Trading Act 1989 (Qld) ss 38 (misleading or deceptive conduct), 39 (unconscionable conduct), 40 (false or misleading representations.
[68] *Australian Securities and Investments Commission Act 2001* (Cth), s 12DA.
[69] See for example, *Dale v Nichols Constructions Pty Ltd* [2003] QDC 453, where the Court considered whether the interest rate on the loan was sufficient to make the transaction unjust. Also Howell (2006).
[70] QOFT (2006), p 19.

4. Commentary on interest rate caps

In August 2005 the Centre for Credit and Consumer Law released a background paper which analysed the literature on interest rate caps and identified the arguments given for and against capping.[71] More recently the Consumer Action Law Centre has prepared a draft literature review as part of a report on payday lending, which reviews the more recent literature and again analyses the arguments given for and against capping.[72] In this chapter we will summarise those key arguments drawing on these reports as well as other literature.

Key arguments against the introduction of an interest rate cap can be summarised as follows:-

1. A cap will exacerbate financial exclusion, by removing an option for people who cannot access credit through mainstream services.[73]

This argument has been articulated as a warning that:

> Policy makers and regulators must be mindful that setting caps on fees or setting implied interest rates arbitrarily low could easily curtail or eliminate the flow of credit to the high-risk borrowers who need it most.[74]

The argument was accepted by the UK government when it introduced the Consumer Credit Act 2006 without a cap:

> The government analysed independent research and decided not to introduce an interest rate ceiling in the UK. Introducing caps would harm the very consumers they are supposed to help. Caps would reduce the range of credit products available, force vulnerable consumers to use inappropriate alternative products or even to go outside the regulated market to loan sharks. However, we will look again, for example, if presented with fresh evidence that overturns the original findings.[75]

The CALC review is quick to dismiss this argument noting that:

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[71] Howell (2005)
[72] Ashton (2008)
[73] Howell (2005), p 26, citing Engel and McCoy (2002), p1313; Ashton (2008) pp8 & 9.
[74] Stegman (2007) pp 186-187
[75] See "Frequently Asked Questions on Consumer Credit Act 2006", http://www.berr.gov.uk/consumers/consumer-finance/credit-act-2006/FAQs/page244.

> While individual consumers in financial hardship may very well desire the opportunity to obtain credit no matter how bad the terms, as a matter of policy it is not at all clear that the withdrawal of loans with exorbitantly high interest rates is a bad thing.[76]

This view is supported by the findings of a US organisation that surveyed people in North Carolina following the termination of payday lending in that state, to ascertain whether the payday lenders were missed by those people.[77] The interviewees were comprised of 159 households that had had a recent financial crisis, and 240 households that had not. It is worth setting out at some length some of the key findings.

> The vast majority of households surveyed- more than three out of four- said the elimination of payday lending had no effect on their household. This percentage declined only slightly for those families that experienced financial distress (71%) or who had been payday borrowers in the past (68%). The overwhelming majority of households – almost nine out of ten- said payday lending was a 'bad thing'. This strong negative rating held true for households that had experienced a financial hardship or had borrowed from a payday lender in the past. Respondents who felt they were better off without payday lending well out-numbered those who thought they were better off with it. For the full sample, twice as many respondents said the absence of payday lending has had a positive effect on their household than said it has had a negative effect. The 159 respondents who actually experienced a recent financial shortfall- arguably those most likely to consider a payday loan and miss its availability- had responses similar to the overall survey population…former payday loan borrowers generally felt the absence of payday lending to be a good thing, rather than a bad thing.[78]

The argument that a cap will exacerbate financial exclusion depends upon current high rates reflecting the true cost of fringe lending such that an interest rate cap will cause fringe credit providers to withdraw from the market. This is certainly the assertion of fringe credit providers themselves, for example Cash Doctors' assertion that:

> Cash Doctors' average cost for providing a loan to date is $100. If Cash Doctors charged a mainstream unsecured loan interest rate of 12% on a $200 loan over our average loan period of 24 days, $1.58 of gross revenue would be generated, resulting in a $98.42 loss on the loan. If Cash Doctors charged the proposed capped interest rate of 48% per annum, $6.31 gross revenue would be generated yielding a $93.69 loss on the loan.[79]

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[76] Ashton (2008), p9.
[77] Center for Community Capital (2007)
[78] Center for Community Capital (2007) p4.
[79] Ellis and Teahan (2007)

While most commentators accept that that is the case, there is no empirical evidence as yet to support the argument that fringe lending cannot continue on a sustainable basis under a 48% cap, given sufficient loan volume and greater efficiencies in product delivery. Fair Finance UK is an organisation that is operating a sustainable small loans social enterprise in London at rates of between 28% and 35% per annum[80] and National Australia Bank is currently engaged in an experiment in partnership with fringe lender Mobile Finance Pty Ltd trading as Money Fast to demonstrate the actual costs of offering loans in the fringe market. They aim to "break even", lending at a rate of 28.25% per annum.[81]

There is evidence of interest rate caps leading to an absence of fringe credit providers in the market, one example being Quebec where there is a 35% cap and where no payday lenders operate.[82] Such evidence:

> ...may be used to illustrate the impact that regulatory decisions may have on the continued viability of the industry.[83]

In relation to Quebec, however:

> It is important to highlight that Credit Unions have played a much more prevalent role in the Quebec alternative credit market, and accordingly, interest rate caps are not a complete explanation.[84]

It seems likely that a viable, safe affordable alternative to fringe lending may be just as effective in discouraging fringe lenders from entering or continuing in a market, as an interest rate cap.

New York is another example of a state without payday lenders however this is unsurprising given its general cap of 6% per annum (with an exception allowing banks to charge 16% per annum).[85] This is clearly a rate aimed at prohibition not just regulation.

2. Diversity and competition will be reduced by interest rate cap.[86]

While there is evidence in chapter 7 of this report, of a diversity or range on the annual percentage rates of interest charged by fringe lenders, there is no evidence of competition on the basis of price in this market as will be discussed below.

The CALC notes that such an argument has some basis in well functioning markets, but argues that the fringe credit market is not a competitive, well functioning market and that

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[80] See www.fairfinance.org.uk
[81] See www.nab.com.au
[82] Ben-Ishai (2008) pp32 & 33
[83] Ben-Ishai (2008) p33
[84] Ben-Ishai (2008) p33
[85] Mann & Hawkins (2007) p31.
[86] Howell (2005), p27; Ashton (2008), pp5-7.

fringe borrowers do not fit within the "rational actor" model that underpins the neoclassical economic theory driving this argument.[87]

A related argument is that if a cap is introduced, credit products currently offered at below the capped amount will gravitate upwards towards the cap.[88] This argument is not borne out by evidence and there is certainly little likelihood that mainstream products will "gravitate upwards" towards this ceiling, given strong reputational concerns in that sector.

3. Interest rate caps are easily avoided, difficult to enforce and waste regulatory resources.[89]

The effectiveness of the cap in New York in prohibiting payday lenders from operating there is said to be not so much about the cap, but more about effective enforcement. New York regulators believe that:

> New York has managed to exclude payday lenders only through conspicuously aggressive enforcement…the large national providers know that they would face litigation immediately if they opened stores in New York.[90]

Mann and Hawkins argue with regard to New York that:

> The difference, it seems, is not in the usury limit but in the ability of regulators to bring and prevail in litigation to enforce them.[91]

To be effective, a cap must be accompanied by effective enforcement which, it should be acknowledged, is likely to be costly. Mann & Hawkins give the example of Texas as a state with a 24% cap, but where the law is circumvented by fringe lenders operating in Texas but partnering with out-of-state banks.[92]

There are concerns regarding the "blunt" nature of an interest rate cap, and suggestions that a "structured cap" based on calculations of all costs (defined either under the heading of "fees" or "interest") of lending, is preferable.[93] This would enable regulatory control over the costs of fringe credit, but in a manner informed by *actual costs* as demonstrated by empirical evidence. It could be argued that this would allow fringe products to remain available to consumers but on fairer terms.

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[87] Ashton (2008) p7
[88] See discussion in Howell (2005), pp 29-30.
[89] Howell (2005), pp27 & 28, citing Durkin (1993), p828.
[90] Mann & Hawkins (2007) pp31 & 32
[91] Mann & Hawkins (2007) p32
[92] Mann & Hawkins (2007) pp 29-31
[93] Manning & De Jonge (2006) pp26-27

A similar idea is to allow the fringe industry to put forward its own suggestion for regulation with a view to arriving at a regulatory structure acceptable to both regulators and the industry, enforced under a model of "enforced self-regulation", described as the public enforcement of privately written rules.[94] Such privately written rules are likely to be well informed and therefore more effective and appropriate[95] and clearly less likely to lead to a departure of fringe credit providers from the market. Importantly in terms of regulatory efficiency, this model would be less likely to lead to attempts by the industry to circumvent or avoid regulation through loopholes. One example is what is described by Mann and Hawkins as "explicit toleration".[96] In the United States, a group representing major payday lenders, has prepared a model bill[97] which has been adopted in a number of States in the US, for regulating the payday lending industry.

> The model bill contains several notable features: loans can only be made for $500 or less, loans can only be renewed 3 times, borrowers can rescind a loan within a day, lenders must obtain licences to operate, lenders cannot use threats of criminal prosecution for check fraud, and most striking, fees are capped at 20% of the first three hundred dollars lent and 7.5% of any funds lent over three hundred dollars. [98]

Criticisms that might be raised against such a model would include the inappropriateness of setting a cap at the point where the products are profitable for suppliers, as opposed to the point at which consumers are adequately protected against the risk of finding themselves in "debt traps" and "debt spirals". The focus of any capping measure should be on what is reasonable and affordable for consumers, and will not cause harm to vulnerable consumers. If a product cannot be offered at such a rate then it is arguable that it should not be offered at all.

4. In the case of one type of fringe loan- the payday loan- the loan amount is so small that even a seemingly high rate of interest does not equate to anything more than a minimal debt burden on the borrower.[99]

The CALC review notes however that their own research:

> ...indicates that 40% of payday loans are for $500 or more (and 14% for $1000 or more). When one considers that payday borrowers can borrow $1000 or more per loan, and take out several loans per year from the same lender or a different lender, it becomes clear that it is often not the case that payday loans are for small dollar amounts, and for this reason it is not reasonable to conclude that the debt burden from these exorbitantly priced loans is relatively low.[100]

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[94] Baldwin & Cave (1999) p133
[95] Baldwin & Cave (1999) p 40
[96] Mann & Hawkins (2007) pp24 & 25
[97] The Deferred Deposit Loan Bill.
[98] Mann & Hawkins (2007) pp24 & 25
[99] Ashton (2008), p11.
[100] Ashton (2008), p11

A related argument is that it is not the cost of the original loans that are problematic, so much as the rollovers and renewals of loans, and that this should be the focus of regulatory intervention as opposed to a cap:

> Policymakers and regulators should focus more of their attention on ways to limit rollovers and back-to-back renewals of payday loans, rather than focusing on the price of a single short-term advance.[101]

The evidence presented in chapter 7 of this report confirms that an ability to be "rolled over" is a common feature of many fringe credit products, with 15 out of the 21 payday products examined and 76 out of the 102 non-payday products examined, having this feature.

Key arguments in favour of a cap were:-

1. Caps are a means of protecting people from usury and exploitation.

The CCCL report quotes Ramsay's comment that:

> Ceilings are one attempt to ensure that individuals do not pay what are regarded as exploitative rates for credit.[102]

This may be particularly important in a non-competitive market where borrowers find themselves in an unequal bargaining position with little choice between products.[103] This problem is compounded by the current heavy reliance on disclosure regulation to protect consumers. Mandating disclosure by credit providers[104] as a means of consumer protection is based on an assumption that if borrowers have all of the relevant information they will be in a position to make rational and appropriate choices. This is not going to adequately protect vulnerable low income consumers who have no choice of product.[105]

By limiting the amount that can be charged for credit, those who can least afford to pay high costs for credit are protected from doing so. In discussing the historical commitment to usury laws in the US, one commentator notes that:

> This commitment sounds in an ancient moral tradition sceptical of the advisability of high-cost loans to those with limited means.[106]

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[101] Stegman (2007), p186
[102] Ramsay (2000), p20 quoted in Howell (2005), p 22.
[103] See discussion in Howell (2005) pp22-23, and in Ashton (2008), p 29.
[104] For example see sections 14 and 15 *Uniform Consumer Credit Code*.
[105] Ashton (2008), p31.
[106] Peterson (2008) p6

2. High cost credit reduces the asset-building capacities of low-income households through causing or exacerbating over-indebtedness.

Whereas accessing affordable credit can assist people to asset build, high cost credit can lead to "debt spirals" and "debt traps". CALC assert, with respect to payday lending, that:

> Payday lending causes a debt trap- that is, it causes consumers to take on debt loads that their income is insufficient to pay off. It also leads to debt spirals- that is, revolving and increasing debt.[107]

The problems that arise due to "repeat borrowings" and the consequent over-indebtedness of low income consumers[108] will clearly have an impact on their purchasing power and ability to acquire assets.

In the US, one organisation has noted that:

> Those states which enforce a comprehensive interest rate cap at or around 36 percent for small loans have solved their debt trap problem; realizing a savings of $1.5 billion for their citizens while preserving a more responsible small loan market.[109]

3. Lack of competition in the fringe market permits excessive pricing and inefficiencies.

A lack of competition is evidenced by a lack of price advertising by fringe lenders in Australia.[110] Most advertising by fringe lenders promotes features such as 'easy access', 'no credit checks' and 'bankrupts okay', rather than the cost of the product.[111] There do not seem to be competitive forces operating in the fringe market with respect to price.

> Research indicates that payday lenders almost uniformly charge the highest rate permissible in their jurisdiction.[112]

Evidence also suggests that fringe lending is a highly profitable business for suppliers,[113]and there is no clear evidence as yet to suggest that fringe credit products cannot be supplied sustainably at a lower interest rate, such as at the 48% capped rate. In this regard we refer to the operations of Fair Finance UK and the NAB/ Money Fast experiment referred to above.

An argument can be mounted that in an uncompetitive market regulatory intervention is both justifiable and necessary.

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[107] Ashton (2008), p 26
[108] See discussion in Howell (2005), pp23 & 24; see also Reifner (2004), p3.
[109] King & Parrish (2007) p4
[110] Wilson (2002), p77; Howell & Wilson (2005), p. 136.
[111] Howell (2005), p 24 citing Wilson (2002), p 49.
[112] Mann & Hawkins (2007) p 35 citing Bair (2005), p29
[113] See discussion in Howell (2005), p25, citing Lott & Grant (2002), pp14 & 22; and Bruch (2000), p 1270.

> A government inappropriately cedes regulatory power to a private enterprise when it allows businesses to define the terms of commerce with consumers in realms in which competitive forces do not constrain the terms.[114]

4. Demonstrating a demand for fringe products does not justify their continued supply.

In this regard the CALC argues that we should not:

> Conflate demand with need....To argue...that wherever there is demand there ought to be supply, regardless of the social harm, is not helpful.[115]

This is consistent with Bruch's comment that:

> Payday lenders say they are providing a valuable service that borrowers are entitled to receive. Those outside the industry heartily agree that payday lenders are providing a service; however, they submit that this service is predatory, usurious, and unconscionable, and that in some cases denying credit to an individual is in the individual's best interest.[116]

This is a difficult argument in that it presumes to "know what is best" for low income consumers notwithstanding that they may be deprived of access to credit as a result. Financial exclusion, which in Australia is primarily about lack of access to mainstream credit particularly short term credit[117], has been shown to have significant social consequences.[118] Further, it has been argued that the provision of short term credit is an essential financial service which needs to be available to all members of the community in order to cover emergencies and smooth out the cost of large purchases.[119]

Perhaps a better argument is one that acknowledges the need to "meet the demand" but to do so in a safe and affordable way through ensuring the availability of safe and affordable credit options. The argument would be that regulators need to construct a policy and regulatory environment to encourage and facilitate safe and affordable small amount lending to low income consumers, to offer real choice in the market place. The point has been made that:

> Despite an obvious market, competition has failed to provide low-income consumers with short-term credit at rates comparable to those for more affluent consumers.

[114] Mann & Hawkins (2007) p37.
[115] Ashton (2008), p. 30.
[116] Bruch (2000), p1287
[117] See discussion in Howell & Wilson (2005) p129; and Chant Link and Associates (2004) p58.
[118] See discussion in Howell & Wilson (2005) pp130 & 131.
[119] See discussion in Howell & Wilson (2005) p130, citing Office of Fair Trading (UK) (1999), p19.

> Low-income consumers have identified the sort of financial product they require. It is a matter of social equity that it be provided to them at a fair and just price.[120]

And further that:

> The time has come to comprehensively address the plight of low-income consumers in need of short-term credit, and it is unacceptable to adopt the stance…which amounts to resignation to the fact that payday lending, an exploitative form of lending, is the best that can be made available to these consumers.[121]

[120] Wilson (2002), p82
[121] Wilson (2004), p206

5. Method

In addition to general literature reviews, the research involved:

- a telephone survey of micro-lenders in Queensland; and
- qualitative interviews with consumer advocates, mainstream and micro-lenders, and regulators.

Survey of Micro-lenders

The primary source of product data collection was the contacting of businesses located in Queensland and identified through the Yellow Pages and from a list of members of the Financial Services Federation. Seventy-five (75) telephone calls were placed over a twenty-eight day period in 2006, and this resulted in forty (40) responses. The responses yielded both quantitative and qualitative data.

Respondents to the survey were asked specific questions concerning a $300 personal loan product and a $1000 personal loan product. These amounts were chosen to serve as proxies for a small consumer loan and a large consumer loan respectively. Specific questions asked with respect to each product were:

- What was the minimum and maximum available terms of the loan;
- Was there a minimum income requirement;
- What were the total repayments over the minimum and maximum terms;
- Was there a default interest rate or other default penalty;
- Were there membership, establishment, administrative or other fees;
- Was security required to be provided by the borrower;
- Was the loan able to be rolled over.

Nature of businesses surveyed

The study sought to collect data pertaining to consumer credit products with traditionally higher rates of interest or repayments. Consistent with the aim of the study no data was collected from businesses which promoted themselves as or whose names suggested they were residential or commercial mortgage providers, commercial lenders or business financiers, leasing financiers or specialists, investment financiers or patient financiers.

Statistical Relevance

In order to estimate the potential number of consumer credit providers in the Queensland market a search of the Yellow Pages for "financiers" in Queensland was conducted, yielding 324 results. These results were filtered using a process where those business names containing the keywords "cash", "loans", "finance", "credit", "money" and "payday" (or derivations) were retained and these results which also containing the keywords "home", "mortgage", "rental", "leasing", "business", "investment", "capital", "equity", "asset", "management", and "commercial" were disregarded. Results pertaining to businesses known to be outside the scope of the survey were also disregarded (see below Nature of businesses surveyed). This procedure yielded 136 discrete results.[122]

This figure may be inflated because it is presumed that some businesses identified using the above criteria would provide an advisory and or investment service rather than lending. It may also be deflated because some businesses or franchisors may not list a separate number for each of their outlets or franchisees. It should be noted that of the 136 businesses, 67 are franchisees or similarly branded outlets, representing 13 franchisors or brands.

Results were obtained from 40 of the approximately 136 credit providers. The aim of the survey was not however to yield sample data from which robust statistical inferences about the underlying product population could be drawn, but rather simply to provide qualitative and quantitative information about products currently available in the marketplace and their attributes.

Locations of businesses surveyed

Data was primarily received from businesses operating in the Greater Brisbane Metropolitan Area. Regions which yielded data include:

- Brisbane
- Southport
- Gold Coast
- Sunshine Coast
- Ipswich
- Hervey Bay
- Rockhampton
- Gladstone

[122] This search was conducted on 17 July 2006

The Annual Percentage Rate

The annual percentage rate (APR) is a variable currently adopted by the *Uniform Consumer Credit Code* which serves as an annual reference percentage rate which must be disclosed in all consumer credit contracts.[123] It is from this rate that the product's daily, monthly, quarterly or half-yearly rate is derived by dividing the APR by the appropriate compounding frequency.[124] The relevant percentage rate of interest derived from the APR must be applied to the *unpaid balance* whenever an interest amount is calculated.[125] A rate constantly applied to the original principal would appear deceptively low in light of the interest actually required to be paid.

For the purposes of comparison rate calculation, the *Uniform Consumer Credit Code* stipulates that the APR must include all fees and charges in accordance with the following formula:[126]

$$APR = nr * 100$$

Where:

n is the number of repayments to be made per year under the credit contract, annualised so that it is assumed repayments would be made for an entire year, and

r is the solution to the following:

$$\sum_{j=0}^{t} \frac{A_j}{(1+r)^j} = \sum_{j=0}^{t} \frac{R_j + C_j}{(1+r)^j}$$

Where:

> ***j*** is the time, measured as a multiple (not necessarily integral) of the interval between contractual repayments that will have elapsed since the first amount of credit is provided under the credit contract, except that if the contract does not provide for a constant interval between repayments an interval of any kind is to be selected by the credit provider as the unit of time.
>
> ***t*** is the time, measured as a multiple of the interval between contractual repayments (or other interval so selected), that will elapse between the time when the first

[123] *Consumer Credit Code (Queensland) s15*
[124] *Consumer Credit Code (Queensland) ss25 & 26*
[125] *Consumer Credit Code (Queensland) ss25 & 26*
[126] *Consumer Credit Regulation 1995 (Queensland)* reg 33F

amount of credit is provided and the time when the last repayment is to be made under the contract.

Aj is the amount of credit to be provided under the contract at time j (the value of j for the provision of the first amount of credit is taken to be zero).

Rj is the repayment to be made at time j.

Cj is the fee or charge (if any) payable by the debtor at time j (j is taken to be zero for any such fee or charge payable before the time of the first amount of credit provided) in addition to the repayments Rj, being a credit fee or charge that is ascertainable when the annual percentage rate is calculated.

This methodology equates the product's periodic payments and fees to an all inclusive periodic rate of interest from which the all inclusive APR is then derived in the standard way. It is also the formula adopted in New South Wales to prescribe an all inclusive maximum allowable interest rate for consumer loans.[127]

This study adopted this methodology to calculate all inclusive APRs for each product to aid comparability.

Mainstream lenders

To provide a comparison, the websites of a number of mainstream lenders were also reviewed for information about product types and costs. Again, this was not a comprehensive survey, but the information was used for comparison purposes.

Qualitative interviews

A series of qualitative interviews were conducted with key stakeholders located both in Queensland and in jurisdictions that do have some form of interest rate cap (NSW, Victoria and the ACT). In total, 20 interviews were conducted (see Appendix A).

- Nine consumer advocates in Queensland, NSW, Victoria and the ACT;
- Five micro-lenders, operating in Queensland and/or NSW (three were interviewed together);
- Six staff from Government agencies, in Queensland, NSW and Victoria (two were interviewed together);

[127] *Consumer Credit (New South Wales) Act 1995* s11

- Seven representatives from five mainstream financial institutions with national operations (banks and finance companies); two institutions each provided two participants.

Potential participants were identified through the research team's existing knowledge and contacts in this area. Unfortunately, the response rate from the microlenders we approached for interview was poorer than was anticipated.

Potential interviewees were chosen as individuals with some relevant knowledge of the issue, but were not necessarily interviewed as a representative of their employer. This is particularly the case with the participants from government agencies – their comments should not be read as the views of their respective agencies or governments.

The interviews were conducted in 2006.

Interviews were taped and transcribed, and participants were given guarantees that no names or other identifying information would be disclosed in the published results of the research. The process for collecting data through the qualitative interviews was consistent with Griffith University's ethical research on humans' guidelines, and was approved by the Human Research Ethics Committee.

Stakeholder interviews were semi-structured, in that the researcher followed a standardised interview guide, but participants were encouraged to divert from this guide where other insights were relevant. Separate interview guides were drafted for different groups of stakeholders, and the different guides are included at Appendix B. The semi-structured interview process was chosen to allow for some comparability between interviews and issues covered, but also to enable the researcher and participant to explore different aspects or identify new themes in some detail.

The duration of interviews was generally between 30 minutes and one hour, and took place at a time and place of the participant's choosing. Most interviews took place at the participant's workplace.

Interviews were transcribed by an external transcribing service, and interview data analysed to identify key themes and responses raised, and tabulated for ease of comparison. Themes were allowed to emerge directly from the data without preconceived notions of the expected responses, but as the research was designed to capture views about specific regulatory issues associated with this topic, there was also an element of pre-conceived themes in the data collection and analysis.

This report includes extracts from the qualitative interviews. Where necessary, minor grammatical changes have been made to the extracts to ensure clarity.

In reviewing the results, the timing of the interviews is very relevant.

For example, for NSW participants, the interviews took place not long after the 48% all inclusive ceiling had come into effect for all credit providers. Thus, participants from NSW were not able to provide a detailed assessment of the impact of the legislation at the time of the interviews.

For Queensland participants, the interviews took place at a time when there was some public discussion on the issue of an interest rate ceiling, but well before the Queensland Government had made a policy decision. At the time of the interviews, government officials were therefore still in the process of gathering information, and had not reached any conclusions on an appropriate policy response.

The comments of participants should be viewed in the context of the timing of the interviews; as they reflect the state of knowledge and experience of the individuals at that time.

Note also that not all participants answered each question; and in some cases, interviews took place with two representatives of an organisation, but one representative did most of the talking.

6. Finance Options in Queensland

In this section, we summarise the range and price of finance options available in Queensland in late 2006.

PRODUCTS

Banking Products

Banks, or approved deposit taking institutions as regulated by the *Banking Act 1959* (Commonwealth) have traditionally offered customers a wide range of consumer finance products including the personal loan, continuous credit products and overdrafts. These institutions are commonly referred to as "first tier" lenders and offer products featuring a rate of interest and other associated fees and charges competitive amongst the other first tier lenders. Banking institutions currently in operation in the State of Queensland include:

- *Australia and New Zealand Banking Group*
- *Bank of Queensland Limited*
- *Bank of Western Australia Limited*
- *Bendigo Bank Limited*
- *Citibank Limited*
- *Commonwealth Bank of Australia Limited*
- *Esanda Finance Corporation Limited*
- *Heritage Building Society*
- *ING Bank Australia Limited*
- *National Australia Bank Limited*
- *Suncorp Metway Limited*
- *St George Bank Limited*
- *Westpac Banking Corporation*

In addition, a number of credit unions also offer similar products to their members.[128]

Personal Loans

[128] Large credit unions operating in Queensland include Credit Union Australia Limited, Queensland Teachers Credit Union Limited and the Queensland Police Credit Union Limited.

Personal loan products are offered by all first tier institutions.

These products are generally available for any "worthwhile purpose",[129] but are specifically marketed as a source of credit for the purchase of motor vehicles, holidays, home renovations, furniture, weddings, debt consolidation and for educational expenses.[130]

The credit available ranged from $3000.00[131] up to an unlimited amount with provision of adequate security.[132] The term of the loans ranged from one year[133] to up to seven (7) years.[134]

Interest rates on these products vary depending on the provider, whether or not security was provided, and whether the rate was fixed or variable. APR comparison rate ranges are given in the following table:

Product	Min APR	Max APR
Unsecured Personal Loan	11.74%[135]	23.90%[136]
Secured Personal Loan	9.49%[137]	20.67%[138]

The products were generally available with or without security, with a small interest rate premium on unsecured loans as is apparent from the above table.

Application fees ranged from $125.00[139] to $250.00[140] and some products also required payment of ongoing administration fees.[141] Various other miscellaneous fees and charges

[129] See for example "Personal loans from St George" <www.stgeorge.com.au/personal_loan/personal_loan_faqs.asp?orc=personal> 25/11/2006
[130] See for example "Bank of Queensland Personal Loans" < www.boq.com.au/personal_ personal_loan_chooseloan.htm > 25/11/2006 and "Westpac – Understanding personal loans" <www.westpac.com.au/internet/publish.nsf/Content/PBPL+Choose> 25/11/2006
[131] St George secured and unsecured personal loan products <www.stgeorge.com.au/personal_loan/compare_our_personal_loans.asp?orc=personal> 25/11/2006
[132] Commonwealth Bank fixed rate secured loan <www.commbank.com.au/Personal/PersonalLending/FixedRateSecured.asp> 25/11/2006
[133] See for example Bank of Queensland Personal Loans <www.boq.com.au/personal_personal_loan_compareloans.htm> 25/11/2006
[134] NAB Personal loan <www.national.com.au/Personal_Finance/0,,82439,00.html> 25/11/2006
[135] Bankwest unsecured personal loan "Bankwest Comparison Rate Schedule" <www.bankwest.com.au> 25/11/2006
[136] St George Bank 2 year $5000 personal loan "St George Comparison Rate Schedule" <www.stgeorge.com.au> 25/11/2006
[137] Bankwest secured personal loan "Bankwest Comparison Schedule" <www.bankwest.com.au> 25/11/2006
[138] Westpac 2 year $5000 secured personal loan "Comparison Rate Schedule" <http://www.westpac.com.au/internet/publish.nsf/Content/PBPLWC+Rates+Schedule#PLUNS> 25/11/2006
[139] NAB Personal loan "Personal Banking fees and charges" <www.national.com.au/Personal_Finance/0,,9733,00.html#loans> 25/11/2006

were also be payable depending on the particular product, including security fees, loan servicing fees, overdrawing fees and deferred establishment fees.[142]

Motor Vehicle Loan

The motor vehicle loan is a personal loan given for the specific purpose of purchasing a new or used vehicle that is then used as security pursuant to a bill of sale. Loan amounts ranged from $4000.00[143] to $100,000.00,[144] with some providers requiring the age of the car be no more than a fixed number of years.[145] The product was available with and without the payment of a deposit by the customer.[146]

These products are available for the same duration as the normal personal loan product, generally at a smaller rate of interest due to the presence of security. Comparison rates on these products varied between 8.22%[147] and 21.07%.[148]

Establishment fees payable ranged from free establishment[149] to $250.00[150] with some products also requiring the payment of a periodic account-keeping fee.[151]

Continuous Credit Products

Continuous consumer credit products are offered by all first tier institutions in the form of credit cards.

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140 Westpac Unsecured Personal Loan "Choose the right loan – Unsecured personal loans" <http://www.westpac.com.au/internet/publish.nsf/Content/PBPLCR+Unsecured+personal+loans> 25/11/2006

141 See for example "ANZ – Fees, rates, taxes and terms" <anz.com.au> 25/11/2006 An application fee of $125 and a quarterly administration fee of $25 is payable on all ANZ personal loan products.

142 See for example "Commonwealth Bank – Personal loan fees and charges" <www.commbank.com.au/Personal/PersonalLending/Fees.asp> 25/11/2006

143 Westpac Secured Personal Loan <www.westpac.com.au/internet/publish.nsf/Content/PBPLCR+Secured+personal+loans> 29/11/2006

144 Westpac Secured Personal Loan <www.westpac.com.au/internet/publish.nsf/Content/PBPLCR+Secured+personal+loans> 29/11/2006

145 See for example Commonwealth Bank Fixed Rate Secured Loan where the car must be under 5 years old. <www.westpac.com.au/internet/publish.nsf/Content/PBPLCR+Secured+personal+loans>

146 See for example ANZ Car Loans <www.anz.com/australia/persbnk/prdsrv/personal/carloans.asp>

147 Westpac 7 year, $70,000 secured motor vehicle loan "Comparison Rate Schedule" http://www.westpac.com.au/internet/publish.nsf/Content/PBPLWC+Rates+Schedule

148 St George Bank 2 year, $5000 variable secured motor vehicle loan "Comparison Rate Schedule" <www.stgeorge.com.au> 27/11/2006

149 BankWest Secured motor vehicle loan <http://www.bankwest.com.au/Personal/Personal_Loans/Car_Loan/index.aspx> 27/11/2006

150 Westpac Secured Personal Loan <www.westpac.com.au/internet/publish.nsf/Content/PBPLCR+Secured+personal+loans> 29/11/2006

151 See for example Bank of Queensland Car Loans which feature a monthly account maintenance fee of $5.00 <www.boq.com.au/personal_personal_loan_car.htm> 29/11/2006

There is considerable diversity of product offering in this area. The most basic bank issued credit cards featured an annual fee of up to $45.00 per year and interest rates as low as 11.5% on purchases.[152] Many of these basic credit cards also featured an interest free period on purchases, usually between 44 and 55 days.[153] The full balance owing on the card must be paid each month for the interest free feature to apply.

More advanced products feature built in loyalty programs that reward the customer for using the card. These cards feature a higher annual fee and interest rate. The highest interest rate on a first tier continuous credit product was an annual percentage rate of 19.24% on an *ANZ Rewards*, or *ANZ Frequent Flyer Visa Card*.[154]

Overdraft Facilities

An overdraft is a facility offered by a deposit taking institution that enables the account holder to accrue a debit balance in their account, essentially as borrowed funds. These are generally attached to business banking accounts but are also available for use with normal personal banking accounts.

The overdraft credit available ranged from a set minimum limit of $500.00[155] up to a tailored maximum amount dependent on the customer's capacity to pay.[156]

The interest rate ranged from 8.74%pa for a mortgage secured product,[157] to 14.22% for an unsecured product.[158] There was an interest premium on unsecured overdrafts but these cost less to establish because there are no fees associated with the security.

An overdraft establishment fee in the range of $250[159] - $495[160] was payable in addition to further monthly or quarterly fees in some cases.[161]

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[152] See for example "Westpac low rate Mastercard and Visacard" <www.westpac.com.au> 25/11/2006
[153] See for example "ANZ First: Low annual fee Visa"<www.anz.com.au/aus/ind/creditcard/range/first> 25/11/2006 and "Westpac low rate Mastercard and Visacard"<www.westpac.com.au> 25/11/2006
[154]<www.anz.com.au/aus/RateFee/InterestRates/Rates> 25/11/2006
[155] See for example St George Personal Overdraft <www.stgeorge.com.au/personal_loan/personal_overdraft.asp?orc=personal> 27/11/2006
[156] Bank of Queensland Personal Overdraft <www.boq.com.au/personal_personal_loan_overdraft.htm> 27/11/2006
[157] Bank of Queensland Personal Overdraft <www.boq.com.au/personal_personal_loan_overdraft.htm#interest_rates> 27/11/2006
[158] ANZ Personal Overdraft <www.anz.com.au/australia/persbnk/prdsrv/personal/overdraft.asp> 27/11/2006
[159] Westpac Personal Overdraft <www.westpac.com.au/internet/publish.nsf/Content/PBPLCR+Personal+overdrafts> 27/11/2006
[160] Bank of Queensland Personal Overdraft <www.boq.com.au/personal_personal_loan_overdraft.htm> 27/11/2006
[161] See for example ANZ Personal Overdraft where a minimum quarterly fee of $50 is payable. <www.anz.com.au/australia/persbnk/prdsrv/personal/overdraft.asp>

Non Bank Products

Non bank institutions which offer similar consumer credit products and generally compete with banks through the flexibility of their product offerings are commonly referred to as "second tier" lenders. Their products are generally provided at higher rates of interest to compensate the lender for the extra risk associated with the loan. These lenders have a highly visible presence and compete with first tier institutions for the same customers through similar advertising mediums. Such lenders whose products are available in Queensland include:

- *GE Personal Finance Pty Ltd t/a GE Money* – This provider offered a range of 2 to 7 year secured and unsecured personal loan products in Queensland with comparison rates that ranged between 12.10[162] and 41.77%.[163]

- Motor vehicle personal loans for amounts between $2500.00 and $130,000.00 were also offered on terms of 2 to 5 years duration with annual percentage comparison rates between 6.14 and 31.09%.[164] This product is also offered under the trade names *Honda Australia Finance* and *MTAQ Auto Finance*.

- Continuous credit products were offered in the form of an up to 55 day interest free Mastercard with an annual fee of $35.00 and a low rate Mastercard offering an APR of 9.99% on purchases and 18.49% on cash advances with an annual fee of $58.00.[165] Retail specific continuous credit products were also offered (see heading *Retail Specific Finance* below).

- *Virgin Money (Australia) Pty Limited t/a Virgin Money* – This provider offered a no annual fee Mastercard featuring an APR of 12.99% and up to 55 days interest free on purchases.[166] The distinguishing feature of this card was the 12.99% APR also applies to cash advances. This was a considerably lower rate than is available on comparable credit card products.

- *Geneva Finance Ltd t/a G2 Finance* – This provider offered a range of secured and unsecured personal loan products from two weeks to three years duration featuring comparison rates ranging from 28.57%[167] to 49.95%.[168] This provider is a rare

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[162] GE Money 7 year, $50,000 secured personal loan "GE Money Personal Loans Comparison Rate Schedule" <www.gemoney.com.au>

[163] GE Money 2 year, $2,500 unsecured personal loan "GE Money Personal Loans Comparison Rate Schedule" <www.gemoney.com.au> 29/11/2006

[164] GE Money 2 year, $2,500 auto loan "GE Money Comparison Rate Schedule" <www.gemoney.com.au> 29/11/2006

[165] "GE Money – What sort of credit card are you looking for?" <www.gemoney.com.au/cardhome.html> 29/11/2006

[166] "Virgin Money Credit Card" <www.virginmoney.com.au/credit_card/> 29/11/2006

[167] 3 year $10,000 loan product "G2 Finance Comparison Rates" <www.g2finance.com.au/index.php/pi_pageid/68> 4/12/2006

example of a lender which has a payday type product offering at a second tier type rate of interest. For instance, the 49.95% comparison rate on the two week $250 loan returns interest and other fees to the provider of only $4.83. This small profit margin explains the paucity of payday product availability in the second tier lending market.

Retail Specific Finance

Many Queensland retailers utilise finance services provided by *Buyer's Edge, GE Creditline and Go Mastercard*.[169] The buyer applies for a card provided by one of these outlets when making the store purchase. The *Go Mastercard* was being offered to all customers who applied for the *Buyer's Edge or GE Creditline* cards.[170] In all cases the finance is provided by GE Capital Finance Australia Pty Limited at an annual percentage rate of 27.99% for cash advances or purchases linked to a specific promotion.[171] The promotion took the form of deferred payment, an interest free period, or a combination of the two.[172] The interest free period promotions varied depending on the retailer and product. Establishment fees, account servicing fees and payment handling fees could also be payable.[173] If the customer did not wish to participate in specific promotions the card could be used as a regular no annual fee Mastercard with interest charged at 17.99% on purchases.[174]

Another card marketed at the point of sale to retail consumers was the *MyBuy Card*, with finance provided by *Hanover Consumer Finance Pty Limited*. The applicable annual percentage rate was set by agreement between the financier and retailer. Various interest free periods were also applicable.[175]

Store Cards

Specifically branded store cards are relatively rare given the popularity of the generic retail finance providers mentioned above. However, businesses with strong customer loyalty do brand their own finance product. The Myercard featured finance provided by GE Capital Finance Australia Pty Ltd t/a GE Money at an annual percentage rate of 19.99%. An interest free period of 62 days applied to all purchases with enhanced interest free periods available through special periodic promotions.[176]

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[168] 2 week $250 loan product "G2 Finance Comparison Rates" <www.g2finance.com.au/index.php/pi_pageid/68> 4/12/2006

[169] Retailers include Harvey Norman, Retravision, Bob Jane T-Marts, Beaurepairs, Chandlers, Betta Electrical, Forty Winks, Super A-Mart, A-Mart All Sports. <www.buyersedge.com.au> 20/11/2006

[170] "Apply Now" <www.buyersedge.com.au> 20/11/2006

[171] "Go Card benefits" <www.gomastercard.com.au/CardBenefits.htm> 20/11/2006

[172] "Go Finance Options" <www.gomastercard.com.au> 20/11/2006

[173] See for example "GE Creditline Fees & Charges" <www.gecreditline.com.au/AboutUs/fees.htm> 20/11/2006

[174] "Go Card benefits" <www.gomastercard.com.au> 20/11/2006

[175] "MyBuy for shoppers" <www.mybuy.com.au/mybuyforshoppers.html>

[176] "Myercard" <www.myer.com.au/services/myercard.asp> 20/11/2006

The David Jones Card featured an annual percentage rate of 21.90% and an interest free period of 56 days, with additional interest free days becoming available through special periodic promotions.[177]

Bond Loans

This product is basically identical to a regular personal loan product marketed specifically for use to pay a rental bond. One such provider was the *Australian Lending Corporation* which advertised loans specifically for this purpose in Queensland newspapers including the Brisbane daily, *The Courier Mail*.[178] This provider made such loans available at an interest rate of 14.00%pa with the payment of an additional establishment fee.[179]

Micro-lending or Fringe lending products

In addition to the above, there is a range of micro-lending or fringe lending products available in Queensland. These are discussed in the next chapter.

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177 "David Jones Card Features & Benefits" <www.davidjones.com.au/djcard_features.jsp> 20/11/2006
178 Queensland Newspapers Pty Ltd, *The Courier Mail*, Wednesday, August 9, 2006
179 "ALC Finance – Australian Lending Corporation" <www.bondloans.com.au/faq.htm> 4/12/2006

7. Micro-loans in Queensland

This section explores the range of fringe loans and micro-loans available in Queensland in 2006.

In addition to the credit products previously mentioned, there exist other products available in the Queensland marketplace from less visible lenders at significantly higher interest rates. Providers of these products are sometimes referred to as third tier lenders, or fringe lenders, because they operate on the periphery of the consumer credit market that is not catered for by first or second tier institutions. In order to ascertain the availability of these products and specific product attributes such as loan cost, duration, and whether they require security, a survey was conducted of a sample of credit providers believed to supply these products. The key aims of the data collection were:

- To provide details of the type of consumer credit products available from non-bank lenders; and

- To enable a range of annual percentage rates of interest, inclusive of all fees and charges, to be calculated to ascertain the true cost of a sample of these products.

The method for this data collection is summarised in chapter 5 of this report.

Minimum Duration

This question was asked to determine whether there was a minimum period during which customers would be obligated to make repayments associated with these loans.

The minimum duration of the products ranged from 1 to 26 weeks. Many respondents acknowledged the fact that in accordance with the *Uniform Consumer Credit Code* ("UCCC") the customer was free to pay the loan out in full at any time and therefore theoretically the minimum duration of the loan could be whatever the customer wanted, including as short as a single day.[180]

Few respondents were prepared to offer the "large loan" (defined as a $1000 personal loan, as opposed to a 'small loan" defined as a $300 personal loan) on a payday basis, being generally a contract with 8 weeks or less duration (see payday loans below).

[180] *Consumer Credit Code (Qld) s75*

Maximum Duration

Consumers pay more interest the longer the length of the loan, regardless of the interest rate. This question was asked to gauge the potential for indebtedness created by the product.

The maximum duration of the small loan product ranged from 8 to 52 weeks.

The maximum duration of the large loan product ranged from 26 to 78 weeks, the most common maximum duration being 52 weeks.

Standard Duration

Some respondents were unwilling or unable to provide the minimum and maximum duration of their loan products. They were however able to provide the duration of their most popular or standard products.

The standard duration for the small loan product ranged from 4 to 36 weeks. The standard duration for the large loan product ranged from 26 to 40 weeks.

Minimum Income Requirement

Very few respondents stated a minimum fixed income requirement in order for the customer to be eligible for a product. Two respondents required that a customer have an income of $350 per week and $750 per fortnight respectively.

The responses suggest a great deal of discretion is utilised by the credit provider. The most popular requirements were for a review of the respondent's finances to be undertaken, for their ability to repay to be assessed, for their weekly budget to be scrutinised, and for the provision of proof of income. One respondent required that the customer have no defaults listed for at least three months, while another subjected the customer to their own credit scoring procedure.

Qualitative evidence obtained suggested that the respondents screened customers quite thoroughly. One respondent reasoned,

The money has got to come back to us otherwise it cannot go back out (Survey respondent no. 22)

Another respondent provided,

> *We give our customers a strict budget… we have non-customers ring us to help them with their budgets* (Survey respondent no. 37)

Repayments

Respondents were asked to provide information as to the total amount of repayments required to be made during the course of the small and large loan. The survey did not ask respondents for interest rates associated with the product but some respondents sought to provide this figure in addition.

From the data obtained other variables including the monthly and annual percentage rates were able to be calculated. These have all been included in the results. The all inclusive interest rates were calculated in accordance with the formula used to calculate comparison rates under the *Uniform Consumer Credit Code*.[181] Due to the nature of the formula, the all-inclusive rate is unable to be isolated by algebraic manipulation. Iteration was therefore used to isolate the interest rate that equated the weekly repayments with an ending balance of zero if the required number of repayments were made.

Some respondents were unable to confirm the compounding frequency on which their repayment figures were based. For uniformity of analysis it has been assumed in all cases that repayments are made on a weekly basis, and interest accrues and compounds daily on the reducing balance of the loan.

It became apparent that some respondents who provided information as to their actual interest rates in addition to the total repayment amounts requested were not calculating these rates correctly. This mistake took the form of an interest rate which appeared to be a total interest divided by total principal calculation. This has the effect of understating the actual interest rate.[182]

Some respondents also added all fees and charges to the initial principal when performing the interest rate calculation. This reflects the fact that these amounts are also usually loaned, but of course don't change hands. This has the effect of understating the actual interest rate on the principal because a smaller rate of interest on the larger figure consisting of principal *and* fees and charges will yield the same repayment schedule. This methodology is flawed because it applies the interest rate to the fees and charges as well as the principal during the course of the loan. The technique is also in breach of the *Uniform Consumer Credit Code* unless the amount of credit to be provided is specifically stated to be an amount that includes the principal as well as fees and charges.[183]

Example:

Loan Amount	*Duration*	*Fee*	*Weekly Repayment*	*Total Repayments (inc Fee)*	*APR*

[181] See chapter 5 of this report
[182] See chapter 5 of this report
[183] *Consumer Credit Code (Qld) s15*

$1000	26 wks	$350	65.85	1712.10	228.96%
$1350	26 wks	$350	65.85	1712.10	96%pa

It can be seen that this product which provides the consumer with $1000 can yield a completely different APR depending on whether the fees and charges are also deemed to be loaned. In both cases an identical amount consisting of principal, interest and fee is repaid. For the purposes of the data compiled in this study the all inclusive APRs as well as the interest only APRs have been calculated on the principal sum only.

Cogent analysis of the cost of these products requires that the payday loan product and the non-payday loan product be examined separately.

- Payday Loans

The data obtained on those products which may be considered payday loans is isolated in *Table A (1), (2) and (3)*. These products are generally short term, high interest loans for small amounts which escape precise definition. The Working Party appointed by the Minister for Fair Trading to develop options for the regulation of the payday lending market in 2000 defined payday loans as all forms of short term lending for personal, domestic or household purposes of up to 2 months duration.[184] It can be seen that of the 40 credit providers surveyed, only 14 offered or found there was any significant demand for the $300 and/or $1000 product for this time period. Anecdotal evidence suggests that consumers prefer to pay as little as possible on a weekly basis, rather than repay a lump sum. As one credit provider surveyed indicated:

> *The customers generally only care about the size of the weekly repayment.... for this reason we find that the lengthy loans are the most popular.* (Survey respondent no. 9)

The data collected indicates that the all-inclusive APR for the payday loan product in the survey sample ranged from 300% to 3380%. The range of total repayments as a percentage of principal is between 107-165%. This is a more accurate indicator of the actual cost of these loans to the consumer; however it is a poor indicator for the purposes of comparing loans of different duration as longer loans with similar APRs will produce a higher figure. The large standard deviation of 686% present in the APRs for the payday sample suggests that the one week loan product should be considered separately, being an inherently different product.

Table A (1) One week small loans

No.	Principal ($)	Interest all inclusive (% / day)	Fees	Total payments	APR all inclusive (%pa)	Total payments as a % of principal
2	$500.00	1.4247	Nil	$550.00	520	110
18	$300.00	4.7014	Nil	$399.00	1716	133

[184] QOFT (2000)

30	$300.00	9.2604	$170	$495.00	3380	165
38	$300.00	1.8740	$28	$341.58	684	114

The highest all inclusive APRs are attributable to the one week loans because of the effect of multiplying the weekly interest rate by a factor of 52 to obtain the APR. The weekly interest rate is generally a large fraction of the principal because the lender must recover all of their costs and return a profit in the single week. This anomaly has been well documented.[185] Nonetheless there is a great diversity in the cost of the one week small loan in the Queensland market, the sample showing a range of APRs between 520 and 3380%.

Table A (2) Other small payday loans

No.	Principal ($)	Duration (weeks)	Interest all inclusive (% / day)	Fees	Weekly payment	Total payments	APR all inclusive (%pa)	Total payments as a % of principal
3	$300.00	4	1.0685	N	$90.00	$360.00	390	120
6	$300.00	4	1.0790	$25	$90.18	$360.72	394	120
7	$300.00	4	1.3509	$30	$94.33	$377.32	493	126
11	$300.00	4	1.9190	$50	$103.45	$413.72	700	138
22	$300.00	4	1.6044	$10	$95.84	$383.35	586	128
24	$300.00	4	1.6767	N	$99.38	$397.52	612	133
31	$300.00	4	1.7852	N	$101.25	$405.00	652	135
32	$300.00	2	1.4247	$45	$180.00	$360.00	520	120
34	$300.00	2	1.4247	$45	$180.00	$360.00	520	120
35	$300.00	4	0.8219	N	$87.67	$350.68	300	117

It can be seen that the all inclusive APRs are not as large for the small payday loan product of greater than one week's duration. It is also instructive to note that many of the $300 products of two or four week's duration have similar total repayments to the one week products listed, with much smaller APRs. The use of the APR to compare payday loans of different durations may therefore actually be misleading.

Table A (3) Large payday loans

No.	Principal ($)	Duration (weeks)	Interest all inclusive (% / day)	Fees	Weekly payment	Total payments	APR all inclusive (%pa)	Total payments as a % of principal
18	$1000.00	8	0.9459	N	166.25	1330.00	345	133
22	$1000.00	4	1.3348	$10	313.63	1254.52	487	125
30	$1000.00	1	3.0135	$170	1231.01	1231.01	1100	123
32	$1000.00	2	1.4247	$150	600.00	1200.00	520	120
34	$1000.00	2	1.4245	$150	600.00	1200.00	520	120
35	$1000.00	4	0.8219	N	287.91	1151.64	300	115
38	$1000.00	1	0.9462	$55	1068.15	1068.15	345	107

[185] See QOFT (2000), p12

The data indicates that larger loans are also available on a payday basis. The all inclusive APRs on this product range from 300% to 1100%, identical to the small payday loan product. The total payments as a percentage of the principal sum ranged from 107% to 133%; a result very similar to that of the small payday product. The large APRs of the one week small loan product are not present with the large loan product because the same fixed administration costs and profit associated with the small product over one week can be recovered as a smaller percentage of the large product whether over a short or longer period of time.

- Non-payday loans

The data obtained on those products which may be considered non-payday loans is isolated in *Tables B(1) and (2).* Most of the loan products offered by the credit providers surveyed were for periods in excess of two months, with a minimum repayment period of six months the most popular. 101 of these products were identified from the sample of credit providers. The all-inclusive annual percentage rate for this type of product in the survey sample ranged from 114% to 580%.The annual percentage rates are smaller than that for payday loans because the monthly interest rate (obtained by dividing the APR by 12) can be smaller while still returning a suitable profit to the credit provider because interest is payable over a longer period of time. Once again an analysis of the total repayments as a percentage of principal for these loans is instructive. The range lies between 134% and 307%. Thus it can be seen that, putting aside the possibility of payday loans being “rolled over”, or the funds being re-lent, these loan products, when considered on an individual basis, are actually more profitable for the credit provider than the payday product, with the borrower on average paying more interest in both real terms and as a fraction of the original loan amount.

Table B (1)Non payday – Small loans

No.	Principal ($)	Duration (weeks)	Interest all inclusive (% / day)	Fees	Weekly payment	Total payments	APR all inclusive (%pa)	Total payments as a % of principal
1	$300.00	26	0.7562	$30	$21.76	$565.76	276	189
	$300.00	40	0.7272	$30	$17.97	$718.80	265	240
2	$500.00	26	0.3284	N	$25.83	$671.58	120	134
3	$300.00	39	0.4905	$100	$14.18	$553.00	179	184
4	$300.00	26	0.5753	$25	$19.00	$494.00	210	165
5	$300.00	26	0.6411	$25	$20.00	$520.00	234	173
6	$300.00	21	0.7608	$25	$24.33	$511.00	278	170
7	$300.00	12	1.0225	$30	$38.54	$462.51	373	154
8	$300.00	26	0.6105	$50	$17.58	$457.05	223	152
	$300.00	52	0.5421	$50	$13.45	$699.11	198	233
10	$300.00	26	0.6723	$175	$20.44	$531.44	245	177
	$300.00	36	0.5290	$175	$15.35	$552.60	193	184
11	$300.00	26	0.9307	$50	$24.67	$641.50	340	214
14	$300.00	16	0.8568	$30	$30.00	$480.00	313	160
15	$300.00	13	0.9409	$73	$35.44	$460.73	343	154
	$300.00	26	0.7410	$73	$21.53	$559.79	270	187
16	$300.00	26	0.9501	$20	$25.00	$650.00	347	217
	$300.00	39	0.8324	$20	$20.00	$780.00	304	260
17	$500.00	26	0.4964	$50	$29.69	$772.00	181	154
19	$300.00	24	0.7792	$15	$22.99	$551.76	284	184
20	$300.00	24	0.7792	$140	$22.99	$551.76	284	184
21	$300.00	24	0.7792	$140	$22.99	$551.76	284	184
23	$300.00	26	0.6020	$100	$19.37	$503.62	220	168
24	$300.00	13	0.9215	N	$35.15	$456.95	336	152
29	$300.00	26	1.0073	$175	$26.00	$676.00	368	225
	$300.00	52	0.7371	$175	$17.00	$884.00	269	295
30	$300.00	12	1.5893	$170	$47.69	$572.28	580	191
32	$300.00	26	0.4813	$45	$17.60	$457.60	176	153
34	$300.00	26	0.4813	$45	$17.60	$457.60	176	153
35	$300.00	26	0.8219	N	$22.84	$593.84	300	198
36	$300.00	13	0.8219	$50	$33.69	$437.98	300	146
	$300.00	26	0.6746	$50	$20.48	$532.38	246	177
37	$300.00	26	0.7128	$175	$21.08	$548.08	260	183
	$300.00	36	0.5290	$175	$15.35	$552.60	193	184
	$300.00	32	0.6076	$175	$17.50	$560.00	222	187
38	$300.00	52	0.5247	$28	$13.15	$683.80	192	228
39	$300.00	52	0.4317	$175	$11.60	$603.20	158	201
	$300.00	26	0.7052	$175	$20.96	$544.96	257	182
40	$300.00	36	0.7499	N	$19.00	$684.00	274	228

The all inclusive APRs for the small loan product have a range of 120% – 580%, with repayments as a percentage of principal ranging from 134% to 195%. The wide range of APRs indicates a divergence of product offering in this market. However, it can be seen that the larger APRs are attributable to the products of shorter duration. Conversely, it can also

be seen for example that the products offered by provider numbers 15 and 16 have very similar APRs, but very different total repayments as a percentage of principal. This is due to the fact that provider 15's product is of 13 weeks duration, compared to the 26 week duration of provider 16's product. This again highlights the dangers of using only the APR to compare products of different duration.

Table B (2)Non payday – Large loans

No.	Principal ($)	Duration (weeks)	Interest all inclusive (% / day)	Fees	Weekly payment	Total payments	APR all inclusive (%pa)	Total payments as a % of principal
1	$1,000.00	26	0.7545	$100	$72.51	$1,885.26	275	189
	$1,000.00	52	0.7203	$100	$55.61	$2,891.72	263	289
	$1,000.00	40	0.7266	$100	$59.87	$2,394.80	265	239
2	$1,000.00	26	0.3123	N	$51.00	$1,326.00	114	133
3	$1,000.00	26	0.5112	$250	$60.08	$1,562.00	187	156
	$1,000.00	39	0.4330	$250	$44.33	$1,729.00	158	173
4	$1,000.00	26	0.6690	$58	$68.00	$1,768.00	244	177
	$1,000.00	35	0.6621	$58	$59.00	$2,065.00	242	207
5	$1,000.00	34	0.6214	$50	$57.47	$1,953.98	227	195
6	$1,000.00	33	0.6608	$50	$60.36	$1,992.00	241	199
7	$1,000.00	26	0.6099	$50	$65.00	$1,690.00	223	169
8	$1,000.00	39	0.5421	$50	$50.00	$1,950.00	198	195
	$1,000.00	26	0.5408	$50	$61.53	$1,599.78	197	160
	$1,000.00	52	0.5234	$50	$43.76	$2,275.52	191	228
9	$1,000.00	32	0.4070	$350	$48.28	$1,544.96	149	154
	$1,000.00	36	0.3564	$350	$42.60	$1,533.60	130	153
10	$1,000.00	26	0.4692	$175	$58.08	$1,510.00	171	151
	$1,000.00	36	0.3784	$175	$43.64	$1,571.00	138	157
11	$1,000.00	26	0.6105	$75	$65.00	$1,690.00	223	169
12	$1,000.00	36	0.5129	N	$50.32	$1,811.52	187	181
13	$1,000.00	26	0.4932	N	$59.24	$1,540.36	180	154
	$1,000.00	52	0.4590	N	$40.15	$2,087.80	168	209
14	$1,000.00	26	0.5096	$70	$60.00	$1,560.00	186	156
	$1,000.00	39	0.4853	$70	$47.00	$1,833.00	177	183
15	$1,000.00	26	0.5490	$73	$61.94	$1,610.44	200	161
	$1,000.00	52	0.5273	$73	$43.99	$2,287.24	192	229
16	$1,000.00	26	0.6105	$50	$65.00	$1,690.00	223	169
	$1,000.00	39	0.6510	$50	$56.00	$2,184.00	238	218
17	$1,000.00	29	0.5839	$50	$60.00	$1,740.00	213	174
18	$1,000.00	26	0.5014	N	$59.62	$1,550.00	183	155
19	$1,000.00	36	0.3870	$300	$44.04	$1,585.44	141	159
20	$1,000.00	36	0.3870	$300	$44.04	$1,585.44	141	159
21	$1,000.00	36	0.3870	$300	$44.04	$1,585.44	141	159
22	$1,000.00	26	1.1510	$10	$95.27	$2,477.00	420	248
23	$1,000.00	26	0.4150	$100	$55.56	$1,444.56	151	144
24	$1,000.00	52	0.4300	N	$38.58	$2,006.16	157	201
	$1,000.00	26	0.6156	N	$65.25	$1,696.50	225	170
25	$1,000.00	26	0.5908	$385	$64.00	$1,664.00	216	166

26	$1,000.00	31	0.5451	$320	$56.00	$1,736.00	199	174
27	$1,000.00	26	0.5615	$50	$62.55	$1,626.30	205	163
	$1,000.00	52	0.5290	$50	$44.08	$2,292.16	193	229
	$1,000.00	26	0.3468	$100	$52.48	$1,364.48	127	136
	$1,000.00	52	0.2933	$100	$31.59	$1,642.68	107	164
28	$1,000.00	26	0.6273	$350	$65.85	$1,712.10	229	171
29	$1,000.00	26	0.6108	$375	$65.00	$1,690.00	223	169
	$1,000.00	52	0.4192	$375	$38.00	$1,976.00	153	198
30	$1,000.00	52	0.7756	$170	$59.13	$3,074.76	283	307
	$1,000.00	26	0.8393	$170	$77.10	$2,004.60	306	200
31	$1,000.00	26	0.6273	$350	$65.85	$1,712.10	229	171
32	$1,000.00	26	0.4813	$150	$58.71	$1,526.44	176	153
33	$1,000.00	26	0.3768	$60	$53.82	$1,399.32	138	140
34	$1,000.00	26	0.4813	$150	$58.71	$1,526.44	176	153
35	$1,000.00	26	0.8219	N	$76.14	$1,979.64	300	198
36	$1,000.00	26	0.5024	$50	$59.67	$1,551.42	183	155
	$1,000.00	52	0.4790	$50	$41.27	$2,146.04	175	215
37	$1,000.00	26	0.4830	$325	$58.74	$1,527.24	176	153
	$1,000.00	36	0.3893	$325	$44.15	$1,589.40	142	159
	$1,000.00	32	0.4185	$325	$48.83	$1,562.56	153	156
38	$1,000.00	52	0.5119	$55	$43.11	$2,241.72	187	224
39	$1,000.00	52	0.3225	$175	$33.03	$1,717.56	118	172
	$1,000.00	26	0.5027	$175	$59.69	$1,551.94	183	155
40	$1,000.00	36	0.5066	N	$50.00	$1800.00	185	180

The all inclusive APRs for the large loan product have a range of 107% to 420%. The total repayments as a percentage of principal ranged from 133% to 307%. This again demonstrates a divergence of product offering in this market, and it can again be seen that the products with the highest APRs are of the shortest duration. The product from provider number 38 is a long duration product of one (1) year. Whilst this product possesses a mid-range APR of 187%, the total repayments as a percentage of principal is an above average figure of 224%, again highlighting the importance of comparing loans using an APR *and* a measure of the total interest payable.

Fees and Charges

Both the payday and non-payday product were found to be available with or without the payment of an additional fee. The additional fee when levied took the form of either an administrative charge, establishment charge, application charge, or a cashing fee. The cashing fee involves the customer taking a cheque or other money order to a bank, which then provides the face value of the order less the cashing fee percentage which is retained in the lender's account.

Table A indicates that the fees payable on the payday loan product ranged from $0 to $170. *Table B* indicates that the fees payable on the non-payday loan product ranged from $0 to $385.

The levying of a fee or charge in addition to the standard interest payments has a large effect on the real cost of the loan. Although the sample is not a representative one, it is interesting to compare the average all-inclusive APR to an interest only APR (excluding fees and charges). The average all-inclusive APR for the payday loan product is 718%, compared to an average interest only APR of 404% when fees or charges are removed. Thus it can be seen on average that fees and charges make up nearly 50% of the total cost of the payday loan products in this sample.

The average all-inclusive APR for the non-payday loan product is 222%, compared to an average interest only APR of 173% when fees or charges are removed. Fees do add considerably to the average cost of these non-payday loans in the sample, but the effect is not as great as that on their payday counterparts because the total interest payments are generally higher.

This data indicates the importance of using the all-inclusive APR rather than just an interest only APR calculation when ascertaining the true cost of a given product and for making comparisons between products.

Default interest rate or charges

None of the sampled products feature the imposition of a higher rate of interest by the credit provider in the event of default by the borrower. Interest in all cases simply continues to accrue at the usual rate, and this is permissible under the UCCC.

Most credit providers do impose a fixed fee in each instance of default, ranging from $9.00 to $36.00. In many cases this represents a direct debit dishonour fee, but the larger fixed fees also denote a payment to the provider. Some providers also require the default fee to be paid on a weekly basis until the customer's account is brought up to date.(Survey respondent no. 2)

Security

Survey results reveal that the payday and non-payday products are offered with or without security, depending on the provider. The type of security required to be given includes motor vehicles or household items. There is only weak evidence suggesting that secured loan products are available at less cost to the customer. Again acknowledging that the sample is not representative, it is interesting to compare the average APRs between secured and unsecured products in this sample. The average all- inclusive APR for secured products was 307%, whilst the average for unsecured products was 327%. The 20% APR premium on non-secured loans seems insignificant given the large spread of APR's across all products confirmed by a standard deviation of 343%. At any rate the premium is only 1.67% per month.

Rollover

Credit providers were asked whether their loan products contained a facility whereby customers could borrow further funds before their existing loans were repaid, effectively rolling the existing loan over into a new loan. Giving the customer the right to roll over their loan furthers their indebtedness and may create a situation where a loan is continually rolled over whenever a customer is unable to make a repayment. This has the potential to perpetuate the repayments. The rollover risk is of greatest concern with the high APR payday loan products because if the product is continually rolled over the actual repayments will start to approach the extremely high APR.

Of the 21 payday products for which data was obtained, 15 were able to be rolled over. Of the 102 non payday products, 76 were able to be rolled over.

Most credit providers were only prepared to allow the loan to be rolled over where specific conditions had been met, for example, where the customer had made at least 50% of the repayments, had made 8 repayments in a row, 20 repayments in a row, or was "a good payer".(Survey respondent no's 11,16,19 and 20) Others establish the loan as a continuing credit contract product from the outset so that the customer is able to continually withdraw provided the outstanding amount never exceeds the original principal. Some providers also levied a redraw fee. (Survey respondent no. 23)

Microloan Product Summary

Result Ranges

Product Type	***Principal ($)***	***Available Duration (weeks)***	***Fees ($)***	***APR all inclusive (%pa)***	***Total payments as a % of principal***
Payday	300	1	Nil - $170	390-3380	110-165
	300	2-8	Nil - $50	300-700	120-138
	1000	1-8	Nil - $170	300-1100	107-133
Small loan	300	12-52	Nil - $175	120-580	134-295
Large loan	1000	26-52	Nil - $375	107-420	133-307

In analysing the sample of microloan products from 40 lenders in Queensland, the following issues are worth highlighting:

- The sample suggests that there is a diversity of product cost, duration, security requirement and rollover availability in the Queensland market for payday loan products and small and large personal loans from micro-lenders;

- Customers are generally required to have some form of income and be able to provide proof of income;
- Secured and non-secured products are available but there is only weak evidence that the presence of security reduces the cost of the product;
- There is a range of all inclusive APRs for similar products in these markets, indicating that competition may not be acting to produce convergence of price;
- The payday loan products have the larger all inclusive APRs but require a smaller repayment as a percentage of the principal loaned than their non payday counterparts, they are thus less expensive in real terms;
- Small loans have larger all inclusive APRs than large loans, but both products require similar repayments as a percentage of principal;
- Most products are only available with the payment of a fee in addition to the normal interest charges. This fee has on average a large effect on the all-inclusive APR attributable to some products. Fees make up, on average, almost 50% of the total repayments on the payday products in this sample;
- Most products are provided on a continuing credit contract basis or are able to be rolled over at the request of the customer;
- The APR is a suitable device for comparing the cost of similar or different sized loan products repayable over similar timeframes;
- The APR can be misleading if used alone to compare products of similar size over different durations. A complementary measure which takes into account total interest payable should also be utilised;
- Some credit providers do not understand the correct use of the APR. They determine annual rates for their products by simply dividing total repayment by principal. This is misleading because it ignores the reality that interest is applied to a diminishing balance, and yields an artificially low result.

Given that the sample is not representative, this conclusions cannot be directly extrapolated to the microloan market in Queensland. However, the information provides a useful snapshot of the types of products available in 2006.

8. The views of consumer advocates

In this research, we interviewed consumer advocates based in Queensland, where there were no upfront controls on the cost of credit at the time of interviews, and consumer advocates based in New South Wales, Victoria, and the ACT, where an interest rate cap or caps is imposed on credit that is regulated by the *Uniform Consumer Credit Code* ("UCCC"). The specific questions asked of the consumer advocates are set out in appendix B.

This chapter summarises the views and perspectives of these consumer advocates in relation to the merits or otherwise of controls on the cost of consumer credit.

All of the consumer advocates interviewed for this research worked for organisations that provided legal and/or financial counselling casework and advice services. Many (but not all) of the consumers that come into contact with these services would be living on a low income, or would be otherwise disadvantaged in the consumer credit market. For the most part, consumers contact these services when they are in financial difficulty and/or have a complaint or concern about a financial product or service. Therefore, consumers who are managing their credit commitments, and who are happy with their choice of product and provider, are unlikely to come into contact with these services.

The experiences and responses of the consumer advocates are consequently coloured by the experiences of the consumers with whom they work. This has lead to criticisms that the comments of consumer advocates do not represent the experiences of consumers generally (or even, on this topic, the experiences of consumers of fringe loans generally). On the other hand, the experiences of these consumers can point to problem areas, even if it is not necessarily possible to quantify the extent of these problem areas without further research, including research into the experiences of a broad cross-section of fringe lending customers.

The position of low income and vulnerable consumers in today's consumer credit market

Consumer advocates uniformly raised concerns that consumers living on low incomes are often disadvantaged in today's consumer credit market. Their credit needs are not normally met by mainstream lenders; they have limited choice in product and provider (or believe that they have limited choice); and their finance needs are often attended to with a degree of urgency that does not normally facilitate reflection on purchasing decisions (even assuming

the likelihood that consumers behave in the 'economically rational' fashion that underpins most consumer protection legislation).[186]

Reasons why consumers take out high cost credit

Consumer advocates pointed to a range of circumstances in which individual consumers, particularly those living on a low income, are likely to take out high cost credit – that is, credit with effective annual interest rates that are considerably higher than those offered by mainstream lenders. (Chapters 6 and 7 of this report show a range of interest rates on products available on mainstream and micro-loan or "fringe" lenders in Queensland in 2006, and a comparison highlights the considerable differences in costs.)

One key reason given was that many consumers, particularly those on low incomes, are seeking relatively small loans, at least initially. Often, consumers are seeking to borrow sums less than $1,000 or $2,000. For example, one advocate noted that, in relation to payday loans:

> *The typical amount to start off is usually two to five hundred dollars. That is the typical amount. And it's usually for car rego or, you know, it can be bond loans …* (C6, p4)

However, many mainstream lenders shy away from offering small loans. For example, data at cannex.com.au shows that while some (small) credit providers – usually locally based credit unions – have minimum loan amounts of $1,000 or less; most of the banks and larger institutions, with a wider geographic reach, have a minimum personal loan amount of $3,000 - $5,000.[187]

Advocates also noted that consumers may be using high cost loans because they are not seen as credit-worthy by mainstream organisations (they have a poor credit record; their income is too low). This can be the case for both small and large loans, with the consumer advocates interviewed also discussing cases of high cost loans for larger amounts, including in the case of consumers who are borrowing to purchase housing (or to refinance an existing housing loan).

For example, advocates referred to larger loans, secured by housing or expected litigation proceeds (crimes compensation payouts). In these examples, a number of the consumer advocates interviewed raised concerns that, while these loans might be offered at interest rates that are below the maximum that applies in some jurisdictions, they are offered at an unreasonably high cost, given the nature of the security standing behind the loan.

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[186] Note the work of behavioural economists that is challenging these assumptions as discussed in Howells (2005) and Willis (2008).

[187] Data from www.cannex.com.au, Selected Personal Loans – Unsecured, 25 July 2007, at http://intranets.cannex.com.au/surveys/perunsec.htm.

[Lenders] are cropping up all the time and in particular with the personal injuries' payouts ... For example [if] you were about to get a victims of crime compensation payout and you were desperate for the money, in the case of victims of crime payments if the person who the order's name is against can't pay the government will pay, so it's pretty guaranteed that you'll get the money even though it might take a little while to get that money. But we're finding that the interest rates in those particular loans typically run over 100 percent. So when you think of how secure that lending is there's no way... There isn't any risk at all.. (C4, p12)

There are a number of reasons why low income consumers might turn to high cost lenders for credit. High cost lenders might be more prepared to lend to consumers with low incomes, or with poor credit records, than would be mainstream lenders.

... the people who use this type of the end of the market aren't the mainstream people, they're the low-income disadvantaged groups. Simply because if they weren't in that group they usually use the mainstream credit, which of course is much lower cost. Plus a definition of the people who use fringe loans is that they can't get into mainstream credit, and that's true based on my casework experience.(C2, p1)

Further reasons cited are the speed and convenience of the services provided by many high cost lenders.

One advocate also commented particularly on the use of high cost loans by those with a gambling addiction, with the speed, anonymity and convenience considered to be a high priority for these borrowers. These borrowers may not necessarily be on low incomes; indeed for some, the opposite situation may be true. However, they are excluded, or self-exclude, from mainstream institutions, and their addiction will often make them vulnerable to exploitative practices.

... I think that 95 per cent of the clients I would see don't have - they're very intelligent people, they're in good paying jobs, so it's not a matter of not being able to read the contract, it's a matter of they don't because they're so desperate to get the money. And I think that's where the protection is needed...they have this belief that next time they'll be okay so if they can just make it over to then. They've probably exhausted all their borrowing from family members or from run of the mill lenders so they go into the next quick loans. It's an important factor for clients, they're quick and they're usually fairly autonomous, they don't have to go through the channels that they would do if they were going to get another credit card..(C5, pp7,8)

In relation to loan purpose, consumer advocates generally referred to loans being taken out for meeting essentials: bills, car expenses, educational needs, and daily expenses. However, there were two exceptions. As noted above, one consumer advocate pointed to the use of high cost loans by those with a gambling addiction.

Another consumer advocate questioned the assumption that high cost loans were used to cover normal living expenses (need):

> *The second issue I think that really needs to be discussed is that the vast majority of fringe lending loans that I see are not for need, they're for want. They aren't for absolute basic necessities; they're like for Christmas presents, gambling and things like that that aren't actually needs. Funnily enough, which is a good thing, when they're actually needs and they fit the NILS criteria and so forth, the expectation is they are getting that assistance … through a NILS program. The big problem is where the money is required for something that isn't a need. That's where the fringe lending market moves in.* (C2, p5)

This type of comment was not reflected in the comments by other consumer advocates. And indeed it may also be locality specific, in that NILS programs and other alternatives to fringe lending programs may be much more accessible in some jurisdictions and localities than in others.[188]

It also may reflect differences in view as to what qualifies as a 'need' and what qualifies as a 'want'.

Consumers are desperate for finance

Almost all advocates interviewed highlighted the desperation of the borrowers who took out high cost loans, and in fact, their comments suggest that they believe that this is a key feature of the fringe lending market.

According to the advocates interviewed, this desperation arises because of inability to save small amounts regularly to meet expected lump sum expenses (car registration, etc); threats of loss of secured property, or disconnection from essential services or housing due to non-payment of bills.

In most cases, advocates suggested or implied that this desperation operates to dissuade the borrower from shopping around; create a perception (if not reality) of limited options; encourages use of lenders who can approve loans very quickly, within the one day; and dissuade consumers from giving consideration to the true cost of the loan.

There was also a suggestion by a number of advocates that this desperation and vulnerability can be consciously or unconsciously played upon by high cost lenders to offer very high cost products:

> *I think there is an element of they are marketing these products to people who are not turned off by high excessive cost. Its finance at any cost and so whether its 48 percent or 100 percent unfortunately its not a market, or they are targeting consumers who are less*

[188] See chapter 6 in relation to finance options.

likely to be put off by the extremely high cost of credit and the difficulty that they will have paying even in the short-term. (C9, pp1-2)

Problems with loans – affordability, unfair, rollovers, securities

Consumer advocates interviewed consistently raised a number of key problems (as they saw them) with high cost loans:

- borrowers often do not have the capacity to repay the loans;
- the common use of rollovers and extensions creates unmanageable debt spirals;
- lenders are exploiting vulnerabilities and desperation by offering loans that are unreasonably priced;
- consumers do not understand the cost of the loans, and indeed, in some cases the cost is not accurately described;
- the taking of securities, particularly security over household goods, is an unfair practice.

These are discussed further below.

<u>Capacity to repay</u>

The consumer advocates interviewed raised concerns that borrowers often do not have the capacity to repay high cost loans. They noted that, for consumers on a low income, particularly those in receipt of government benefits, repayments on a high cost loan can often be impossible to meet, even from the outset.

> *And the other thing is it's the very fact that they're charging that high interest rate that actually makes the possibility of default just so much more real. Because if you're paying on $1000 15 percent like you would on a credit card, you're paying back $150 a year in interest, which is about $3.00 a week, which most people can afford. Or even if you did 30 percent, still $6.00 a week. The chances of people having to default on that because of capacity to pay issues are very slim. However, when you have interest rates of 240 percent that increases your interest to $50 a week on a $1000 loan. Now you're going to have capacity to pay issues. So the chances of the person defaulting are just increased dramatically when you put those sorts of figures in place.* (C4, pp8-9)

And similarly:

> *I mean the next big issue is that they are usually on low incomes right? And the pie of their income is not very big and as a result any payments to a loan usually impacts terribly on them paying other bills, getting food and those sorts of things. I mean for example a big credit provider fringe lender is [micro-lender] and they run straight on the one-third rule - that one third of your income can go straight to repayments to them so they'll end up with one third. Now that seems reasonable if you're going to get a personal loan from a bank*

and you have an income that is actually a wage income rather than Centrelink. But when you're talking about Centrelink a third of your income is an absolute fortune, a big slice of the pie. Whereas Centrelink is actually apportioned and worked out basically to cover essentials of rent and food and bills, and you take that slice of a one-third to the credit provider, the fringe lender and that just causes poverty.(C2, pp2-3)

Well, it doesn't allow to save because if you're on the Centrelink benefit the benefit is the amount you need to survive on, nothing extra. And if they do have a little part time job usually that is paying for the extras that they can't afford because of the Centrelink payment that everybody just takes for granted. You know, so it is very difficult. Very difficult. So I think there should be more products out there that low income people can access.(C6, pp21-22)

<u>Rollovers and debt spirals</u>

Consumer advocates suggested that this situation is exacerbated dramatically if rollovers or extensions of high cost loans, or refinancing or new loans, are permitted by the lender (or a new lender) and taken out by the consumer.

In this context, consumer advocates also suggested that, while consumers might take out a short-term loan with the intention of repaying it within the required timeframe, in fact, they overestimate their ability to do so, with the result that a rollover, extension or refinance is sought; the costs increase; the short-term loan in practice becomes a longer term loan; and consumers enter debt spirals from which it is difficult to escape without a substantial change in their financial position, or bankruptcy.

Largely because experience has shown that vulnerable consumers are not put off by excessive or exploitative rates of interest and in their short-term need for access to credit will not necessarily take into account the likelihood that they will end up with revolving high-cost credit thereby compounding already high rates of interest. It's been pointed out in a number of studies that that's very common behaviour that people will take on say 14 day so called pay day loans with the full intention of paying off those loans at the end of the fourteen day period. But then simply take out another one simply because they're unable to raise the money to pay off the outstanding amount at the end of that period.(C9, pp1-2)

The most obvious impact is it's a debt trap – they never repay the loan. So I see consumer after consumer who basically ends up in a revolving debt trap where they keep renewing the loan and adding more to the loan because they can never repay the original loan. (C2, p2)

... and the back to back loans and what they do is, I find with fringe credit providers, they offer these back to back loans, some loan may not be paid off and they'll say, "Okay, we'll

give you another one which is another lot of fees and then another lot of interest rates on top of that. (C6, pp3-4)

One consumer advocate also suggested that consumer preference is generally for longer-term loans (at reasonable repayment rates), rather than the very short payday loans, but they take out payday loans because these are what the market has delivered. And the market delivered short-term loans due to the initial exclusion of these products from the UCCC.[189]

> *... because my experience from talking to lots and lots of consumers over the phone is they always wanted longer-term loans; they didn't want a payday loan because usually the loan was too big to pay each pay day. They wanted to be able to pay it over a longer term, but the payday lenders arose simply to avoid the Consumer Credit Code so they could charge what they liked.*(C2, p3)

Price of loans is exploitative and uncompetitive

Another concern raised by a number of consumer advocates interviewed was that the price of these high cost loans was in fact exploitative. They suggested that credit providers were taking advantage of the vulnerabilities of consumers to offer products at a very high cost, where the absence of a competitive market for these types of loans results in excessive and unfair profits – the products were priced unfairly.

> *Because competitive sources don't work at all in relation to the low end of the market. The only competition is who can charge the most. So the competition has just completely failed.* (C2, p1)

> *[In relation to loans secured by compensation payments] ... So it ends up costing you $50,000 to have $20,000 two weeks earlier. So it's incredibly unfair and it relies on keeping people uninformed, but also really relying on the desperation of people, in circumstances where there's very very low risk. It's lower risk than a bank, than securing against property.*(C4, pp2-3)

Consumer advocates questioned whether credit providers were operating efficiently, and the suggestion that it would be appropriate for policy makers to work out what the cost of provision for these loans was, and then set an interest rate cap relevant to this figure.

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[189] Section 7(1) of the *Uniform Consumer Credit Code* originally provided that the Code did not apply to credit that was limited by the contract to a total period of not more than 62 days. This provision was amended by the Consumer Credit (Queensland) Amendment Act 2001 (Qld) so that the Code now applies to high cost short-term loans.

... people in Victoria for instance are saying let's work out what's a reasonable profit and cap according to that – that is just absurd. We're not in the business of working out profits. What regulators should be in the business of doing is making sure that consumers are protected from exploitative lending and so putting the cart before the horse that way is just absurd. (C2, p10)

See I think that says that they're saying we're providing the product inefficiently and the market should pay for it and I don't think that's a valid argument really. (C4, p16)

One consumer advocate also noted that the high cost of the loans meant that consumers were not getting any value from the loan, and that this impacted on their ability to save and meet other calls on their income:

I don't think they're getting anything for it at the moment, because if you pay – say you take out $1000 loan and end up paying $60 a week or something and you're paying $50 interest and $10 a week off your principal, it's still going to take you two or three years at $60 a week to repay $1000. You're not getting much benefit for that. It would have a huge impact on being able to save. These loans are unfair. Say you can't charge that and we'd have so many of those people not getting into that situation. (C6, p16)

Understanding the cost of loans

A related concern raised by consumer advocates was that consumers often do not understand the real cost of a high cost loan.

This can be because interest rates in this sector often seem to be disclosed according to the repayment term (ie 20% per month), and to the extent that consumers make comparisons, they make it with annual interest rates.

Now the other thing that we've really found in our work is that people get quoted the interest rate, they get told 20 percent and we've actually done some cold calling on that, 20 percent. Even if they're told that's per month, but generally they're told the interest rate is 20 percent. They don't realise it's 20 percent per month, so they compare 20 percent to 15 percent and they think well that's not too bad, I can afford that or that's fair. Whereas when they get in there and get the money and then subsequently realise it's 240 percent they think they've been severely ripped off and it's too late for them to do anything about it. (C4,pp8-9)

[Are they quoting them as annual interest rates or monthly interest rates?] *They actually do whatever interest rate that the person is taking the payment out and usually it's monthly, which sounds quite reasonable and, I mean, people are gobsmacked when you sit down and actually do the interest with them. And some know it and feel ashamed, like, how could I have got caught up in that, you know?* (C5, pp5-6)

Consumer advocates also pointed to common scenarios where consumers in fact do not look at the cost of the loan at the time of signing, largely due to their immediate need for finance. In these circumstances, consumers will take out the loan almost regardless of the cost. They don't necessarily have any understanding of the real cost of the loan, but even if they did, it would be unlikely to factor heavily in their decision making process.

Unfair taking of low-value securities

A final major concern that consumer advocates raised about the provision of high cost loans was the unfair taking of securities, to secure repayment of the loan. Concerns were raised both about the taking of vehicles as security (ie comparing the value of the vehicle to the size of the loan), and even more vehemently, about the taking of security over basic household goods, including furniture, whitegoods, pots and pans, and other items that would not be available to an unsecured creditor in the event of the consumer's bankruptcy.[190]

The primary concern raised was that these types of low-value securities were not being taken with a view to the credit provider taking possession of the goods and selling them to recoup their costs in the event of a consumer defaulting on their loan. Instead, consumer advocates were concerned that these low value securities were used to (unfairly) ensure that consumers prioritise their loan repayments over their other living expenses.

> *And then they always, if they can, take security then over a car and it always amazes me because one people are very desperate to keep their car, so even if the loan is $8000 and the car is only worth $1000, because they are so reliant on that car they'd do anything to pay that money, not to lose the car. And that's the whole reason why some of those lenders take security over household goods. They can't get any money from that, it's just a ploy to put pressure - unimaginable pressure – on people to pay up, because the last thing that you want to be doing is having someone come into your house, or the threat of someone coming into your house and taking the TV the kids are watching.* (C4, pp8-9)

> *[In relation to security over household goods] .... a lot of these people get to the point that because they have to pay these debts otherwise, "Right, I'm going to lose the pots and pans, I can't cook. The kids' blankets, the car", they tend to say, "Well, look, I'll go to the Salvos for a food parcel because I can't afford to live.* (C6, p9)

As discussed below, many of the consumer advocates interviewed suggested that credit providers should not be permitted to take security over basic household goods.

Personal impact – short-term and long-term (demand for loans)

[190] See section 116 *Bankruptcy Act* 1966 (Cth) as amended

Underlying all of these concerns was the common view held by the consumer advocates interviewed that, in most cases, high cost loans have a deleterious impact on borrowers, at least in the long-term, but also often in the short-term. Most pointed to a situation where repayments on high cost loans divert limited household resources to loan repayments, impacting on the ability of households on low-incomes to meet their basic living expenses because, in reality, there is little fat or buffer in their income/expenses equation to allow for the (relatively) large loan repayments that are required under most of these high cost loans.

Consumer advocates pointed to immediate financial and non-financial costs for consumers, including an inability to meet basic expenses, and stress and negative impacts on personal relationships.

> *If the situation is that you are not able to pay for what you've got to pay for week to week then it's not going to improve your situation, and on top of that a credit payment as well and if it's a high cost credit payment then it's just going to tip you over the brink. Though in the short term I suppose what happens is you just cut back your expenses on other things, but if you're not living very high then those other things are going to be basics and things for your children, things for their education, nutrition so that's the short-term. The long-term effect is that you just have to bail out and then you can't cope at all and then you become bankrupt so you lose any assets that you have, if you even have assets. You're much worse off than before and that's financial. And then on top of the financial things you have all the non-financial things like the stress that it causes an individual when they are slowly going under and the impact upon their relationships. So the impact of high cost credit is considerable.* (C3, pp2-3)

> *I think it's the high cost obviously leads to some people being unable to pay, it then leads to penalty fees. It just makes things worse and possibly worsens their situation and given that most people who are using this credit are in some sort of financially desperate situation to start with it just exacerbates it.* (C8, pp7-8)

> *I only spoke to someone yesterday who said that's the very thing they were doing, they were paying back a loan to [micro-lender] and they were having to go down and get food parcels because the loan was secured against their car and they couldn't afford to lose it. So does that mean that other agencies are just picking up the tab for lending and for them being able to recover that interest? Because it's not only going to affect food, it's also going to affect whether they can pay their school fees, or their electricity bills or their phone bills, or their phone gets cut off; or whether they can remain at the place that they're living in, so whether that makes it more difficult to make rental repayments. But I know that often happens where people have said to me I have to get food parcels because I don't have enough money because the money is coming out for this loan.* (C4, p12)

Of course, to some extent, these are the impacts more generally of living on a low income:

> *But of course the underlying reasons why people are there [accessing high cost credit] is that they either don't have sufficient income to manage ongoing expenses and are not likely to be able to augment that income in sufficient time to pay off the loan, and certainly unable to do so to cover the high rates of interest that are often levied as well.* (C9, p2)

Consumer advocates recognised that there was a demand for these high cost loans, and that, at the time, consumers often believed that the loan had a positive impact – in that it enabled them to re-register or repair their car, or replace broken whitegoods, or prevent essential services from being disconnected. However, consumer advocates were concerned that, in the long-term, the existing financial position of most borrowers, and the high cost of repayments, in fact, ended up making the consumer's financial position worse.

> *… so it is fulfilling a need, but the reality is that the cost of that product is more likely than not to compound the financial difficulties of borrowers in that situation. It's a product that preys on their desperation and need for short-term cash, but really because of the high cost either of fees or interest or both that are associated with that product, it only ends up in most cases compounding their financial difficulty.*(C9, p2)

> *… I think one of the key arguments on pay day lending is that the evidence suggests that having that sort of credit available, first of all, the main use of it is because people are financially desperate and in a spot and they have a shortfall with rent or bills or some other sort of thing. Dean Wilson's research here didn't cover a lot but we haven't much else to go by, you know, he basically said by looking at the number of people who had borrowed again a number of times in a year all had refinanced their loans; if you add all of them up then … and if you assume that if someone has to borrow that many … you know, if someone had to get a loan every couple of months then you can probably make an assumption that the original loan that they got didn't necessarily help them. It temporarily helps but then they're sort of in a worse situation and they have to keep using these loans.* (C8, pp3-5)

> *Now I can understand – and I'm sure this is the point that they're making is – if you're desperate to register your car you will want to borrow $500 to register your car. However, if you get that money and can't afford to pay it back you end up losing your car anyway and the whole way to get your kids to and from school any way, how has providing that credit actually helped those people? It hasn't helped them at all and what we need to do is develop alternative ways to make access to credit affordable …*(C6, p12)

On the other hand, some consumer advocates did acknowledge that some consumers might gain some benefits from high cost loans, where, for example, the alternative to the loan might be more costly, or where the consumer was less vulnerable and speed was an issue.

For example if you go somewhere that's giving you a loan for a fridge and it's a very ... let's say it's a very responsible lender or whatever, even if there's quite a bit of interest on there there's a benefit, you're paying it off over time, you know, it's actually having a fridge ... having a fridge is going to mean savings in the long run or whether you're buying a cheap car to go to work or, you know, the sorts of things people might get with say a loan from the Brotherhood or something. I actually think that it's not just one's low cost and one's high cost; I actually think that the Brotherhood...type loans go back a bit like they do in the old days where you actually had to have a purpose for getting a personal loan. So first of all there's a genuine, specific purpose. Secondly that purpose often means savings in the future, whether it's enabling you to get to work or cook more meals at home or whatever it is.(C8, p6)

Here a distinction seems to be drawn between very high cost loans, and loans that are more costly than mainstream loans, but not unreasonably so.

Overall, however, the consumer advocates interviewed appeared to reflect the view that, particularly in the long term, very high cost loans are ultimately detrimental to consumers.

Broader – society wide - impact of loans

Consumer advocates also raised concerns that very high cost loans can have a negative impact more broadly, particularly in the sense that consumers with insufficient income to meet their loan repayments and their daily living expenses look to assistance from charities and community service organisations, and/or government welfare agencies.

I also think that it also puts a strain on welfare agencies because a lot of these people get to the point that because they have to pay these debts otherwise, "Right, I'm going to lose the pots and pans, I can't cook. The kids' blankets, the car", they tend to say, "Well, look, I've got [to go] to the Salvos for a food parcel because I can't afford to live". So there's also an impact on welfare agencies too. And scary thing about it is that they're going without food and the children are going without food because they have to pay. And they're going without school needs, but, you know. Yes, it's an impact on... on the whole of society, really, the whole of the community. (C6, p9)

Need for regulation

Consumer advocates were asked whether there was a need for controls on the cost of credit in order to protect low income and vulnerable consumers. The unanimous response from the advocates was that there was a real need for controls. Although the interviewers did not specifically identify interest rate caps as one form of cost control, all advocates responded with the view that an interest rate cap was an appropriate form of control.

In making the case for an interest rate cap, the advocates interviewed pointed to concerns about the negative impact of high cost loans on individuals and the broader community; the

vulnerability of fringe lending customers to unaffordable loans; exploitative pricing; the risks of roll-overs and back to back loans, and of debt spirals, and other matters discussed above.

Impact on credit providers

The consumer advocates interviewed were primarily focused on the impact of high cost loans on low income and vulnerable consumers, and of the potential beneficial impact for this group if high cost loans were prohibited through the mechanism of an interest rate cap.

The advocates interviewed were aware of the comments made by lenders in this sector to the effect that they are or would not be able to offer small loans in an environment where interest rates were capped at (for example) 48%, including fees and charges, and that consequently these lenders would go out of business if such a regulation were introduced (or would seek to offer non-Credit Code loans).

The advocates responded to these concerns with the following points.

Some of the advocates interviewed were sceptical of the veracity of those claims, and felt that the industry players were either not trying to develop a business model that would work within an environment of capped interest rates and/or were not operating efficiently. They accepted that a cap would have an impact on these lenders, in that it would reduce their profit margin, but were not convinced either that all would be put out of business, or that those credit providers who would be or were put out of business were businesses that were operating efficiently in any case.

A number of advocates were of the view that at least some business would continue to operate, even if interest rates were capped at 48% (including fees and charges):

> [There's not going to be suddenly a hole in the market because everybody closes down?] *No, because I still think at 48 per cent, if they cap it at 48 per cent they still make a lot of profit and it makes it easier for some of their clients to service the debt.* (C6, p16)

One advocate also suggested that if businesses were not offering a valuable product for the community they would not stay in business anyway:

> *Any industry that does not represent clearly in the community what they're about doesn't stay around for long anyway.*(C5, pp16-17)

Other advocates conceded that the introduction of an interest rate cap, including fees and charges, might have the effect of making it impossible to offer small, short-term loans in a commercial setting. However, they felt that the impact of these high cost loans was such that removing the loans from the marketplace was key, even if it was not in fact possible to offer these loans commercially within an interest rate capped environment.

One advocate noted:

> *So to me this isn't a question of reflecting the actual cost of the service provision, it's just that if that is the real cost of service provision in that space, and you're not able to offer a product or service at a rate less than that and you're specifically targeting a lower income or vulnerable group of people then that's loan sharking, that's actually what it is. You're preying on that vulnerability.* (C1, p5)

Again, this type of response was consistent with views that greater efforts need to be put into developing alternatives to high cost loan products, and/or to the need to access small amount loans, and/or to educating mainstream lenders that vulnerable consumers are not necessarily a bad risk, as long as the repayments are actually affordable.(eg C4, p12)

Some of the advocates interviewed were also sceptical of claims that the loans were high cost because the class of borrowers was high risk (because of low income, poor credit history, etc). They suggested that comments about risk were inconsistent with the fact that many loans were secured with property, or were effectively secured through a direct debit arrangement. One advocate also noted that there was no evidence available about the actual level of defaults and risk compared to mainstream lenders.(eg C4, pp7-8) This same advocate also expressed the view that it was important to consider the average of the loans on which the lenders are able to receive an income:

> *So say they lend $4 million and they end up getting across the board – say they end up getting $1.5 million a year on those loans, well they're making [...] loads of money. Do you know what I mean? It's not even accurate to say well we've got a ten percent failure rate, default rate, if in fact you're still making across the board 50 percent on the money that you're lending, or recovering 50 percent a year on the money that you're lending.*(C4, pp7-8)

Advocates also noted that it is incorrect to assume that consumers who are living on a low income are necessarily high risk borrowers. Important here is the affordability of repayments, with one advocate commenting that levels of default on the part of fringe lending customers might be

> *…because they went to these dodgy credit providers in the first place.*(C4, p12)

In discussion about the impact on individual credit providers, two advocates were also cognisant of the fact that, if lenders were unable to operate commercially, they might end up in the advocate's office, seeking advice, or seeking unemployment benefits. There was some sympathy for this outcome; however, the advocates who raised this took the approach that the negative impacts of those lenders continuing to offer high cost loans were 'too great'. (eg C5, p16; C6, p11)

What about exclusion and the loan sharks?

Consumer advocates were asked whether the introduction of an effective interest rate cap has or would lead to greater levels of financial exclusion. Advocates were also asked whether the introduction of caps has resulted in consumers turning to loan sharks for finance.

The general response of consumer advocates to concerns about financial exclusion in the sense of a lack of access to short-term credit was, as discussed above, that the inherent harm in these products outweighed potential benefits, and that the market was a safer place without them. In relation to 'loan sharks', consumer advocates gave a number of different responses.

Consumer advocates in those jurisdictions that did have an interest rate cap did not identify an increase in the use of loan sharking (however defined). Factors included the fact that the cap in some jurisdictions was not a cap on the total cost of credit:

> *So there's no loan sharking because I mean the loan sharks are mainstream because there's no real cap.* (C8, p10)

Others suggested that provision of high cost loans was, by definition, loan sharking.

Others noted the possibility that, if there was demand for small loans, and interest rate caps caused one source to dry up:

> *So if the demand for money to be provided at extraordinary high interest rate – if that demand is high enough well then that will create another source of supply.* (C3, p4)

However, no advocate pointed to evidence of an increase in the use of so-called loan sharks following the introduction or extension of an interest rate cap; one advocate noted that those using loan sharks might be less likely to seek advice or assistance from legal or consumer organisations than those seeking finance from other organisations, and so might not come up on the radar of consumer organisations or regulators. (eg C3, p4)

Another consumer advocate was very critical of the argument that the cost of credit should remain unregulated (in Queensland) so as to prevent consumers from seeking finance from loan sharks:

> *The argument often is you'll send all these people underground to dodgy lenders. I mean we don't have any evidence of that. The evidence isn't that the problem is any worse in NSW and Victoria where there is a cap, to that in Queensland where people still go to those lenders. It's like saying God we won't make robbery illegal because people might then murder. Murder people to stop the robbery from coming out. It's not very helpful. I just don't think that's a very helpful analogy at all, and there just isn't that much evidence that would suggest that that's actually happening.* (C4, p9)

Form of regulation

Consumer advocates were asked a series of questions designed to explore what form an interest rate cap, if introduced, should take. The overwhelming response was that any cap introduced needed to be a cap on the total cost of credit, rather than simply a cap on the interest rate. Consumer advocates noted that the Victorian regulation placed no real limit on the cost of credit in that jurisdiction, and as one advocate noted:

> *While you can charge whatever fees you like there's very little point [in capping the interest rate]. The only people who are going to breach the cap are just going to be ignorant because they're going to document something as fees rather than as interest.* (C8, pp12-13)

The model used in NSW, where the cap or ceiling was based on the total cost of the loan, including fees and charges, was preferred.

In terms of the size of any cap, all of the advocates interviewed were in favour of a cap of *no more than 48%*, including fees and charges, and a number were in favour of reducing the cap even further.

> *Well, I know that 48 has been bandied around and I think that's too high. I would go perhaps no higher than 40.* (C5, p10)

However, consumer advocates had mixed views about the merits of:

- linking any cap to a reference rate;
- imposing a different cap for unsecured vs secured loans;
- imposing a different cap for loans of different values.

Exploiting loopholes

Consumer advocates in those jurisdictions that had an interest rate cap were asked whether experience had demonstrated any loopholes or practical problems with the legislation.

In the main, three issues were identified:

1. A cap that is imposed on interest rates alone, without also controlling the cost of fees and charges, was ineffective in putting the brake on the cost of credit. Attempts to challenge the fees and charges of one credit provider were unsuccessful, leading one consumer advocate to comment in relation to the City Finance case:

> *So I think, you know, you'd be crazy to be a regulator and start trying to enforce the cap if you have a look at what happened in that case. So it'd be a waste of time; they'd just reword it [the contract document]. While you can charge whatever fees you like there's very little point.* (C8, pp12-13)

2. In NSW, the all inclusive interest rate cap originally applied only to short-term loans (less than 62 days). However, this lead credit providers to offer loans for 63 days, simply to avoid the regulation. This loophole was removed by the recent amendments, which imposed the cap on all credit provided under the UCCC.

> *And then NSW quite rightly went and tried to find a loophole and introduced an effective cap and then the market moved to where it wanted to be in the first place which was over 62 days ... And then of course that became another loophole which has now just recently been plugged in the last – 1 March – (making a comprehensive 48 percent cap across the board).* (C2, p3)

3. In NSW, the extension of the all inclusive cap to all credit providers has lead some credit providers to find ways to offer credit outside the boundaries of the UCCC, for example, through business purpose declarations. However, consumer advocates suggested that these are loopholes that exist in the UCCC generally, and are not specific to the interest rate caps regulation. For example:

> [Has experience with the cap demonstrated any loopholes or other practical problems with the legislation?] *It's too early to say. I'm certain there will be the old problem of avoiding the code. There are quite a few fringe lenders who successfully excluded loopholes in the consumer credit code, so I expect that will continue.* (C2, p4)

Not just about interest rate caps

There was an overwhelming sense from the consumer advocates interviewed that, while regulation to cap interest rates was an important part of the response to the issues associated with high cost credit, it was not the only response. Instead a more holistic approach was needed, one that addressed the range of issues associated with fringe credit.

Particular mention was made of the regulatory approaches of: prohibiting unfair contract terms; requiring assessments of capacity to repay; prohibiting the use of irrevocable direct debit authorities; prohibiting the taking of security over household goods (so-called 'blackmail securities') and low-value vehicles; and prohibiting or limiting the extent to which loans can be 'rolled over' without any reduction in principal.

Again if you have a suite of responses that range from a blunter instrument like a cap through to a more active and user-friendly unfair contracts prohibition then what you don't pick up with one you can pick up with another. (C1, p7)

Absolutely and I think segmenting out individual elements of the regulatory structure is actually not altogether helpful. The cap is part of a range of mechanisms that if you want fair outcomes you have to touch all of the bases. So it seems to me that you don't get there entirely by a cap, because there will still be people – if there's credit available above and beyond that – who would purchase it. The question is should there be, and if you're going to introduce something like a broader concept of unfair contract terms, then cost will factor in part of what builds a picture of unfairness. (C1, p2)

One consumer advocate also was of the view that the suggestion in the recent Consumer Credit Review in Victoria[191], that all credit fees and charges be reviewable on the grounds of 'unreasonableness' (Option 5.3) was worth looking at, whether or not an (effective) interest rate cap was in place. In particular, this was seen as a response to concerns that some loans might be unreasonably high cost, given the underlying security, even though they might not be in breach of any interest rate cap. (C8, pp14-15) This advocate also noted that the recommendation incorporated a suggestion that regulators and consumer agencies would be empowered to take action to challenge unfair fees. (C8, p16)

Another advocate raised concerns that the Victorian proposal would not be an effective solution because of the concerns about access to justice issues, and the barriers that prevent individual consumers from taking legal action to address unfairness. (C2, p6)

One advocate also mused about the possibility of imposing geographical restrictions on the location of lenders, noting for example, that they open up near gambling venues and Centrelink offices. (C6, p17)

Non-regulatory approaches, including better hardship policies from service providers, and increased access to no interest and low interest loan schemes were also seen as key components of the policy response.

It does remove what was very much a stop-gap measure that was being used by some consumers. Now what that does of course is increase the onus on policy makers and others to come up with alternative ways to assist consumers who are in those sorts of financial difficulties, and whether that's improving access to financial counsellors, improving access to hardship policies offered by various service providers and utility companies, and/or improving access to low-cost other forms of short-term finance such as limited overdrafts are all policy issues that should be considered as a consequence of the exit of pay day lenders from that market. (C9, p3)

[191] Consumer Affairs Victoria (2006)

A call to the mainstream lenders

Consumer advocates interviewed generally expressed their concerns about financial exclusion of low income consumers from the consumer credit market. However, from their perspective, inclusion was about inclusion on fair and reasonable and affordable terms.

A number of advocates specifically spoke of the need for mainstream lenders to get involved in this market, and provide alternative, affordable options for low income consumers seeking relatively small amount loans. Advocates noted that low income consumers were not necessarily poor credit risks – what was important was that the repayment amounts were reasonable and affordable.

Alternatives suggested included:

- low, fixed limit (eg $500) credit cards;
- limited overdrafts; and
- educating mainstream lenders to the lower risk (or at least lower than assumed risk) of this customer group.

The distinction between lack of access because mainstream lenders choose not to offer a suitable product, and lack of access because of poor credit histories was specifically acknowledged by one consumer advocate. However, the advocate noted that in some cases, a poor credit record may arise due to the inability of the borrower to meet the excessive costs of a high cost loan.(C4, p17) By implication, it may not, therefore, be an indicator of a borrower's capacity to meet a more affordable arrangement. The advocate also noted that a poor credit report might also reflect inaccurate default listings on the credit reporting database(s)(C4, p17) (The issue of credit reporting was also specifically discussed by lenders and government agencies in this research.)

9. The views of micro-lenders

For this research, we interviewed five fringe lenders; three of those interviewed operated different businesses within the one franchise group. Each of the lenders interviewed was in the business of providing small loans, for relatively short periods of time (for example, 6-12 months). However, they were not involved in payday lending, where loans might be provided for 2 or 4 weeks. They saw this form of lending as a different model to what they were doing. As one participant noted, in relation to the different models of lending:

> *Well micro-lending doesn't relate to what the ANZ Bank does and payday lending sort of relates to what we do, but not really. And payday lending doesn't relate in any way to what banks are doing.*(ML1, pp32-33)

The fringe lenders that we interviewed for this research were keen to talk about this issue, and to promote a regulatory response that acknowledged the demand for small loan products, and the actual costs of providing those products on a commercial basis.

Micro-lenders – business models, operations, products and services

The micro-lenders interviewed were happy to provide information about their business models and operations, and the types of products and services they offered.

A summary of the types of products offered by the lenders interviewed is provided in the tables below. Note that these loan products are in the range of products identified in our survey research with micro-lenders (see chapter 7).

Loan A (ML5)

Minimum amount	$300
Maximum loan amount	$5,000
Average loan amount	$1,990
Interest rate	43%
Comparison rate	
Establishment fee	$175-$375, depending on size of loan
Other fees	Change direct debit arrangements - $10 Default fee - $20
Security	Mostly – vehicle or household securities
Loan type	
Average loan term	About 30 weeks

Redraw permitted	

Loan B (ML1-3)

Minimum amount	$300
Maximum loan amount	$5,000
Average loan amount	$1,990
Interest rate	39%
Comparison rate	170% (6 mth loan, $1000)
Establishment fee	$140 - $650 (depending on size of loan)
Other fees and charges	
Security	Yes – normally vehicle. Company policy against using household securities
Loan type	Principal and interest personal loan
Average loan term	
Redraw permitted	Yes, after 20 weeks of good payment. Will require another credit check – fee charged.

Loan C (ML4)

Minimum amount	No specific minimum, in practice, smallest amount borrowed is $200-$300
Maximum loan amount	$2,000
Average loan amount	
Interest rate	20% / mth, annualised to 240%
Comparison rate	
Establishment fee	$30 - $50.
Other fees and charges	Pass on actual cost (eg dishonour fees from bank)
Security	Will do some unsecured loans, but most are secured. Vehicle is normally the security given.
Loan type	Personal loan, fixed period
Average loan term	6 months
Redraw permitted	

Loan D (ML4)

Minimum amount	No specific minimum, in practice, smallest amount borrowed is $200-$300
Maximum loan amount	$2,000

Average loan amount	
Interest rate	20% / mth, annualised to 240%
Comparison rate	
Establishment fee	Establishment fee: $30 - $50.
Other fees and charges	Pass on actual cost (eg dishonour fees from bank)
Security	Some unsecured, but normally require security, and normally use vehicle
Loan type	Continuing line of credit
Average loan term	Repayments styled so as to repay full amount in 6 months
Redraw permitted	Yes, credit limit is approved; once they've paid pack a certain %, then eligible for redraw up to the limit

In relation to the products offered by micro-lenders, there seem to be two distinct models:

- (relatively) lower interest rate, but higher fees; and
- higher interest rate, but lower fees.

In the tables above, Loans A and B are an example of the first model; Loans C and D an example of the second model.

As one lender noted, these two models can often operate in a similar way, if the loan repayments are met within the terms of the contract, but there can be a substantial difference if the borrower subsequently seeks another loan.

> *And there are really two camps of micro-lending. One is for example the camp where it's low application fee, high rate of interest. Then you've got the other camp, ... high application fee, low rate of interest. The costs work out exactly the same where you're talking straight take a loan, repay it back, finished. The costs differ significantly where for example you take a loan, you repay it back, you re-borrow more money. In our instance you pay your upcoming application fee of $30 or $50, you pay your interest over time; you come back and say I need more money. There is no other application fee you pay interest over time. If you go to somewhere that charges the high up-front fee you pay, for example, [a] $350 application fee, which is another generalisation. I don't know many places that do. You pay four percent a month over time. You come back to re-borrow more money, another $350, four percent over time. And then if you want to repay early during that time well you've paid your $350 up front, you don't get any refund of that. So if you borrow your money today and pay back tomorrow it still costs you that $350, plus one day's interest at four percent.* (ML4, p25)

In terms of the business model, most of the micro-lenders interviewed emphasised the high administrative and setup costs associated with these small loans. These costs reflected:

- The time taken to undertake detailed checks of the potential borrower's financial position, and capacity to repay. None of the lenders interviewed used an automatic credit scoring method as used by the banks and other large lenders. For example, one lender noted:

  So we take a lot time going behind the points scoring, talking to employers, relatives, references, looking at bank accounts, testing the information they give us on expenses, income, even visit the people to confirm what they say in relation to where they are living. It wouldn't come as any surprise to you that sometimes people lie when they're applying for money so we spend a long time. The audit we had done says that the amount of time spent on applications can vary anywhere between 3 ½ hours to 6 ½ hours to get an application done. So there's a lot of time put in it, as a result of that the costs upfront to us are very high. (ML5, p6)

  … we do more checks than the banks do for a home loan. And so that goes to costs. (ML2, pp16-17)

- The fit-out, accommodation, and office costs of these small operations, with costs being higher in city centre localities.

- The small scale of operations. One lender provided two examples of the first 12 months of start-up business; one averaged 30 new loans and 13 extensions per month; the other averaged 11 new loans and 4 extensions per month. Average costs per loan (excluding start-up costs) were $314 and $613 in the first year. (ML2)

  One lender also noted that its business model is:

  > *… designed around this principle that we lose money on the smaller loans. The larger loans recoup some profit. In the middle is roughly where it is at around 350, 400 around the middle, which is very much around these costs, which are when you're here. So it's a bit like when you go to a supermarket and I use the words of my old boss and they're not derogatory, he goes 'We prostitute some lines to bring the people in, have minimal margin. We have our high mark-up items in fruit and veg there, but at the end of the day we make X percent profit.' And that's how our model has to work. Because we could not charge $300 establishment fee on a $300 loan.* (ML2, pp16-17)

As shown in the loan examples above, most of the lenders interviewed focused on secured loans, with the most common security being the borrower's vehicle. One lender had a

company policy not to take securities over essential household items. However, this lender questioned the logic of the concern about household securities, in light of the facts that:

- some borrowers do not own a vehicle;
- there is no legal or other restriction on borrowers pawning essential household items.

For example:

> *One thing the government has to realise is not everyone has a vehicle and some people don't have a vehicle because they don't drive; they might be quite well-off but they don't drive, they can't drive. So in our case we don't use essential household items, we use non-essential household items. But if you bring in legislation which says you can't use and expand the range of household items ..., Is it better for them to lose possession of those goods and pawn them off, because they need finance or have them secured with the possibility of losing them if they don't repay the debt?*(ML2, p11)

Another lender did take security over essential household items; however, this participant did express some disquiet about this practice, and noted that it would be interesting to compare the default rates on unsecured loans to those secured by household goods.(ML5, pp15-16)

The participants also raised concerns about the efficacy of taking security over household goods:

> *So in every conversation I had, they say, you know you want to over-commit people so you can repossess their goods. Nothing could be further from the truth from anyone. We don't want their goods; they're not worth anything. In here I put half the time you've got a loan for $1000 and you've taken household items, you get some [crappy] old TV that you wouldn't put in your own house, and if you do try and sell it the second-hand guy says oh yeah I'll give you $20 for it.*(ML1, p34)

Also:

> *But in reality you know you might secure household items but you've got to go through a lot of hoops to actually take those items.*(ML3, p21)

Credit risk and impact on cost of products

The lenders interviewed for the research also noted that their customers typically represented a higher credit risk than those of mainstream credit providers, and that this also impacted on the cost of the credit products offered:

> *We're a high-risk lending entity because we lend to the people who may have credit problems, which means they have the propensity to fall over or they don't necessarily always have the means to pay, or it's someone who is more likely to go out and spend the rent on something frivolous; for whatever reason we may not get paid. So our rate of return or rate of bad debt is worse than for example the banks. Our security is more tenuous and we used to take security over a car, it's much easier to dispose of or destroy a car than it is a house. They're not always insured for the correct value and they generally lose value rather than appreciate. So you've got a number of factors, which say okay you are a high risk group for lending to these people in the first place, and without being too general it's ... if you do something of great risk you deserve great return. I think that's just the way it is, you get danger pay for this you get whatever for that. So therefore if you're a high-risk lender you should be able to get an increased rate of return.* (ML4, pp14-15)

However, one interview also reported a relatively low default level:

> [And what about default rates?] ... *it's fairly low. The percentage of capital written off when we did a lot of work for a particular purpose last year was something like 1.7% of capital written off. The 80% of the clients we have pay every week on time or every month or every fortnight whatever it is on time every time. Of the remaining 20% you'll find that 80% of those will fall behind by one or two payments and we then talk to them and try and get them either back on track or at least to maintain their two payments behind the whole way through. So 80% of those you have no trouble with. So its 20% of the 20% which is what 4% or something that we have real trouble with. So the actual number of clients who default vary between franchises depending how big they are from almost nothing up to some who have 10 or 12% of people that they have trouble with, but that really varies almost within inverse proportion to the size of the franchise, the smaller the number of loans the quicker you can get on to them as soon as they miss a payment. Of course the quicker you get on to them the more chance you've got of coming to an arrangement with them whereby they're happy and we're happy as well.* (ML5, pp9-11)

And another participant praised the money-managing skills of low-income earners:

> *But the other thing you find is that people with the best budgets are on the lowest income to a degree because they need to squeeze the last dollar out of everything, and they have a really good budget, but they don't have the income to have anything left over.* (ML4, p12)

Responsible lending

Credit assessment

Participants were at pains to counter any perception that they were engaged in irresponsible lending. They stated firmly that they properly assessed a person's ability to repay a loan, and did not lend money in circumstances where the person was assessed as being unlikely to be able to meet the loan repayments.

As explained above, these lenders did not use the automated credit scoring models used by mainstream lenders. Instead, they individually assessed an applicant's financial position and credit history (as far as possible – see comments on credit reporting below).

> *Well we obviously look at peoples' flow ability when they come in and our application form was designed to say okay look show us all your income; show us all your outgoings, we will break it down very systematically. We'll look at what you have left; we'll base how much you can afford to repay based on what you have left, how much you can afford to pay then dictates how much we lend to you. Say for example the repayments on a $1000 loan are about $65 a week. If you can only afford $40 you won't get $1000, you'll get six or seven hundred I think it is.* (ML4, pp8-9)

> *We don't have any point scoring. We look at everyone individually. Even though we know that young males are probably higher risk than young females simply because they're a young male makes no difference to us. We try and assess each person. The result of that is that there are no preconceptions at all. The people we don't lend to are people that we believe can't repay or won't repay.* (ML5, p23)

In assessing capacity to repay, one lender explained that it focused on ensuring that:

> *…their payments don't exceed two thirds of that unexpended income after they take into account you know the movies and everything they go to. We've found that people won't change their habits to pay a loan back.* (ML5, p 28)

Lenders also explained the efforts they took to check the reliability of a potential borrower's financial position, noting that there might be a tendency to under-estimate expenses:

> *… we ask them to bring in bank statements and the reason for that is not only to confirm that they are getting money into their account but to look at any other information, we tell them this, we look at any other information on the bank account and the bank statement that might be of significance. For instance, for people who are withdrawing money from holes in the wall at Jupiter's Casino then that's something we can raise with them and say that "look we're concerned that every Thursday afternoon you take $200 out of Jupiter's, why?" we just want to try and get a handle on that. If they walk in with a lotto ticket in their pocket, we ask them how often do you do that, you know try and get a full picture of what they do. We've got one of our franchisees at [town] -we struggle with trying to get accurate information from people about their living expenses, they always downplay them- She came up with a scheme of saying to people when you know when a*

single woman with three kids and she says I spent $50 a week on food, while we both know that's garbage. If you say to people: 'look you're not being truthful to me', quite often people get quite offended and say 'I'm a very careful budgeter I know how to do this'. They really get offended. So she suggested we turn into a sort of joke and say ... 'where do you buy your bread from?'. You know, that sort of thing. So [we] try and draw them out and if they won't and we know that they say they're only spending $50 a week on food, when we're doing the assessment, we disregard that and put in a figure that's reasonable based upon external data from, you know, cost of living and various things like that. And so we try and get an accurate figure and say to them we think you can only afford this amount of money and go from there. So every application is different though. (ML5, pp 23-24)

This individualised credit assessment also meant that lenders did not automatically reject applications from people whose main source of income was a pension or benefit, or who had a poor credit report. The lenders emphasised that each application was considered on its individual merits. For example one lender noted:

We don't lend to people who are currently bankrupt of course because you would be cutting your own neck type of thing. But if you've been discharged from bankruptcy; you have defaults on your CRA, not if they're current unless you're borrowing the money to get out of that situation, or there's a good explanation for it which we will check out, then we will lend to this type of person.(ML4,p13)

Another way in which one participant also assisted consumers was to pay creditors and bills directly, rather than providing a cash loan to the borrower:

So if someone comes in, for example bonds are a big one. Bonds for rentals. They can pay their rent, but they can't get a bond together. So when they apply we say find a house, figure out how much the bond is, tell us who the real estate agent is, and we pay the bond direct to them. That way it doesn't go through them and then suddenly disappear.(ML4, pp10-12)

This type of exercise took more time and lead to the increased administrative costs of operating a small loans business.

One lender also raised the issue of what he termed 'debt-shifting', as a phenomena that adds to the complexity of credit assessment, but also to the risk of lending (in terms of likelihood of repayment):

Debt shifting is where you've got a landlord or Energex or Telstra are threatening to either evict you or cut you off, and you come to us for a loan. These people, all they are doing is shifting the debt. They haven't got the ability to pay the landlord, the back rent or Energex, but the landlord and Energex have got more power than us because they can cut off the power, they can evict the person. So they come to us and these people are the people

who predominantly tell us lies, they suppress the truth, they expand the truth and they outright lie. We've got to assess that to see whether they are telling the truth. If we give them a loan all we've done is shifted their responsibility to Energex to [the lender]. And that's where part of our job is very hard; that's where the girls have really got to assess that. In the [suburb] office now we've virtually got a policy that we won't pay people's back-rent. If they can't afford to pay the landlord and that's a roof over their head, they're definitely not going to pay us. (ML2, p 10)

Purpose of loan

Lenders also placed some restriction on the types of purposes for which they would provide loans. For example, one lender explained:

> *We don't lend for frivolous things. If someone wants to go on a holiday or buy a new stereo or whatever, or buy Christmas presents for the kids, no look sorry we're not going to lend you money because you're going to waste it on something that's not a necessity.*(ML4, pp10-12)

The same lender also implicitly criticised lenders that suggested that consumers could borrow money for what the participant saw as 'frivolous' purposes, suggesting that there was now less consumer demand for loans for such purposes than there had perhaps been in the past:

> *But it's starting to get to the stage where people understand what's important and what it's going to cost and they don't really come in unless they need to. Back in the early days it was a case of oh you lend money I'll just come and get some money type of thing. And some places do still target that. Probably a good example is the [Company x] ads. Need money to take a girl on a date; go and see a concert; get married type of thing. Well from our point of view okay sure that's fine that's an important part of your life, but don't put yourself in a bad situation to get that, it's a want it's not a need, it's not a necessity.*(ML4, pp10-12)

Taking a different approach, one lender indicated that it focused on the customer's ability to repay, rather than on the purpose of the loan:

> *If we go through the process of assessing their ability to repay it doesn't matter what the emergency is or what the requirement is right now, if the credit provider does the assessment, does the checks and they can afford to repay it then yes they should be entitled to obtain credit.*(ML2, p 43)

Rollovers

Another aspect of responsible lending is the extent to which customers in default are permitted to rollover or extend loans (possibly incurring additional fees).

One lender explained:

> *We have it that if you pay back a minimum of 40 percent ...,Say, for example, you get your balance down to $600, you're eligible for redraw back to the $1000. So if they're able to prove to us that they can make consistent repayments and get that principal down, then we'll consider them eligible for a redraw. So that's the formula we use. We don't say you've got to pay back the full 1000 before you can have more, but by the same token we don't want to be someone's personal ATM, in which case they come in and they borrow back and then they make a repayment, and then they borrow that payment back and they go backwards and forwards. So they've got to reduce it down to a certain amount otherwise you get see-saw lending and people get themselves into trouble, once again. A lot of what we do is based around getting people to be stable and not get themselves into trouble, because then we don't get paid and they get chased and everyone loses* (ML4, pp 5-8)

Assistance if difficulties emerged

The lenders interviewed also explained that they continued an individualised credit management approach through the life of the loan, and took a sympathetic approach to hardship applications (whether formally characterised as such or not). Again, they contrasted this with the approach of larger, mainstream lenders:

> *And the other thing is we're more sympathetic. If you missed one of your car payments with the bank their system would automatically default you. Whereas we don't, we protect their credit history. We talk to them and if they're not out and out dubbing us we try to protect their credit history. We don't list them as a default. We say to them okay make the payment up at the end of the loan or do this, or make a token payment of $10 instead of $110. So we're protecting their credit history, we're giving them a chance to prove that they are good clients.* (ML1, p26)

> *We also encourage the clients as much as we can, a lot of the people that come to us, don't know what a budget is so we prepare a budget for them and give that to them at the time they settle the loan and say this is what you told us you spend, this is what you told us you earn. The loan payment is a particular amount this is keep to this, if you have any problem please come back to us. I do all the training for the Consumer Credit Code compliance for franchisees and I tell them that, treat every discussion with a borrower in relation to payments as an application under section 66 and frankly agree to everyone unless what they are asking is totally unreasonable just agree to it, it's better to get, if the payment is $20 a week, it is better to get $15 than get nothing ....* (ML5, pp9-11)

Again, this type of approach added to the cost of providing a small loan service, and the approach was contrasted with that of mainstream lending institutions, and proffered as a reason why mainstream lenders were no longer in this space:

> *These people generally come in and they take a lot of time to deal with. We're not talking about sophisticated borrowers at all. They've got to be coached through their application form. They've got to be asked questions, they don't write things down and they don't put things down unless you specifically ask them how much do you spend on alcohol, how much do you spend on cigarettes, what does it cost you to run a car? ... So they take a lot of time to coach through.*
>
> *And they're not generally the world's best payers. They might miss one or two so you've got to ring them up and say look, you know you've missed your payment ...*
>
> *So they're a very high service need type of borrower. Banks don't want to know about that. They don't even want people to come into the bank anymore. They specifically say we don't want people in our branches; we want you to use internet banking and telephone banking. Well that just doesn't work for these people at all.* (ML4, p 29)

This lender also noted:

> *Banks are not geared to do what we do. In fact banks don't even understand what we do.* (ML4 ,p 20)

Micro-loans as an essential service for financially excluded consumers

All of the micro-lenders interviewed highlighted what they saw as the essential nature of their service. They noted that they provided finance to help consumers manage unexpected expenses or bills, and argued that without access to this type of finance, their customers would be in an even more difficult situation.

Low income consumers, with limited capacity to save, were obviously a part of their customer base:

> *So it's an unfortunate part of society that just live hand to mouth, but if they weren't able to get access to this type of credit then the car would be unregistered and how am I going to get kids to school; how am I going to get to work? Or the car is my work, how am I going to drive around type of thing? And then they go without or something suffers until they get the money to come in or sort something out.* (ML4, pp 10-12)

However, lenders also explained that the circumstances of their customers varied widely. Their customer base included both pensioners and wage earners; consumers on higher incomes, but with a blemish on their credit record (they would, for example, consider

lending to some who had been discharged from bankruptcy (ML4, p13); and others excluded from mainstream institutions because of the consumer's preference for small loans, and/or the lender's inflexible criteria in relation to a borrower's credit history.

One lender explained:

> *Generally it's [the customer base] – to make a generalisation, it's upper lower-class to lower middle-class. We have a couple of different accounts. We've got pensioners because we will lend to pensioners ... the other account is the average wage earner who lives week to week. We find a lot of our borrowers do not have the capacity, the know-how, the force of will to save ...*(ML4, pp 8-9)

Consumers on higher incomes also borrow from micro-lenders. One explained:

> *...we've had people that have been earning literally you know $60,000 - $80,000 come and apply for loans and they do it for all sorts of purposes. We've had bank managers come and apply for a loan through us simply because they don't want their employer to know that they're applying for a loan.* (ML5, pp 2-3)

Borrowers who have unsuccessfully sought finance from other lending institutions were also part of the micro-lenders' customer base:

> *... in one franchise we looked at the average was there were seven prior enquiries over a particular period of time for the people that were applying.* (ML5, p 6)

In this context, lenders indicated that the relatively high cost of credit in this sector was not a key driver for potential borrowers.

> *Obviously the cost of credit is a major issue because people will need money for whatever reason. If everyone offered the same produce then that's one thing, but not everyone offers the same product and not everyone offers the same product to the same people. Now where you're talking about regulating the cost of credit you've got to be fully aware of who is offering what products to what people, at what times for what reasons, at what costs. Unfortunately government is not aware of all these things.* (ML4, p 2)

> *It's a bad term for our industry but we're lenders of last resort. If you can get the money from someone else go get it from someone else, if you can get it from your neighbour, your mother, your uncle whatever do it because it will cost a lot of money. If you can't get it from anywhere else it's better to pay the cost of credit than go without, because it's something you need.* (ML4, p 12)

According to the lenders, loan purposes also varied considerably. However, micro-lenders suggested that the majority of loans were provided for meeting essential living expenses, for example:

- to meet unexpected or lump-sum car-related expenses (tyres, repairs, insurance, registration, fines, etc) (eg ML1, p 18; ML4, p 11).
- Bond loans (eg ML4, p 11),
- Fridges and other whitegoods (eg ML4, p 11)

Urgency was also a key factor, and the ability of micro-lenders to provide finance quickly was attractive to their customer base.

> *We get a lot of single mums. We do get pensioners and the reason for doing it is usually car repairs, anything to do with their car. If they can't get their car fixed they can't get to their job, as simple as that really isn't it?* (ML3, p 18)

> *Okay, so medical procedures, debts, education, funerals, sick relatives. It's generally fairly urgent sort of stuff, we don't have many people coming and saying look I've got a trip I'd like to go on next Christmas. It's generally the car has broken down I need to get to work tomorrow. That sort of thing. So it's generally fairly urgent.* (ML5, p8)

> [Is credit an essential service?] *Absolutely, you know you can see from that list the sort of things that people get it for, they access small amounts of money for essential services generally. You know I've put this in submissions all over the place but fixing a car – it's not because they want the car it's because they need to get the kids to school or to work or similar, very very rarely do we have people coming saying I want to borrow money to go on a trip or something like that.* (ML5, pp 21-22)

One micro-lender also noted that loan purposes varied quite markedly between different regions of Queensland, reflecting differences in the nature of local economies and the make-up of the population (ML4, p 11).

Customer satisfaction

Importantly, micro-lenders also reported a high level of customer satisfaction with their services:

> *So many of our customers are grateful that we exist. For example one of our customers, he's a perfect payer, he's got a job but I think he's got a $100 default on his credit. While he must be a 40-year-old male he needed dental work and basically he came in, got the loan and every six months or so he comes back, it's another $1000 so he can get more dental work done. The guy is just so grateful that he can get that done...* (ML2, p 26)

The level of customer satisfaction was also reflected in the demand for their products.

Practical impact of an interest rate cap

Overall, the micro lenders interviewed were highly critical of the prospect of governments introducing interest rate ceilings, particularly if they were of the size and form introduced in NSW (48%, inclusive of fees and charges). The lenders objected on both practical and philosophical grounds.

On the practical side of the equation, lenders emphasised that a 48% cap, incorporating fees and charges would simply make it impossible to run a micro-lending business as a going commercial entity:

> *This is a harsh reality cost; let's have a look at what it costs to run these businesses.* (ML1, p 6)

As discussed earlier, this was because of the relatively high administrative costs associated with offering small loans, short-term loans, particularly given the service-intensive model used by most lenders; and the limited period in which lenders could recoup the costs of the loans.

In an environment with an interest rate cap, lenders suggested that legitimate micro-lenders would be forced from the market, leaving consumers with significantly reduced options:

> *The other is okay I'm a consumer; the government has just wiped out micro-lending. I need $600 to fix and register my car, where do I get the money? I go to the bank and the bank doesn't want to know about me. Sure they've got their little boutique pairings off in the back hills of Victoria, but that's never going to be across the board. Banks are not geared to do what we do. In fact banks don't even understand what we do. So you can wipe banks off your list. In fact if you want less than about five grand, they'll just say apply for a credit card. I need my car registered today what's 28 days on a credit card going to do me – no good? I can go to the government, but I work so Centrelink is no good to me. How else am I going to get money out of the government, there's no other way. I can go to the other finance companies, well they've sort of dried up and I don't want to borrow five or ten grand, I want $600. I don't want to have to make repayments on five grand, plus I don't want to wait two weeks for it because if you can find a finance company with less than a week's turn around, generally you're going through a broker and they're going to charge you money as well, I can't afford that. Or I can go to a community group for example St Vincent de Paul or Salvation Army or Smith Family – I need some money to fix and repair my car. We can give you food vouchers or we can help you and assist with housing or we can give you clothing for your children. None of which is any good to me, I've got to get my car on the road, so what do I do? The answer is, there is no answer. Sorry, the one other option is I can go down to [pawnbroker] or any other pawnbroker and hand over every piece of furniture or whatever I've got in my house; get maybe enough to get my car back on the road, or I come back to a house with nothing in it.* (ML4, pp 19-20)

Alternatively, micro-lenders would be forced to provide credit that was not regulated by the *Uniform Consumer Credit Code* ("UCCC")– for example, by relying on a previous exemption under the UCCC for bills of exchange and structuring the transaction in that form.[192] In relation to the NSW legislation, one lender (operating in that jurisdiction) noted:

> *We had the option of either shutting down or continuing to do what we do under the same, effectively the same cost to the borrower as we were doing at the end of February and still operate effectively as we did so even though the lenders are not required to provide notices that are required under the Code and things like that but we still do it.* [Okay, so can just explain to me what you're doing in NSW, you said you went for the Bill of Exchange?] *The contract that we enter into, that the people enter into is not a Consumer Credit Code contract. It is a bill of exchange so we just do basically the same as we're doing but under a [bill of exchange] …* (ML5, pp4-5)

This lender saw the Bills of Exchange option as the business's only option, despite indicating a preference for Code-regulated loans:

> *And we want to, the Consumer Credit Code is really important because it gives protection to borrowers. At the moment we would be quite within our rights if someone had you know given us a car as security just then grab it you don't have to give notice under the Bills of Exchange Act but we do, you know, it is very important I think that people know that they're not going to have someone knocking on their door on Saturday morning at 6 o'clock getting a car. So we still give notice. I don't think anyone has since 1st of May given notice on any basis, the intention if it ever came up is we said we would give notice and we're very keen to get back under the Code to do anything we can to get back under the Code.* (ML5, pp 4-5)

Lenders were very sceptical about the possibility that the community based no-interest loan and low interest loan schemes could be scaled up to meet the demand currently being serviced by commercial micro lenders:

> *I don't think the market is going to provide sufficient money for NILS and so forth. … the banks champion the amount of money they're providing –you know $3 million over three years for the whole of Australia –well that's nothing, so you know I think they've got to. They do, in this $500 interest free loan for Centrelink clients. The only way this thing is going to be sorted out I think is if the Government does provide money but it's really…The total amount that they allocated for a three year period was the same amount that alternative credit providers were offering in any one month.* (ML5, p 26)

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[192] As of 30 November, 2007, promissory notes and bills of exchange are largely now covered by the Code.

One lender also raised a concern that, with an interest rate ceiling, consumers would be less inclined to consider their purchases seriously:

> *And if you start regulating the cost of credit then you end up with the instance where someone's not going to be fully aware of what they're getting themselves into and the reasoning for that is, if something is expensive to a person then they realise well there's something slightly different there, I've got to watch what I'm doing, or I've got to look at it carefully; I've got to understand what I'm buying. Most consumers are aware of that, but if you see a whole table of things all at the same price then you don't pay too much attention, you're just going to pick up the first thing you see, how do you know what you've got?* (ML4, p 3)

There was a further concern expressed that prices would gravitate towards the ceiling:

> *And what you'll find that people will gravitate to the ceiling rate and that will be it. So rather than saying here's a range that you can charge at, you're effectively saying for all practical intents this is what you will charge. Yes, you're creating an open licence to charge at that rate, because the government says this is the rate to the extent to which we consider it to be legal. Therefore you're saying if you charge this amount it's legal, so everyone will probably charge that amount.* (ML4, pp 1-2)

> *But at 48 percent all you're going to ensure then is that everyone in this market always gets 48 percent and that's another thing we see is happening.* (ML2 ,p 24)

One lender also objected to an interest rate ceiling on more philosophical grounds. Most notably, that it was inappropriate of the government to regulate the price of consumer goods; instead it should be left to market forces:

> *If you have an open market economy where people are free to charge whatever they want people will buy what they're able to afford.* (ML4, p 2)

Likely compliance costs following the introduction of an interest rate cap were raised as an issue by most lenders, but not necessarily a major one (and certainly not in comparison to the profit implications of an interest rate cap).

> *But compliance costs other than the strict money costs it would impose on us by dropping our rate of return, compliance costs are pretty much nil, because we're geared to be Consumer Credit Code compliant at the moment. If they introduced a new disclosure document for example it really wouldn't cost us too much because I draft all our documents anyway. If we had to change the way our program calculated interest that's something that might cost us a little bit, but we've got programmers on retainer to do that type of thing. So it's probably very low impact, low cost from a procedural point of view. So that's not a worry.* (ML4, p 24)

Another explained:

> *Compliance is probably the wrong word. There would be research and development costs for new products, new contracts.*(ML2, p 32)

And:

> *in the overall scheme of things, we know that compliance is going to cost a particular sum a year, it might be $100,000 a year, we'll just spend that where it needs to be spent.* (ML5, pp 19-20)

But possibly a role for an interest rate cap with a high ceiling?

Despite concerns about the interest rate cap introduced in NSW, a number of the lenders were not necessarily averse to some form of interest rate ceiling, as long as it was 'realistic'. The views of what might be realistic differed significantly from the current regulation in NSW:

> *No I agree there needs to be a cap, but what it is I don't know. I mean 48 percent is obviously too low, but we do have to weed out these very high-end people who are putting people into difficulties. You've got to look at what it's costing people to run their businesses I guess.* (ML3, p 6)

> *As I said I'm fairly new to the finance industry and I was quite surprised at how much, once I got into the industry, interest rates can vary and how high they can go. So I think somewhere along the line there's got to be a cap. But since I've been in this industry and seen the amount of work involved, and the returns on the work that we have it would have to be a substantial cap, so that's my feelings.* (ML2, p2)

> [So if we did have a cap – I'm trying to pin you down on this one – if we did have a cap, I mean do you think it would have to be as high as 500 percent?] I *know it's probably somewhere between 250 and 500.* [Okay so it wouldn't be below 250?] *I don't think so.* (ML2, p 41)

Another lender suggested that a cap would need to be at least 170% (inclusive of fees and charges (ML1, p 41).

One lender was reluctant to be pinned down on an appropriate size for a cap, however, this lender suggested that the competitive rate was 20% per month, and that this should be a minimum for any interest rate ceiling:

> *Most people in the industry charge around 20 percent a month. If people could come in and undercut that and make a decent rate of return, they would because there is that much competition it's not funny. .... The fact of the matter is they haven't. So as a roundabout way of saying it 20 percent is probably the least effective rate you can charge and exist and yes it is a pretty cut-throat industry. ... So any interest rate cap would need to come in above that. .... But it certainly couldn't be less than that because then you're asking people to exist below what the competitive rate is, so that's one way of looking at it* (ML4, p 34)

Alternative models

Lenders were also asked for their views on alternative mechanisms for structuring an interest rate cap. While there was not a lot of discussion on the question, some comments were made.

One lender was supportive of a floating cap, which was at least linked to the Consumer Price Index, in order to reflect the fact that expenses go up:

> *The NSW legislation, again I've got to say the people who advise the minister have no brains because there's nothing written in there. Expenses are going to go up. Everything including the interest, the Tax Office even charge you is linked to the CPI. So they're saying here's your cap on what you can charge, but if there was any margin in there next year it's eroded by three percent, three percent, three percent. So their costs are going to go up and there's no allowance to float it up with CPI. So that's a horrendously misconceived model in the commercial sense. ...So if there is a cap built in it has to at least take into account CPI increases.* (ML2, pp 35-36)

And another lender was less supportive of an all-inclusive cap, instead suggesting that separate caps on interest and on particular fees and charges was a more appropriate policy response:

> [Yes, so your beef is with the fees and charges being included?] *Absolutely.* [So do you object to the 48% interest rate cap?] *Not at all.* (ML5, p 5)
>
> [So it's a cap on interest rates and a separate cap on fees and charges?] *We would have no objection to that whatsoever.* (ML5, pp 14-15)

Consumer credit regulation as one size fits all

A major concern raised by the micro-lenders was that the UCCC, and proposals relating to Annual Percentage Rates and regulating the cost of credit in particular took a one-size-fits-all approach. Instead, they suggested that the differences between small amount, short term credit and other forms of consumer credit were significant.

In particular, micro-lenders were concerned that the use of an Annual Percentage Rate for short-term loans was misleading and/or confusing for consumers, and implicitly, lead to community concerns about the high cost of small loans:

> *The trouble is the type of rules that are trying to be brought in are a bit like – and I go back to the comparative rate formula as a scenario – they brought in the comparative rate formula and it's akin to trying to measure the width of an atom with your car's speedometer. Insomuch as the comparative rate formula was designed for very big long-term loans, not short-term loans. And hence as a measuring tool for a small item it's like trying to use your car speedometer to measure the width of an atom. Yes it's a measurement, but it's very inaccurate and that's what I think the legislators have got to be very mindful of is banks and small lenders cannot really work under the same rules and regulations, because what works for the banks that are 100 years old; very highly capitalised versus small business.* (ML1, p 6)

> *But to come back to if there is a form of credit cost trapping it needs to take into account the terms we're talking about. If you introduce something on a yearly scale it then measures favourably against the products, for example what the banks and other finance companies bring because they work around a yearly rate. Sure the repayments may be weekly, fortnightly, monthly but they're working in terms and numbers of years- whether it's five years or 30 years. If you then try and compare that to a monthly then you're effectively multiplying everything by 12 because we work on a weekly or fortnightly payment, but a monthly term and a six-monthly payout. So instead of year we're talking month.* (ML4, p 32)

> *They focused on the fact that she was paying 98 percent interest and that was Naomi Robson on Seven is it? And all she really wanted to focus on was the fact that 98 percent was outrageous and it probably is outrageous if you're used to paying 7.32 percent on your mortgage. But if you've got the expenses that we have and [micro-lender] [has] then it's not unreasonable.* (ML2, p 9)

One lender’s response to this issue was to suggest that credit regulation be structured in a manner similar to the regulation of body corporates, with a core set of principles applicable to all lending, but then specific modules to reflect the different types of loans:

> *I said a while ago – not that it will ever happen – effectively we should have a consumer credit code that's ...similar to what's done for the Body Corporate Community Management Act. You've got a core Act and then you've got modules that apply. For example what they do is they have a residential standard module; they have an accommodation module; they have a commercial module and they have a small schemes module, which I haven't looked at in a while. Commercial doesn't relate to small schemes, commercial is designed for an office building, commercial is designed for something with eight lots or less or whatever it is. And both of them sort of relate to the residential standard module, but they've got their own intricacies. Well micro-lending doesn't relate*

to what the ANZ Bank does and payday lending sort of relates to what we do, but not really. And payday lending doesn't relate in any way to what banks are doing. So you've got all these things, but they're all lumped under the Consumer Credit Code, which places it's stake over the lot. It was designed to cover banks. Our industry has really cropped up since then ... So we came in after the legislation came in and we found well okay we've got to comply with it, but it's not designed to meet what we do and you're trying to get a square peg in a round hole, which doesn't fit. So my first answer is no don't bring any caps in because it is anti-competitive for a start, but if you're going to bring a cap in you've got to reform the legislation to take into account what actually happens in society because it just doesn't fit. (ML4, pp 32-33)

Other responses to overcommitment and financial exclusion

In addition to their strong views about the legitimacy of, and need for, the services provided by micro-lenders, one lender had a number of suggestions (other than an interest ceiling) that would assist consumers and lenders to reduce overcommitment.

These were:

1. Improving the credit reporting system so that credit reports contain comprehensive information about a borrower's credit history:

   There needs to be a positive reporting database. For example Baycorp as we know only shows applications for credit and credit defaults. Now at that conference that I didn't end up going to down in Melbourne a couple of years ago I think one of the South African speakers talked about a model they were looking at where a central database was held for everyone's credit. And it contains key information to identify the person. It actually contained all their credit card details summarised, so for example you might have a total of $30,000 in credit cards. They also wanted to record how much you had consumed out of that total credit and a flag of credit cards of whether you'd been making repayments on time. The utilities, whether utilities had been paid because utilities they see as credit, whether they've been paid. And the model they were talking about there every credit provider had to subscribe to that credit database and so we would have to, as credit providers, report to that database on a monthly basis and say here is the current outstanding debt and yes or no were repayments made on time during the month. Again it's a cost benefit analysis. Would Australia be far better off if we had this database and people couldn't over commit themselves financially? Would the credit card debt continue to spiral out if another credit card company could already see that they've got a massive debt? (ML1, p 7)

2. Allowing credit providers to access the Centrepay system;

   If you wanted to bring around, you personally, the greatest social change for Australia ever for welfare recipients you would campaign ... the politicians to have loan repayments

to come out of Centrelink – out of their Centrepay. It would be social reform for this reason. Centrelink the employer then can monitor the percentage of debt repayment to their income. So Centrelink could set a limit so again they can't lie and they can't over-commit themselves. Secondly the payments would come out and you would save Centrelink recipients literally I would have to say hundreds of millions of dollars in bank fees every year. Those two things would change the face of social reform. But if the payments were coming out of Centrelink the banks would be down hundreds of millions of dollars, and welfare recipients would have hundreds of millions of dollars more to spend on the essential items and then the bad debt - like it just goes on and on – then the bad debt ratio for micro lenders like ourselves would reduce, therefore in theory you could supply cheaper product to the market if you knew you were going to get paid. (ML1, pp 14-15)

3. Mandating a maximum percentage of income that can be devoted to credit repayment:

Okay I have a theory on this. Many years ago when my mum and dad got a home loan for the very first time the banks have this general ruling that you could not, if the loan repayment was more than 30 percent of your disposable income you couldn't get that prime lending loan. Now maybe part of the legislation is not to cap rates, but maybe part of the legislation is to say you can't commit more than X percent of any person's disposable income to debt retainment. Now that then would sort of change the way everyone – that would make everyone do a budget as a first thought.. (ML1, p 9)

10. The views of mainstream lenders

For this research, we interviewed representatives from five mainstream lenders. In this category of 'mainstream' lenders, we included the major and minor banks, credit unions and building societies (authorised deposit-taking institutions), as well as the large finance companies, who provide a range of consumer credit products and other forms of finance.

A key feature of the interviews with mainstream lenders was an acknowledgement that, at least in current and proposed forms, an interest rate cap was unlikely to have any direct impact on their business or product offerings. From that perspective, the participants were perhaps somewhat more detached observers of the debate than the other categories of participants.

Need for interest rate caps

Most of the participants expressed support for the idea of some controls on the cost of consumer credit, at least in principle. While the policy rationale for such controls was not necessarily clearly articulated, concerns around the social impact on low and income and vulnerable consumers seemed to be a driver:

> *I think socially it is my view is that it is something that needs to be addressed. It's just a trick of how you address it.* (B1, p 25)
>
> *What it will do is help those that currently aren't caught, so your fringe credit providers that are generally charging the higher fees and charges, it will bring them into line, because I mean really that's where the low income or vulnerable customers get into trouble. They can't get the finance through the banks and therefore go through these payday lenders and so forth and that's where they get stung with all the hefty fees and charges. So yes it will help regulate or it will be you know to the customers' best interest if there is some sort of level playing field.* (FC1, p 9)
>
> *Pure economics is very fine in theory but in practicality then what happens is pay day lenders and those type of unscrupulous lenders then take advantage of people who are at their most vulnerable. So it's a real challenge for the legislators to say 'right how do you legislate so that the market can behave effectively and efficiently?'. So it's supply and demand and all that sort of stuff works but how do you also protect people that traditionally would not be available for normal traditional finance.* (B1, p 6)

One participant was more critical of the policy reasons for an interest rate cap, and instead suggested that other strategies would better provide consumer protection:

I think when it comes to interest rate caps our view is we actually don't see the rationale for an interest rate cap. What we actually think is the most responsible way and we consider it, we take responsible lending as one of our three strategic pillars in this organisation. Our three strategic pillars, one is about growth, one is about is returns and one is about responsible lending. We take our responsible lending obligations extremely seriously. We think the best way to protect consumers is to ensure that there is full and adequate disclosure of contracts. One of the things that we've talked about is at the end of the day two things would protect consumers. One is a competitive market and we believe consumer finance is a competitive market but, two, ensure that there is full frank disclosure and transparency and one of the ways of possibly doing that is bringing forward or including things like cooling off periods on contracts. Making sure that there is an appropriate amount of time for customers to absorb terms and conditions in contracts and give customers the option of independent advice. So we think that that is the most appropriate model rather than creating these caps that are really artificially set. (FC3, pp 7-8)

Impact on mainstream lenders

Potentially, a contributing reason for support for controls on the cost of credit by mainstream lenders (or lack of opposition to it) was the view that any such regulation is unlikely to have any direct impact on mainstream lenders:

In terms of this particular requirement and the difference between Victoria and NSW, look to date we haven't had any impact at all but that's because of the level at which it is currently sitting. (FC1, p 8)

No not really, we don't get close to the interest rate cap. We don't want to get close to the interest rate cap. (B2, p 14)

Look for us at [Company E] we don't have any products that come near that [48%] but again we're in a very benign interest rate environment so I'm sure we would all scream if rates go to what they were in the 80s. So if it were that scenario then 48% comes a bit closer. (B1, p 27)

However, one participant did raise the hypothetical scenario of a mainstream lender's product coming close to a 48% (all inclusive) cap:

We actually did a test of some of the products that we offer and it was theoretically possible- although highly unlikely- that we could actually reach that cap and it was an instance where a customer who had a credit card with a low rate credit card of 9.95% p.a. They had an annual fee, they used a number of different foreign ATMs, they then did certain types of transactions, then they didn't make a payment, then they didn't do this,

then they didn't do that and before long the actual annualized rate was 48%, theoretically. The actual probability of that happening is very very low and that customer would have been picked up in our collections process and managed accordingly much earlier in the process. So although 48% p.a. sounds generous and you could argue extreme, theoretically a mainstream conservative lender could potentially go there, although it is very unlikely to occur. (B1, p 7)

It is also worth noting here that the NSW legislation does not include default fees or other contingent fees in the calculation of the APR for the purposes of the cap. The likelihood of a mainstream lender breaching the cap in NSW (the jurisdiction with the strictest form) is therefore in practice even more unlikely than suggested by this participant.

But will it be enforced?

Even for those who supported some form of interest rate cap, there was a level of scepticism about the practicalities of implementing such a regime. In particular, concerns were raised about the likely level of compliance monitoring and enforcement:

Yes I think there is a need to have interest rate caps but the government or whomever is setting interest rate caps, needs to set them in such a way that they can actually be policed and enforced as well. It's no use saying okay well lets have no effective cost of finance above 50% or 40% when there's no executive arm to actually go and monitor what's actually happening. (B2 ,p 10)

I think you need to look broader than banks or building societies and credit unions who traditionally, and that's a broad statement, who tend to behave and treat people with respect because we've all got different stakeholders. We've not only got shareholders, we've got customers, we've got staff, we've got a group of stakeholders who ensure that we behave appropriately because if we don't we soon lose customers and if we don't have customers or shareholders who aren't happy and we don't have staff, so there's a knock on effect. But there's fringe players out there who get away with behaving outside the rules or outside what's reasonable. So as a legislator how you legislate against that, it's a challenge. Because usually the people who they have taken advantage of also don't have the ability or competency even sometimes, that's a broad statement, to actually know what their rights are, to know the process of how to reasonably and fairly treated (B1, pp 9-10)

Participants also raised concerns about the extent to which any legislation on this issue will be circumvented:

Look people who want to take advantage of people will try and find loopholes in whatever legislation is built…Which makes you wonder about the interest rate cap idea if they can

find a way around it anyway. Exactly, is it effective? So the regulators have got a real challenge. (B1, p 25)

… generally those fringe lenders have innovative ways of getting around these things. (FC4, p 11)

And what form should it take?

In terms of the form and size of any cap, most mainstreamer lenders who answered this question were of the view that an all-inclusive approach to a cap was the most appropriate response. The alternatives, regulating the interest only, or setting a cap on interest and a separate cap on fees, were generally not seen as being effective or practical.

I think that at the State level, I would personally be in favour and support appropriate interest rate caps, allied with this increased support in executive and sort of enforcement side to do that. I would say as a start set the bar higher- maybe make the interest rate caps at 50% or 60%, give people a sort of an opportunity to become responsible basically, an amnesty for 12 months and then say right while this amnesty is on you guys get your act together, or we're coming after you. And from 1 January 2008 it's game on. That would be my recommendation. (B2, pp 17-18)

Absolutely critical, it's the only way, otherwise people will say I've got a 1% interest rate and a $300 approval fee. So yes it's the only way, effective cost of finance is the only way to operate. (B2, p 11)

I think the Victorian model where interest rates were capped but some of the fees and charges stood outside that was an interesting, well intentioned approach which actually didn't resolve the problem. We ended up with a lot more fees and charges. (B3, p 10)

We'd be averse to having any regulation in terms of capping of fees. Happy to in terms of including that in a capped interest rate, which you know would include fees and charges but not actually regulating or capping fee charges themselves. (FC1, p 22)

I agree from a regulatory point of view and a policy point of view, there doesn't seem too much point in setting an interest rate cap if the credit provider can then structure things so they operate below that but then charge high fees and we're talking about protection of the vulnerable so we can't assume they'll fully understand how much something is gong to cost them and therefore I think for it to be meaningful it should include fees and charges. (FC2 ,p11)

The view was not universal, however; one mainstream lender was in favour of a cap on interest, but not fees:

> *I think if we were to have a cap it would be an interest rate cap without the fees.* (FC3, p 10)

While one participant supported the quantum of an all-inclusive cap of 48% (similar to that in NSW):

> *I think it's a good idea to bring the 48% in Queensland.* (FC1, p 9)

One criticism of the NSW model, however, was that it effectively led to a "double regulation" of fees:

> *NSW are sort of out there having a look at it at the moment. They've spoken to us and asked us questions about caps and features of our products and what not but it's sort of curious to me that there is that cap there that includes fees where a number of fees are regulated already and it seems double regulation and I don't see a lot of sense in that.* (FC3, p 10)

Another participant supported the idea of a cap scaled by reference to the size of the loan:

> *That's a very relevant point I think to caps, is that the cap should in my mind only apply to loans in excess of say 3-6 months or should be or possibly should be scaled relative to the period. For example if somebody wants 3 months' money the costs from a financial services provider, the cost of origination of that loan, the discussion, the maintenance and then drawdown and repayment and all the rest are proportionately higher to you know, are a greater proportion, you have less time to recoup that for example through interest. So just using an effective interest rate, so if there was 3 months money I would say set a cap at 70% as an example, 70% effective cost of finance, 6 months make it 50, 12 months make it 40. So maybe scale it relative, you know such that the affordability should drive everything. You know 3 months' lending at 70% effective cost of finance is more affordable than 12 month lending at 70% cost of finance if you know what I mean. I think my recommendation would be to scale it.* (B2 pp 14-15)

Another also noted that the size of the cap should be set with some regard to the costs of doing business:

> *The one caveat that I'd make to that though is that I think in setting the regulation one would need to make sure that what is introduced isn't so onerous that it's going to impose a significant cost on the credit providers and therefore mean just that their costs of doing business go up so much that they do have to increase their fees and charges to such a level*

that you approach that cap. If that was happening you'd need to look at a higher cap I think. (FC2, pp 11-12)

The need to arrive at a uniform solution

Concerns were expressed by some mainstream lenders that the lack of consistency, certainty and uniformity in credit regulation in Australia, added unnecessary complexity and cost to their role as credit providers.

> *We're on a wing and a prayer at times. I think that the biggest thing that we as an institution would like is certainty. When regulators bring out a piece of legislation without being cynical, it tends to be because of some sort of political pressure and politicians with all the goodwill in the world …are just reacting- some sort of knee jerk reaction- and I think given the complex nature of financial services, I think one of the tings that we would desire the most is consistency in approach and certainty in approach.* (FC4, p9)

> *Generally speaking in terms of laws obviously from a corporation's perspective you want consistency across the States. You can imagine operationally trying to manage the different requirements in each State. It's horrendous, we'd rather consistency. In terms of this particular requirement and the difference between Victoria and NSW, look to date we haven't had any impact at all but that's because of the level at which it is currently sitting…if a State was to bring on something that was really inconsistent with what's currently in, then yes that may cause us some problems.* (FC1, p 8)

Is there a need for micro-lenders in the marketplace?

Some mainstream lenders expressed views as to the value or otherwise of micro-lenders in the market place. One saw a need for micro-credit, because it was not a market in which this lender saw itself operating, but subject to regulation:

> *We are not going to operate in that market, we're looking at a fringe lending market here, so yes I think we need to look at regulating them, to a certain extent in that they need to be under the same obligations as the larger banks in terms of responsible lending, and part of that is affordable, but I wouldn't want to see them wiped out because I don't think we have an alternative and we need to provide a service to that part of the market.* (B3, p10)

Continuing the call for regulation of micro-credit was another lender who saw 'fringe players' as dragging down the reputation of banks and harming consumers in the absence of effective regulation:

> *Yes I think also too though that the regulators do need to look at the fringe players. I know that's a broad description, but I think it's the fringe players that drag down the reputation*

of the major players because you look in the media and stuff and bank bashing is still a bit of a hobby horse but really people now realise that banking is actually very competitive and if you want a good deal consumers are empowered to go to their financial institution and say I want more and given the way the market works, this happens. But that's consumers who are empowered. Consumers who aren't empowered are fair game for the exploitative lenders, and the unfortunate position at the moment is that they probably fit outside traditional credit criteria. (B1, p24)

So whose responsibility is the provision of affordable credit?

Some of the mainstream lenders interviewed are engaging in the provision of low interest loans to low income consumers, in partnership with community organisations. One of them expressed a view, however, that governments must play a key role in ensuring access to affordable credit for low income consumers.

I think government is critical in this space in that a lot of these services were previously part of government's responsibilities. We're also seeing changes to the welfare system, such that we're probably getting a higher number of people meeting the kind of requirements for the criteria of low income. We're also seeing I think a higher proportion of casualisation and contracting in the workforce and I think that's just a change in market requirements but which means that again we're excluding more people. So if we are to meet the needs of all Australians I don't think it's up to the private sector to step up and fill that space. (B3, p 9)

One lender not currently engaged in the provision of affordable credit to low income consumers, indicated a willingness to become engaged in this area as part of the lender's corporate social responsibility activities:

Look I think it is something we would certainly be interested in considering given too particularly I was saying earlier that people at [company]actually get paid for the opportunity to go and spend time in the community so if the structure is there, we've got a very large pool of employees who combined have got a very long experience in the industry, there's no reason why we couldn't consider that. (B1, p15)

11. The views of regulatory staff

In our research, we interviewed staff members from the relevant regulators in three states, New South Wales, Victoria and Queensland. Participants held senior policy or enforcement responsibilities in relation to consumer credit regulation in their jurisdiction. However, they participated as individuals, and their responses should not been regarded as statements of the respective government's positions or views. As outlined in chapter 3, each of these jurisdictions has a different regulatory response to the question of high cost credit:

- NSW imposes a maximum interest rate of 48% (including fees and charges), on all credit regulated by the UCCC;
- Victoria imposes maximum interest rates of 48% (for unsecured loans) and 30% (for loans secured by a mortgage), but does not impose a ceiling on loan fees and charges;
- At the time of interviews, Queensland did not impose any ceiling on interest rates or credit fees and charges, although legislation similar to the NSW model has now been passed and came into force on 31 July 2008 in Queensland.

The interviews with the staff of regulatory agencies were designed to explore the reasons for introducing, or not introducing a ceiling in those jurisdictions, and the impacts of the different regulatory approaches.

History and reasons for a cap in current form

A key influence on the form and status of a cap in each of the three jurisdictions was historical, in the sense that the regulations in their current form derived largely from earlier credit legislation (eg the 1984 Credit Acts in NSW and Victoria), which in turn, were derived from the Money Lending legislation, imported from the United Kingdom in the 1920s.

> *We've had a cap in New South Wales since the 80s, under the old Credit Act. When the Code came in, that [cap] was just brought forward.* (R1, p 2)
>
> *Partly an easy response to that is that the "Regulating the Cost of Credit" research paper by Ian Manning goes into the history.*[193] *He actually quotes the exact time at which the 48 percent came into operation in Victoria, which I haven't rehearsed or memorised. So I think the gist of the history of the thing is it's very much a reaction to the similar thing which was in place in the United Kingdom since the 19th Century over there and*

[193] Manning and de Jonge 2006.

certainly I think the debate – again Ian's paper can give you the detail – but I think the debates were about the usurious side of things. I think that's really where the 48 percent when it was introduced here came from. It was not so much considerations of market power or credit exclusion, it was really isn't there a rate above which credit surely is usurious and exploitative? (R6, pp 1-2)

In implementing the current regulatory arrangements, there appears to have been some analysis of the appropriate size of the cap, at least in NSW. For example, NSW participants referred to a review by the Commercial Tribunal on the appropriate size of a ceiling:

In the review, in the Commercial Tribunal, there was a review done in the late 80s in the Commercial Tribunal in New South Wales and from the report that they put out, they said that at that time they looked at what was happening in other States, at the time Victoria had the 48% cap, and there hadn't been any great representations from credit providers in Victoria, that they couldn't operate within that cap, or they had any concerns about the cap. So it seems to me that, based on that sort of information, the Tribunal in New South Wales went 'Okay, let's--- and also for issues of consistency and uniformity, that they looked at that issue of the 48% cap. (R2, p 4)

This review referred to the then *Credit Act*; as noted above, the participants explained that the size of the cap was simply moved across to the UCCC regime.[194]

On the other hand, one Victorian participant commented:

I don't think there has of course been any – to my knowledge – open discussion except that which we're now generating in the Consumer Credit Review about whether or not for instance the 48 percent is pitched correctly, and it's 30 percent for secured credit here. (R6, pp2-3)

In relation to an appropriate size for a cap, one Queensland participant commented:

Well you'd think that even just for consistency you'd have to look first at why they shouldn't be set at levels that are set interstate. Do you know why 48%? I understand that there was some legislation hidden in Victoria or New South Wales that had that amount. I mean ... why would you set it at 48%, or 50% or 75%? It's a reasonably arbitrary figure ... (R3, p8)

The interest rate ceilings in the *Credit Acts* were ceilings on the interest rate only. There was no requirement to incorporate credit fees and charges when calculating whether the interest rate ceiling had been reached.

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[194] (Note that the Credit Act 1984 was amended in 1993 to provide a cap that was linked to the Supreme Court Interest Rate (set at four times the Supreme Court rate). At the time of introduction of the UCCC, the Supreme Court rate was 12%; the maximum interest rate introduced in the Consumer Credit Regulation 1996 was set at 48% (and not linked to the Supreme Court rate).

In part, as the participants explained, this reflected the current state of the credit market at the time. Participants explained that, at the time of the introduction of the UCCC, there were few products with fees and charges included; and there was little evidence of fringe lending. One participant from NSW commented:

> *Under the old Credit Act, we didn't, there was only one interest rate allowed and no fees and charges. Everything had to be rolled up into that, so effectively that was fees and charges included. That was the total cost of credit.* (R1, p 2)
>
> *When the Credit Code was first introduced in New South Wales, we didn't really have a lot of fringe lenders or we didn't have any that we knew of.* (R1, p 2)

And in relation to the Victorian experience:

> *As you are aware when the 48 percent was first introduced I think it's probably fair to say that pretty much all or close enough to all of the cost of credit was in the interest rate and therefore you didn't really need to apply the cap to anything other than interest.* (R6, pp 4-5)

Subsequently, when the UCCC was introduced, and removed restrictions on the types of fees and charges that could be imposed on consumer credit, the question of incorporating fees and charges into the maximum ceiling calculation became an issue:

> *It's only since the Consumer Credit Code came into being with the full capacity to decouple interest from fees and charges to assist kind of a user pays type thing; you don't have cross-subsidisation; you can levy the fees and charges that correspond with the underlying costs of a particular form of credit. It's only with this almost absolute freedom to levy whatever fees and charges you want, that we've suddenly been faced of course with the prospect of an increasingly irrelevant interest rate cap.* (R6, pp 4-5)

NSW has addressed this issue by imposing a 48% all inclusive cap, first to credit of up to 62 days in duration, and subsequently, to all credit regulated by the UCCC:

> [What were the reasons for including or excluding fees and charges in calculating the cap?] *It's really about avoidance of the maximum rate requirements. Because they were charging a low maximum rate, a low interest rate or a lower interest rate, and then imposing excessive fees, in our view. And it wasn't really the fees that were charged up front, like establishment fees, although those were excessive for the amount of credit sought.... It was the practices, rather than interest rate and the upfront fee. The practices, which were about--I think I'm rolling about ten questions into one here--were about giving money to consumers who really couldn't afford to repay it, And then when they defaulted, charging excessive default fees and all those things that went along with default, like enforcement fees and fees for writing letters. So, all of these costs were coming in down the*

road from the consumer coming into the contract. [These costs] vastly exceeded the maximum rate, and therefore we thought it necessary, or we were certainly extensively lobbied, to extend the cap to include fees and charges. (R1, p 3)

The all-inclusive cap was subsequently introduced to overcome the avoidance problem of loans being structured at 63 days in order to avoid the cap:

By extending out the provision, the fees and charges were already included for under 62 days, so it was extending out that provision to all loans regardless of the length of time, which makes sense when the lender goes for 63 days, it is just an extension of that current provision. (R2, p 8)

In relation to Queensland (which, at the time of interview, did not have an interest rate ceiling), participants noted concerns that a 48% cap did not address the costs of small lending; might drive many lenders to charge that amount; and that unconscionability provisions were a more effective response to the concerns of the public. Referring to the Government's discussion paper on interest rate caps, and the explanation in this paper of a previous policy decision *not* to recommend an interest rate cap in Queensland,[195] one participant noted:

I recall that the reasons were that the concern was that there would be a de facto, acceptable limit on the no interest charged if we set the 48% ceiling…Because it was permissible by the legislation. That was what the legislation said. So there were concerns about that. It was thought the public interest could potentially be addressed through the unconscionable conduct provisions in the code. It was also a concern that there was no recognition of the increased costs as a proportion of an amount. (R3, p 1)

Policy reasons for / against cap

We asked participants for their views on the policy reasons for or against an interest rate ceiling, however, there was not necessarily a consensus view on this issue.

For NSW participants, key concerns were around the vulnerability of the borrowers, and their inability to exercise market discipline on lenders:

… that there really isn't one [a market] in terms of this market, this fringe lending industry, because the consumer has no power and they have no choice. They don't have any influence on the market there, so they can't influence either prices or the development of the industry. (R1, pp 16-17)

I think one of the things that concerns us most is that most of these people that they were lending to, probably the bulk of the people they were lending to, were consumers who should never have got that sort of credit in the first place, and couldn't afford the

[195] QOFT 2006 p 7.

repayments. So that then it [the loan] became really exploitative and leads that consumer into a spiral of debt that they really couldn't escape from. ... these people were really vulnerable. They had no alternatives, or didn't think they had alternatives, and so were going further down the debt spiral all the time. (R1, p 13)

Another participant commented on the effectiveness of competition in the market:

> *But there are other parts of the credit market, which are I guess far less competitive and the small amount credit market has been said to be one of those, although competition continues to increase in that market. And is it the case that we're saying that there are very high fees and charges associated with credit from the likes of [microlenders] and the rest of them and some of the promissory note lenders, and the reason for that under the classic theory is there's less than full competition. So what we would be doing by intervening in the cost of credit is trying to bring about, or at least trying to remedy the fact that competition hasn't delivered fully as in other areas of the market, and it has in terms of keeping costs down.* (R6, pp 5-6)

One participant highlighted the difficulty in articulating the policy reasons for intervention:

> *I mean in a sense you really can't go forward without saying what are we on about? Is it just the usury, is it market power, is it credit exclusion, what is it?* (R6, p7)

There was also a suggestion that there was a universal view that there was a certain point beyond which the cost of credit was beyond the pale:

> *I think there is still an etiquette around to the effect that there comes a point when the amount that it's costing somebody to borrow money goes from being a sort of a transaction into which both parties have entered into with their eyes wide open. And it becomes at some point just a little bit beyond the pale. And I suppose you eliminate at some point the nominal contract theory of two freely contracting parties. And you end up instead with somebody who pretty much has no effective choice but to borrow the money, at least on these rates and under those terms and conditions.* (R6, p 2)

Impact on fringe lenders

Views on the impact on lenders of an interest rate ceiling were divided amongst participants.

Some participants noted the potential for an all inclusive cap (along the lines of that in NSW) to make it very difficult (if not impossible) for credit providers to offer small, short-term loans:

I honestly can't see how a credit provider would survive on a 48 per cent return on their money when you look at – when you consider that on average, from my understanding of the industry, about 10 per cent of loans go bad so you can cut 10 per cent off their profits straight way. Because it's not just the interest they're going to lose. It's their capital outlay, or the principal they loaned – they loaned $1000 out. They lose the interest but they then lose the $1000 they lent to that person. So it's not just the interest they lose. They lose the principal as well. (R4, p 5)

The credit providers I think it would – decimate is probably a pretty harsh word but I think it would greatly affect the industry. I think you'd have a lot of people shutting down. Only the bigger operators would survive. (R4, p 6)

On the other hand, one participant indicated that claims about the sustainability of business models in an interest rate caps environment had not been made out:

We have heard of it, of course. They've supplied figures which you can dispute on a number of bases. They claim costs which you may dispute as being legitimate or not, or the actual figure that they supply you can actually dispute. But I think a lot depends on economies of scale and efficiencies as well. I don't know that any of them have actually applied efficiencies to their processes. So that it's very hard to know from what they supply to us, and of course they're going to say that. They're not going to get the same kind of profit margins that they did when they were operating without any cap. (R1, p 4)

There was also a suggestion that a cap on interest alone has had, or would have, a lesser impact on credit providers:

But in this environment that we've had of a small amount of cash loans being available, or people seeking a small amount of cash loans without using a pawn to get them the 48 percent clearly has had no impact on availability. (R6, pp 10-11)

In part, this is likely to relate to the fact that additional return can be made through imposing fees and charges, which have no maximum ceiling. In this context, one participant referred to the potential for a 'reverse engineering process', where interest rates are reduced to comply with the ceiling, but fees and charges are increased, so that the cost of credit to the consumer is unchanged:

City Finance we know for a fact and it's on the record and it was part of the submissions that were made to the tribunal here; we know for a fact that when it was pointed out to them by credit advocates and by us that they had exceeded the 30 percent ceiling in Victoria, I think they were thinking about 48 percent and forgetting about the fact that often they were securing their credit with motor vehicles and therefore we have the 30 percent ceiling for secured credit. As soon as they discovered that they were going over

the 30 they simply re-engineered the figures so that they sat at 30 on the knocker for an interest rate, and then they recovered the money that they would otherwise have 'lost' by upping the fees and charges a bit. In discovery we actually got hold of documentation which was a description of a reverse engineering process where they simply said we still want this return, we still want 35 percent return or 49 if it was unsecured or whatever. Now we have to stick to 48 and 30 for unsecured and secured respectively, so what do we need to do or what charges do we need to introduce or what fees do we need to increase in order to keep the current rate of return? So I guess that's an example where the 48 percent interest rate has had a direct effect. But it's only had an effect in terms of juggling your disclosures effectively and creating a few new fees. It didn't have any effect on the actual cost of the credit to the consumer. (R6, p 9)

This same participant also noted that a lack of clarity around the definitions of interest, fees and charges also creates some uncertainty about the applicability of a ceiling that applies only to the interest rate:

> *There's a bit of grey sometimes as to what is properly classified as interest and what's properly classified as fees and charges, rather than just relying on the black and white in the credit contract. So I suppose that's the other. If we leave aside honest and proper – here's the interest, here's the fees and charges or there's no interest and there are fees and charges - you have this difficult question of law sometimes as to what is properly to be regarded as a cost in the nature of interest. And so if you have a situation where it's not clear into which camp a particular element of the cost falls you have got yourself a real complication because you're unable to say whether 48 percent or 30 percent has been exceeded because you don't know which side of the ledger the amounts should sit under.* (R6, pp 12-13)

A major impact (or potential impact) of introducing an interest rate ceiling that was identified by all participants was an increase in avoidance of the Consumer Credit Code by credit providers:

> *We do know that there have been impacts in other ways, that some of the lenders are trying to avoid it [the cap], by various means.* (R1, p 6)

In all jurisdictions that have an interest rate cap, the cap applies only to credit that is regulated by the UCCC. Thus, if a credit provider is able to avoid the application of the UCCC, it can avoid the application of the interest rate ceiling:

> *… I'd suggest if people are taking opportunities of loopholes now, yet not under this legislation that we've enacted, they're finding them under the [Consumer Credit Code].* (R2, p 11)

In terms of mechanisms to avoid the Code, participants mentioned a number of examples:

One of those is bill facilities, and bills of sale, so there's a move to actually bring those under the Code. There's also business purpose declarations. Pawnbroking issues, where they're calling it a pawnbroking function rather than credit provision. (R1, p 6)

Setting up the brokerage...To do it as an intermediary, so you set up a brokerage so that you charge a fee as a broker and then the other part of your business is the credit provider. (R2, p 6)

Another mechanism mentioned was 'tiny terms' – where the arrangement is advertised as 'interest free' (and thus outside the jurisdiction of the Code) but the deal effectively inflates the purchase price to compensate for the lack of interest:

We're seeing an increase of is what we call tiny terms loans and what that is, is typically car finance. What it will be will be a car that's worth about $2000 or $3000. They sell to you for $7000 or $8000 and say that it's interest free, no fees and charges and the car is worth $8000, so the car is truly worth $2000 or $3000. The figures we are seeing is double or even triple the price of what the car is worth (see R4, p 6)

Impact on mainstream lenders

There was general agreement amongst participants who addressed this question that an interest rate cap would have minimal impact on mainstream lenders, even if it were to include fees and charges:

I think there's less impact on mainstream lenders in terms of the cap, just for the sake that mainstream lenders mostly aren't charging above it to start with. So bringing in fees and charges into the 48% hasn't had as much of an impact on mainstream lenders as it has on fringe, because mainstream lenders haven't been charging above that to start with. (R2, p 8)

However, NSW participants noted the specific exemption from the interest rate ceiling for Authorised Deposit Taking institutions (ADIs):

... there's an exemption in New South Wales for ADIs, for those products which are unintentionally caught [by the cap], in a way, like overdrafts, where they slap on a large fee. We're not suggesting that these credit providers are entitled to charge that [amount] for that product, but we're saying that those consumers who go to those lenders and are charged this fee do it basically with the option of taking it or not taking it. It's their choice. They could probably find other options. So we're not so much concerned with that, and we don't want to reduce the convenience of those products to that sort of consumer, who basically has their eyes open and can take it or leave it. (R1, p 8)

One participant also noted that some mainstream products can also be high cost if default fees are incurred:

> *Now if you target the small amount market by itself though, how do you respond to the prospect – or what do you say to the consumer who has borrowed $100 on their credit card and then the direct debit comes in late or whatever, and in month number one they miss the payment date by one day, there goes $25, $30, $35 – depending on which institution they're with. And then in the following month because of the world of electronics they draw down beyond the limit - say they've got a very modest limit – and there goes another $35 in default fees. So just in the space of two months they've already paid $70 for their $100 originally, without adding in the interest that they start to pay because they haven't repaid the amount in full at the end of the first month.* (R6, p 6)

Impact on consumers

In terms of the impact of an interest rate cap on consumers, participants raised a number of different issues. A number specifically acknowledged the potential for a decrease in the availability of credit choices for consumers who are unable to access mainstream lenders:

> *The effect on the consumers I think you'll find that they have reduced, or significantly reduced options.* (R4, pp 6-7)

And in relation to other options:

> *I suppose the problem is first of all they won't be able to go to the banks because the banks won't touch them. ... banks aren't interested if it's under $5,000. You'll find the consumers will want them – again the benefit of seeing from the point of view – from my point of view is I get to speak to consumers and you do get a lot of single mothers, unemployed people, people down literally to the last dollar. You'll find that they will find ways of getting credit.* (R4, p 8)

In turn, there was a concern that this would lead to an increase in loan sharking:

> *I would hazard a guess and say that a lot of loan sharking probably would increase if you brought in a cap on everything.* (R4, p 4)

On the other hand, one participant noted:

> *People say on the other hand that introducing a cap would be throwing borrowers to the loan sharks, but the largest loan sharking case ... has been with Queensland where there is no cap.*[196] (R3, p 3)

[196] Referring to the case of *Queensland v Ward* [2002] QSC 171.

Another suggested that the availability of alternatives is likely to increase in the medium term:

> *I mean I think that the way things are looking at the moment there's every chance, not in the short term, but in the medium term that there will be a much greater availability of small amount fixed-term credit on a more affordable basis than you can get it from [microlender] and that ilk. ... We can do some work on the education front here because there are some other avenues for getting small amounts, like Centrelink advances and so on.* (R6, p 14)

And, in terms of the impact to date in NSW:

> *We've had nothing from consumers or consumer advocates to say 'Look, we're desperate, we can't get credit'. So, we won't really know yet, I think it's too early to tell at this stage.* (R1, pp 5-6)

Another noted that the introduction of an interest rate ceiling might lead to an increased ruthlessness on the part of lenders:

> *I believe that you'll find, especially if – say again a figure, 48 per cent, say that hypothetically, I would assume that as a lender, if I was a short-term loan lender, I would then be utterly ruthless. The moment someone missed a payment, bang, repossess the car. Give them a 30 day warning and then repossess it because I'm making minimal money on that as it is, that loan, so we're currently, according to credit providers, are really nice people and they don't repossess at the first notice I think you'll find they'll be utterly ruthless because they have to be to make money.* (R4, p 8)

In terms of benefits to consumers of interest rate ceilings, one participant wondered whether there was evidence to suggest that there are fewer high cost loans in the jurisdictions with interest rate caps than without:

> *I don't know what the research is to say whether there is less of a problem with unfair expensive loans in New South Wales and Victoria where they do have caps.* (R3, p 3)

And another identified what might be seen as a paternalistic benefit for consumers:

> *Or again are we saying here as a matter of public policy that really there are lots of people who it would be better if the stark choice is between credit at an incredible rate of knots, rate of dollar cost, versus doing without that credit then better that they do without the really expensive credit and cop the consequences,* (R6, p 6)

And another commented that consumers would benefit because regulators, rather than individual consumers, would be expected to police the cost of loans and take action for breaches of the cap:

> *[it] imposes the onus on the regulator, because you would make it an offence possibly to go over a cap. That becomes a regulator's responsibility. Whereas if it's an unconscionable amount of interest, or fees and charges are imposed on the loan, then that's a consumer responsibility and a lot of consumers won't take that action because they don't have the money to obviously, or they're just not prepared to go to court over what may be a relatively small amount.* (R3, p 6)

In relation to consumer satisfaction with the loans and services offered by payday and microlenders, one participant noted the reported[197] consumer preference for at least some of the characteristics common to high cost loan providers:

> *The micro-lenders tell us that people prefer their convenient hours. They're open after hours. Some of them don't like banks, they don't like credit cards, so they go to them.* (R3 ,p 4)

Another noted that a lack of complaints did not necessarily indicate complete satisfaction:

> *One thing too, just in relation to the consumers being happy. It may be less that they're happy than that they don't complain. There's that vast body of consumers in this socioeconomic bracket who just don't complain, because they're so used to this sort of debt merry-go-round, and also being, if I can say, done over by everybody, that they just don't complain anymore. They just put their head down and get on with it. There are also those who have been, in fact, warned off complaining. …--and there are those who don't want the world to know about their gambling secrets, and so many things that actually prevent people from complaining. I think if it's lack of complaint, yes, but whether they're genuinely happy, I don't know.* (R1, p 14)

Regulatory options

In considering the various regulatory options available to manage the cost of consumer credit, participants highlighted the influence of factors such as the existing regulatory framework, the uniformity agreement on consumer credit, the practices of other jurisdictions, and the simplicity vs complexity of different options.

For example, the existing regulatory framework, and the constraints imposed by the uniformity agreement influenced the extent to which governments could start with 'a clean slate' in making regulatory decisions:

[197] For example, in Wilson 2002.

> *One of the things that we had to take into consideration is that the legislation is there and has been in force and is uniform. So we're actually constrained by the uniformity agreement, really, that allowed us to set a maximum rate. Everything else has been consequent on that ... we weren't starting from scratch, we were starting from a baseline of legislation already in place ...* (R1, p 12)

Another noted the influence that a major jurisdiction (like NSW) had on the decisions of other jurisdictions:

> *It's enormously attractive to simply take the NSW approach not only because there's a degree of simplicity and ease of enforcement and everybody knows where they stand, but then secondly from Victoria's point of view you might as well say 'it's already happened in NSW'. NSW is a very large jurisdiction, so we've already got this regime in a quarter of the country population wise or more actually. So we might as well just follow suit.* (R6, p 7)

A drive for uniformity on credit regulation is seen in many other areas, and it would not be unreasonable for the decisions of the largest jurisdiction (NSW) to have a significant influence on the decisions of the smaller jurisdictions.

Despite this, the Consumer Credit Review in Victoria did not recommend the adoption of the approach taken in NSW. Instead, it recommended that all credit fees and charges should be reviewable on the grounds of unreasonableness.[198]

> *... if fees and charges tend to be mostly what's doing the damage let's have a much great capacity to challenge them when they're ridiculous.* (R6, p 15)

However,

> *But in a sense we're having a little bit of a dollar each way here because we have to say - and indeed I think we do somewhere in the report, in the narrative of the report – we do say that we'll keep a weather eye on the NSW situation and if it proved to be a spectacular success then we would clearly have to have another look at that technique.* (R6, p 8)

Simplicity in administration and enforcement was also an issue raised as a factor in determining the appropriate regulatory response, with a suggestion that caps vary according to the type of loan effectively dismissed because of implementation complexities:

> *I think the authors of the report [Manning and de Jonge] sense that a simple plan is a good plan and this would be a complicated plan. And so I think they're almost sort of saying out loud to the reader that they can see that this would be a rather unlikely regulatory scenario.* (R6, p 8)

[198] Consumer Affairs Victoria (2006), option 5.3.

In terms of the form of any cap, again, the participants' comments reflected the regulatory position in their individual jurisdictions.

There was a clear acknowledgement that a cap on interest alone would not be effective in constraining the cost of credit:

> [Referring to the City Finance case]: *I guess that's an example where the 48 percent interest rate has had a direct effect. But it's only had an effect in terms of juggling your disclosures effectively and creating a few new fees. It didn't have any effect on the actual cost of the credit to the consumer.* (R6, p 9)
>
> *I think fees and charges, if there was going to be a cap, your fees and charges would need to be included, otherwise it would just divert the profit which would normally be generated through interest for the fee and charges. It makes it more difficult to compare prices. People tend to compare interest rates rather than interest rates and fees and charges. So we'd need to include everything I think. That's reasonably ascertainable.* (R3, pp 6-7)

In NSW, the problem of the ineffectiveness of an interest only cap has been addressed by incorporating fees and charges:

> [In relation to interest only caps] *Now NSW has said they're useless when they only attach to interest so let's add the rest of the cost of credit in there, at least that's what you can see from the front of the contract.* (R6, p 15)

In Victoria, as noted above, a different approach has been suggested by the Consumer Credit Review:

> *It may be that more effective regulation can be deployed in exchange for the removal of ineffective interest rate ceilings.* (R6, p 15, quoting from Consumer Credit Review Report)

In addition, one participant referred to the recommendations from the Manning and de Jonge research report, which did not support a uniform cap for all consumer credit products:

> *The research plums for and indeed says that there's a public policy justification for capping the cost of credit, and probably including fees and charges. But then it says 'well, the products are so different and underlying cost must be taken into account, otherwise it's not fair to the credit providers. Therefore we couldn't have a single cap as has been implemented in NSW, but rather we would have to have different caps depending on the nature of the credit product.' The nature of the sum market I suppose. So the research however certainly says that would be a rather complex ideal as it might be from the author's point of view, and it might be rather complicated and costly and difficult to have*

a system where the cap involved was different depending on the nature of the product. (R6, pp 7-8)

In Queensland, where no formal decision had been made about an interest rate ceiling at the time of interviews, participants also discussed possible alternative regulatory approaches to high cost credit and overcommitment, some which might need to proceed at the national level:

That's why the better approach might be to align it with the person's ability to repay, and a realistic assessment of that [ability]. That would be more important I think, and that goes with the terms of the loan as opposed to any cap of interest and fees and charges. (R3, p 8)

So the way I probably recommend to look at is from a time point of view. A loan that is say between zero and two weeks or let's say 14 days, has a cap of 1000 per cent. A loan of between 14 days and say two months, that would be 60 days, has a cap of 500 per cent and then anything over that has a cap of under 500 per cent and they are just rough figures. (R4, p 11)

One envisaged a more consultative process for determining the level of any cap:

I think it has to be through industry consultation with lenders and consumer groups – not just consumer groups. What they're set at should be looked at as a reasonable return for their outlay and for their time. (R4, p 2)

None of the participants provided any specific comments on whether caps should be fixed or floating, despite the fact that a number of references were made to the variation in underlying interest rates and costs of funds to providers over time.

Compliance and regulator impacts

Participants were briefly asked about regulator efforts to ensure compliance.

One noted that a likely outcome of the introduction of an interest rate cap would be a need for a considerable increase in staff and resources for the regulator:

Well we would be expected to police it obviously (R3, p 6)

I think you will have to triple our staff at least to police it because you'll find everyone will do all these dodgy loans or very questionable loans or bill of sales or lots of things and so from an investigator's point of view – and there will be a lot of underground lending or loan sharking – so you'll find that you'll probably – I would recommend at least triple the staff in the government, probably even more. (R4, p 8)

In those jurisdictions where a cap already existed, participants indicated that compliance activities did tend to coincide with legislative changes:

> *Well that really depends on a lot of things. It depends on resources; it depends on whether credit is being prioritised in the organisation, which it has been for the last few years. It depends on the attitude of the minister and so forth and it depends on the complaint load that we're getting. In essence the reason for that particular compliance-monitoring program was that it was at the tail-end of 2001 that payday lending was brought within the code and then that was a trigger for doing some compliance monitoring of what these characters were up to. Since then the only – it's really been a bit ad hoc and we've tendered just to be responding to actual complaints and there hasn't been another extensive review.* (R6, p 11)

One also reflected on the difficulties associated with actually identifying the lenders in the market:

> *Yes, very hard. But I just thought, I talked to the other agencies we liaise with, like Legal Aid, and the Consumer Credit Legal Centre, through our customer service area, and then I spent maybe a month reading The Daily Telegraph, going to the ads and ringing up people to get details. So I would certainly say it's not an exhaustive list.* (R2, p 10)

This clearly raises business awareness and compliance issues for regulatory agencies.

Another raised concerns about getting sufficient evidence to prosecute, especially against loan sharks:

> *My understanding is that loan sharking is even occurring ... but I have tried to get witnesses and I can't get people to come forward because they're scared of these people.* (R4, p 8)

Credit reporting

As seen in previous chapters, the credit reporting regime was also seen as having an impact on the relevant environment, both because of its focus on negative listings, but also because of inaccuracies. However, the regime was primarily covered by Commonwealth Government agencies, and so participants did not have direct input into, or knowledge of, the issues:

> *I think some lenders argue that if the credit reporting system is loosened up and for example you can record positive loans instead of negative loans. And by that I mean, at the moment I understand that all they can record is if there's a failed loan, which may be one loan of a dozen that a person's taken out. If they have paid off another loan successfully and more recently, they should probably not be – have the capacity to do that.*

They should probably not be excluded from the loan. But if they're excluded from the loan and that drives them into the microlending market, which is a shame because they might be better off getting a credit card for example, or a short term loan or something through a major lender. I think the scope for the credit reporting system could be changed, but I'm also conscious that the consumer movement believes the current system should be fixed because there's a lot of misreporting of data, and people are accused of having debts that they've never incurred. Things like that. They've paid it off and they're still recorded as bad loans and things like that. That's another point. (R3, p 5)

... yes, it's desperately in need of review. If it went to a positive reporting system, fine, but it has to have the flaws fixed. (R1, pp 17-18)

We're always getting complaints about people in terms of, if they weren't aware that they'd been listed or if it was an incorrect listing, how hard it is to get it off. If the credit provider's not coming to your assistance with dealing with Baycorp, and if they've incorrectly listed you or whatever, if they're ignoring it and not assisting Baycorp, the consumer has a huge burden of proof on themselves to try and get enough information to get Baycorp interested in investigating it. (R2, pp 17-18)

Relatedly, one participant noted the relevance of consumer behaviour and conduct in relation to credit applications:

I mean a lot of – again consumers, they turn around and say 'Oh, look, I had a $500 loan and all of a sudden I owe $700 now and it's because of this high interest rate, say 300 or 400 per cent per annum.' But then when you look at the loan repayments the person missed four or five payments at the start and of course because your interest is such a high percentage on that the consumer is just as much to blame because if they miss payments they're going to get off track. Again there's two sides of the argument there – you could turn around and say 'Well gee should the consumer have even signed up for that loan if they can't afford it?' Maybe the short-term credit providers should be looking at that further. However, if you speak to the short-term credit providers they'll say 'Well consumers don't tell us the full story. They don't tell us about their three other loans they've got out there or they lied to me about the amount that they earn or they earn that much but then they lost their job two weeks later. There are two sides to every story. (R4, p 14)

12. Discussion and conclusion

In this report we have presented the views of some consumer advocates, micro-lenders, mainstream financial institutions and staff from regulatory agencies in relation to the benefits and harms of fringe credit products and the likely impacts of interest rate capping on this market.

Consumer advocates spoke of their experiences with low income consumers who had suffered some harm as a result of micro credit products. While acknowledging that these problems may be "at the margins" in the sense that it may only be the most vulnerable consumers who encounter these harms when engaging with micro credit, these are problems which need to be acknowledged. In particular, consumer advocates referred to instances of micro credit providers lending to people without capacity to repay in accordance with the terms of the loan; lending without accurately describing to borrowers the cost of the loans; allowing rollovers and loan extensions creating unmanageable debt spirals; and the taking of security over household goods. They noted that these loans may bring some short-term benefit to consumers in that they meet an often urgent financial need however they argued that these loans were ultimately detrimental. They all supported the introduction of an interest rate cap, and while not all were convinced that a cap would mean that micro credit products could no longer be offered on a commercial basis due to cost, they took the view that even if that was the case, a cap was still desirable. Their view was that it was better not to have these products available on the market if they could only be offered at high cost, because of the potential harms of such high cost lending. They noted the need in the market place for safe, affordable credit alternatives for low income, financially excluded consumers.

The micro-lenders interviewed (as opposed to the more extensive group surveyed) did not fall within the very short-term payday lender category, with most of them offering loans on 6 to 12 month terms. It is likely that the greatest harms are associated with the short-term 2 to 4 week payday style loans, where borrowers struggle to repay the full amount within such a short time period and where rollovers and loan renewals lead to "debt spirals" for these borrowers.[199] The micro-lenders interviewed acknowledged that costs could become substantial where rollovers or loan renewals were offered. They maintained however that the standard high costs associated with their products reflected the true cost of delivering these loans due to the short term nature of the loans, the risky nature of the loans, and the lengthy application process, which one lender stated could involve anywhere between 3 ½ hours to 6 ½ hours.[200] The overwhelming impression arising out of the interviews with the

[199] See for example discussion in Bruch (2000) and Wilson (2004)

[200] This may highlight inefficiency in delivery of this product, given that Fair Finance UK, who offer a sustainable small loans product at between 28% to 35% per annum in London, claim that the application process takes

micro-lenders was that they believed they provided a valuable service, delivered responsibly with a comprehensive process for assessing capacity to repay, as well as procedures in place for dealing with client hardship in a flexible way. They considered that they were providing an essential service for financially excluded consumers in a space that mainstream lenders were not interested in filling. That said there was no escaping the high cost of these loans. One lender acknowledged that their clients were not really concerned with cost, given that they were really 'lenders of last resort'. Their clients needed finance urgently and liked the speed of service they received from these lenders. On the one hand they expressed concerns that the imposition of an interest rate cap would lead to a "gravitation" of lenders currently lending at less than that, towards that cap.[201] On the other hand, they seemed to accept the need for a cap but a "realistic" higher cap, somewhere between 170% per annum and 250% per annum, or one cap on interest and a separate cap on fees and charges. They were critical of 'one size fits all' regulation in this area, given that the products they offered were very different to those offered by mainstream lenders, particularly in terms of the loan size and repayment period. They all maintained that a cap would prevent them from continuing to offer short term credit.

Mainstream credit providers did not consider that a cap at 48% per annum would impact upon their products, as their rates and charges did not come close to the cap. They did see the need for some cost controls on credit to protect low income, vulnerable consumers, however, they took the view that any cap needed to be inclusive of fees and charges to be effective. Further, effective enforcement was crucial to avoid circumvention or avoidance by micro credit providers. Some endorsed the idea of scaling any interest rate cap to the size of the loan, recognising that different types of products should attract different regulatory responses. One mainstream credit provider expressed a view that it would be unfortunate if micro credit was "wiped out", as there was clearly a need for that type of product, and it was not an area in which that provider wished to operate. The mainstream providers emphasised the need for government involvement to ensure the provision of affordable short term credit. This was not an issue that should be left to the private sector to sort out.

The participants from regulatory agencies acknowledged the lack of science surrounding the choice of 48% for any cap- that this was a rate based on history more than science. They noted that for some people fringe credit represented a convenient service which was unlikely to get them into any trouble, but they also noted that there needed to be protections for low income, vulnerable consumers to prevent them finding themselves in a 'debt spiral'. Such protection was regarded as necessary because of a lack of competition as regards price in the micro credit market, and because there comes a point when the cost of credit is so high that it is simply unacceptable. Some participants in this group accepted that a cap would mean the end of the micro credit industry, while others questioned the

between 30 to 45 minutes. This information was delivered as part of a presentation by the Managing Director of Fair Finance UK at Foresters ANA Mutual Society Ltd, Brisbane on 8 July 2008. See also www.fairfinance.org.uk.

[201] This seems unlikely given the reputational concerns of mainstream lenders, as confirmed by one of the mainstream lenders interviewed who commented that they did not want to go anywhere near the cap in terms of their interest rate.

likelihood of that outcome due to a lack of evidence. They acknowledged the ability of micro credit providers to circumvent regulation, and agreed that there would be considerable costs to government in effectively policing and enforcing the interest rate cap. Some alternatives to capping that were discussed included a strong regulatory response on the grounds of unreasonable terms, which would send a powerful signal to the market that extortionate charges would be pursued in the courts by government consumer agencies; or different, 'structured' caps depending upon the nature of the credit product, for example the loan term and loan amount. Opinions were divided as to whether an interest rate cap was an appropriate regulatory response to the problems associated with micro credit.

Apart from the possibility of an interest rate cap, some regulatory responses arising out of the research undertaken for this report include:-

1. Consultation with the micro industry to arrive at an interest rate cap and other regulatory restrictions acceptable to the industry and to government. Consumer advocates would have issues with this model in that it ignores the cost level at which consumers will be safe by focusing on the cost level at which providers can make a profit.
2. A focus on regulating against rollovers, loan renewals and the taking of household securities on the basis that they constitute the more insidious harms of micro credit.
3. Focusing on a policy and regulatory framework to facilitate the provision of safe and affordable credit to create a truly competitive environment in this market and offer low income consumers real choice.

While there was a divergence of views as between stakeholder groups in relation to some issues, some facts seem to be relatively uncontested:-

- There is a demand for short term small amount credit products in the market;
- Mainstream financial providers are not meeting this demand leaving a "gap";
- Micro credit providers are filling that gap, although at a high cost;
- Micro loans provide at least some short-term benefit to people in meeting an immediate financial need;
- The high cost may be a true cost for micro credit providers in which case a cap will put an end to their business, or alternatively there may be inefficiencies in their product delivery and it might be possible for them to continue to lend within the cap;
- In any event, the high cost, coupled with features such as loan rollovers or renewals, do result in a worsening of some people's financial positions, particularly vulnerable, low income consumers;
- If a cap were introduced *and effectively enforced* at some cost to government, it would prevent consumers paying exorbitantly high costs for short term credit;
- On the other hand, the cap may result in a departure of micro products from the market, leaving a gap which has not yet been filled by no interest and low interest loans programs.

Within the current context, the decision 'to cap or not to cap' really seems to come down to weighing the benefits of having some products available to meet the demand for short-term credit amongst those financially excluded from the mainstream, as against the disadvantages flowing from the harms caused by some of these products to some consumers. The decision would be somewhat easier if we could 'have our cake and eat it too'- if there could be sufficient products in the marketplace providing affordable short-term credit to those financially excluded from the mainstream, who could operate under a 48% (or some other more scientifically calculated) cap. Whether or not a state has decided to cap or might do so in the future, regulatory efforts must surely go into a policy and regulatory framework to promote the provision of safe affordable short-term credit for vulnerable low income consumers.

Appendix A: Participant categories

Identifier	Type
C1	Consumer Advocate
C2	Consumer Advocate
C3	Consumer Advocate
C4	Consumer Advocate
C5	Consumer Advocate
C6	Consumer Advocate
C7	Consumer Advocate
C8	Consumer Advocate
C9	Consumer Advocate
R1	Regulator
R2	Regulator
R3	Regulator
R4	Regulator
R5	Regulator
R6	Regulator
B1	Mainstream lender (bank)
B2	Mainstream lender (bank)
B3	Mainstream lender (bank)
FC1	Mainstream lender (finance company)
FC2	Mainstream lender (finance company)
FC3	Mainstream lender (finance company)
FC4	Mainstream lender (finance company)
ML1	Micro-lender
ML2	Micro-lender
ML3	Micro-lender
ML4	Microlender
ML5	Micro-lender

Appendix B: Discussion guides

For fringe lenders and lender associations:

- Is there a need for controls on the cost of credit to protect low income and vulnerable consumers? Why / Why not?
- What types of credit products do you / your members provide to consumers?
- What are the key costs and terms?
- Who are your / your members' customers? What are their reasons for seeking finance?
- What has been / would be the impact on your business / your members if controls on the cost of consumer credit were to be introduced? What would be / has been the impact on availability of credit to your / your members' typical customer group?
- What are the compliance costs? To what extent is compliance with interest rate caps monitored or enforced?
- If controls are to be introduced or retained, what form should such controls take? At what level should interest rate caps be set? Should caps be fixed or floating? Should caps differ according to type of loan? To what extent should fees and charges be included in the cap?

For mainstream lenders' industry associations:

- Is there a need for controls on the cost of credit to protect low income and vulnerable consumers? Why / Why not?
- What has been the impact on credit providers of interest caps in those jurisdictions that have introduced them? Has there been any impact on mainstream lenders?
- What are the compliance costs? To what extent is compliance with interest rate caps monitored or enforced?
- Where controls exist, are the regulations sufficiently clear?

- What has been the impact on access to consumer credit for low income and vulnerable consumers? Have consumers benefited from the introduction/retention of interest rate caps?

- If controls are to be introduced or retained, what form should such controls take? At what level should interest rate caps be set? Should caps be fixed or floating? Should caps differ according to type of loan? To what extent should fees and charges be included in the cap?

For regulators and government policy makers in ACT, NSW and Victoria:

- What were the reasons for introducing controls on the cost of credit in your jurisdiction? To what extent are those reasons still valid?

- What were the reasons for choosing the particular level at which the cap was set? What were the reasons for including or excluding fees and charges in calculating the cap?

- What types of products are available in the market to low income and vulnerable consumers? What are the typical costs / terms? Does the existence of the cap have any impact on mainstream lenders?

- Has the introduction / retention of a cap reduced access to consumer credit for these groups? To what extent has the introduction of caps benefited consumers?

- What has been the experience of compliance with the cap? What steps do agencies take to monitor compliance with the regulations, and/or to enforce the regulations?

- Has experience with the cap demonstrated any loopholes or other practical problems with the legislation? What steps have been taken to address these issues?

- If controls are to retained, what form should such controls take? At what level should interest rate caps be set? Should caps be fixed or floating? Should caps differ according to type of loan? To what extent should fees and charges be included in the cap?

For regulators and government policy makers in Queensland:

- What were the reasons for not introducing controls on the cost of credit in your jurisdiction? To what extent are those reasons still valid?

- What types of products are available in the Queensland market to low income and vulnerable consumers? What are the typical costs / terms?

- What has Queensland learnt from experience in other jurisdictions (both in Australia and elsewhere) that have introduced interest rate caps or other controls?
- What would be the impact on credit providers, consumers, and regulators if controls on the cost of credit were to be introduced in Queensland?
- If controls are to be introduced, what form should such controls take? At what level should interest rate caps be set? Should caps be fixed or floating? Should caps differ according to type of loan? To what extent should fees and charges be included in the cap?

For consumer advocates and caseworkers in NSW, ACT and Victoria

- Is there a need for controls on the cost of credit to protect low income and vulnerable consumers? Why / Why not?
- What is the impact of high cost credit on consumers?
- What has been the impact of interest caps on consumers? Overall, has it benefited consumers?
- To what extent have low income and vulnerable consumers been excluded from the consumer credit market following the introduction of caps? To what extent have consumers turned to 'loan sharks' for finance?
- What has been the impact on credit providers of the introduction of interest rate caps? Have members withdrawn from the industry, changed their products (and if so, in what way) following the introduction of caps?
- Is there compliance with the cap? To what extent is the regulator monitoring and enforcing compliance?
- Has experience with the cap demonstrated any loopholes or other practical problems with the legislation? What steps have been, or should be taken to address these issues?
- If controls are to retained, what form should such controls take? At what level should interest rate caps be set? Should caps be fixed or floating? Should caps differ according to type of loan? To what extent should fees and charges be included in the cap?

For consumer advocates in Queensland

- What are the types of credit products available to low income and vulnerable consumers in Queensland? What are the typical interest rates, fees, charges and terms?

- Is there a need for controls on the cost of credit to protect low income and vulnerable consumers? Why / Why not?

- What is the impact of high cost credit on consumers?

- What has Queensland learnt from experience in other jurisdictions (both in Australia and elsewhere) that have introduced interest rate caps or other controls?

- If controls were to be introduced, what would the impact been on consumers? On credit providers? On the regulator? To what extent have low income and vulnerable consumers be excluded from the consumer credit market if caps were to be introduced?

- If controls are to be introduced, what form should such controls take? At what level should interest rate caps be set? Should caps be fixed or floating? Should caps differ according to type of loan? To what extent should fees and charges be included in the cap?

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