

Review of the small amount credit contract laws

Consultation on the regulation of small amount credit
contracts and comparable consumer leases

September 2015

CONSULTATION PROCESS

REQUEST FOR FEEDBACK AND COMMENTS

Interested parties are invited to lodge written submissions on the issues raised in this paper by 15 October 2015.

All information (including name and address details) contained in submissions will be made available to the public on the consumer credit website at www.consumercredit.treasury.gov.au unless the party making the submission indicates that all or part of the submission is to remain confidential. Automatically generated confidentiality statements in emails are not sufficient for this purpose. Respondents who would like part of their submission to remain confidential should provide this information marked as such in a separate attachment. A request made under the *Freedom of Information Act 1982* for access to a submission marked confidential will be determined in accordance with that Act.

Submissions should include the name of the organisation (or name if the submission is made by an individual) and contact details including an email address and telephone number where available. While submissions may be lodged electronically or by post, electronic lodgement is strongly preferred. For accessibility reasons, please email responses in a Word or RTF format. An additional PDF version may also be submitted.

Closing date for submissions: 15 October 2015

Address written submissions to :

SACC Review Secretariat
Financial System and Services Division
Markets Group
The Treasury
Langton Crescent
PARKES ACT 2600

Email: consumercredit@treasury.gov.au

Enquiries: Enquiries can initially be directed to the SACC Review Secretariat by emailing consumercredit@treasury.gov.au.

The principles outlined in this paper have not received government approval and are obviously not yet law. As a consequence, this paper is merely a guide to how the principles might operate.

Foreword

On 7 August 2015, the Government announced the review of the small amount credit contracts (SACC) laws and related provisions in the *National Consumer Credit Protection Act 2009* (Credit Act).

The establishment of the review fulfils a statutory requirement under the Credit Act.

The review is being chaired by Ms Danielle Press. The panel members for the review are Ms Catherine Walter AM and Mr Stephen Cavanagh.

The panel has been asked to consider the key legislative provisions that relate to SACCs including the cap on fees and charges and the rebuttable presumption that a loan is unsuitable where the consumer has held two other SACCs within the past 90 days. The panel will also consider whether the provisions that apply to SACCs should be extended to comparable consumer leases and, if so, to what extent.

The purpose of the consultation process is to seek information from interested stakeholders. The submissions that the panel receives from the consultation process will inform the recommendations. The consultation process is an opportunity for consumers, SACC providers, lessors and the community to raise their concerns and put forward their ideas for the panel's consideration.

The panel encourages all those who have an interest in the SACC and consumer leasing industries to comment on the discussion paper and participate in the consultation process.

The closing date for submissions is 15 October 2015.

A final report will be handed to the Government by the end of this year.

The panel looks forward to working with consumers, the community and industry to ensure that the regulatory framework strikes the right balance between providing adequate protection to consumers and reducing regulatory compliance costs whilst taking into account fairness, competition and innovation.



Ms Danielle Press
Chair
Review of Small Amount Credit Contract Laws

Introduction

The purpose of this review is to examine and report on the effectiveness of the law relating to small amount credit contracts (SACCs) and comparable consumer leases. These laws are contained in the *National Consumer Credit Protection Act 2009* (the Credit Act).

The review of the SACC provisions is a legislative requirement under section 335A of the Credit Act. The review will also consider the law applying to consumer leases to the extent that these leases serve a similar market to that of SACCs.

The terms of reference for the review are outlined below.

Terms of reference

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

4. **The review will make recommendations that take into account:**
 - **competition;**
 - **fairness;**
 - **innovation;**
 - **efficiency;**
 - **access to finance;**
 - **regulatory compliance costs; and**
 - **consumer protection.**
5. **In examining the issues set out above, the review should also consider whether the laws relating to SACCs and regulated consumer leases are appropriate for the current economic climate and whether they will continue to meet Australia's evolving needs.**
6. **The review should conduct consultations with stakeholders and hold public meetings where appropriate.**
7. **The review will not recommend the establishment of an additional body or the establishment of a further review(s).**
8. **The review will not recommend changes to any area of the law that the Commonwealth does not have the direct power to regulate.**

LIST OF DISCUSSION QUESTIONS

General instructions

Please include relevant statistics, and a discussion of the costs and benefits in responses.

Please consider the following when making a submission: competition, fairness, innovation, efficiency, access to finance, regulatory compliance costs, and consumer protection.

Question 1: Competing objectives

- How is the need to protect consumers balanced with the need to ensure that the industry remains viable and consumers can still access credit?

Question 2: Complexity

- Could the current regulatory regime be simplified in a way that provides consumers with the same, or a higher level of, protection while reducing the regulatory burden on industry?

Question 3: Sanctions

The Credit Act imposes three types of sanctions - civil penalty breaches, criminal breaches and infringement notices.

- Is the current sanctions regime working?
- Are there any enhancements that could be made to the sanctions regime to make it more effective?

Question 4: Obligation to obtain and consider bank account statements (TOR 1.1)

The law currently requires SACC providers to consider a consumer's bank account statements for at least the preceding 90 days.

- Is the requirement to obtain and consider bank account statements necessary given the broader responsible lending obligations?
 - Are there more effective ways to obtain information about the financial situation of a SACC customer? If so, specify the alternative ways for obtaining information and whether the alternative is simpler, cheaper, or provides more useful information.
- Is it appropriate for SACC providers to use bank account statements for purposes other than complying with the responsible lending obligations, such as for marketing?

Question 5: Restrictions on repeat borrowing (TOR 1.2)

There is a presumption that a SACC is unsuitable if either the consumer is in default under another SACC or in the 90-day period before the assessment the consumer had two or more other SACCs.

- How do SACC providers determine whether a prospective customer has a SACC

with another SACC provider or is in default under another SACC?

- Is a restriction on repeat borrowing necessary to protect consumers?
- Is a rebuttable presumption or a bright-line test (e.g., an outright ban or a limitation on the number of SACCs that a consumer can take out in a certain period of time) more effective? When responding, please consider:
 - the degree of protection afforded to consumers;
 - the complexity for SACC providers who are making a decision to grant a loan;
 - the cost of complying with the requirement; and
 - the flexibility afforded to SACC providers and whether this flexibility is desirable.
- Would the objective of limiting a debt spiral through repeat borrowing be assisted by requiring SACC providers to rely on a recognised prescribed benchmark, such as the Household Expenditure Measure or Henderson Poverty Index (with or without an added margin)?
 - If so, do stakeholders have any views on which benchmark should be used?
 - How should a benchmark be used? For example, should the use of a benchmark replace the need to make inquiries about a consumer's expenses or the rebuttable presumption?
 - What is the likely cost or saving of requiring SACC providers to use benchmarks?

Question 6: Ban on short term credit contracts (TOR 1.3)

The Credit Act prohibits loans with a term of 15 days or less.

- Has the prohibition on short-term lending been effective in preventing lenders from offering loans with a term of 15 days or less?
- Has the prohibition on short-term lending had any unintended consequences that mean it should be changed? If so, please provide examples of these consequences.

Question 7: Warnings (TOR 1.4)

The Credit Act requires SACC providers to provide a specific warning statement to consumers.

- Are the warning statements effective? Could the statements be improved? When responding, please consider:
 - the content of the warning; and
 - the manner in which it is displayed.
- Should SACC providers be required to include a hyperlink to the MoneySmart website when warnings are displayed on webpages?

Question 8: Caps on costs (TOR 1.5 & 1.6)

The Credit Act currently caps establishment fees at 20 per cent of the credit amount, monthly fees at 4 per cent of the credit amount and the total fees payable in default to twice the credit amount.

- The policy intention in respect of the rate at which the cap on cost was set was to provide adequate protection to consumers and continue to allow the SACCs industry to operate. Do stakeholders think the cap has broadly met this objective?
 - When providing a submission, please provide data, such as evidence that it is not viable for businesses to operate or evidence as to how the amount of the cap is causing financial hardship to consumers.
 - ASIC Class Order 13/818 granted temporary exemption from the cap for certain medium amount credit contracts (MACCs) and allowed small amount credit contracts (SACCs) providers to exclude fees charged for direct debit processing from the caps. Should the temporary exemptions provided by Class Order 13/818 be made into regulation?

Question 9: Protection for Centrelink customers (TOR 1.7)

The Credit Act caps the amount of the repayment for consumers who receive 50 per cent or more of their gross income from Centrelink payments to 20 per cent of the consumer's gross income.

- Is the protection for consumers who receive 50 per cent or more of their income under the *Social Security Act 1991* working effectively?
- Do any additional groups of consumers need to be subject to specific protection in relation to SACCs? For example, should the provisions be extended on a similar basis to persons whose income is less than a specified amount or recipients of payments under the *Veterans' Entitlements Act 1986*?

Question 10: National database (TOR 2.1)

The review is required to consider whether a SACC database would enhance the capacity of SACC providers to meet the responsible lending obligations by providing them with access to more comprehensive and accurate information.

- Is there sufficient information currently available for a SACC provider to meet the responsible lending obligations?
- If not, would a database or alternatives such as comprehensive credit reporting be a more effective way to meet the responsible lending obligations?
- If a SACC database is considered an effective method to meet the responsible lending obligations, please comment on:
 - the cost of a database;
 - any privacy concerns;
 - the advantages and disadvantages of having multiple databases operating in parallel;
 - whether a database would assist SACC providers to discharge the

responsible lending obligations; and

- the effect of the comprehensive credit reporting (CCR) regime, including whether or not additional information could be obtained through a SACC database that would not be available through CCR.
- If a recommendation was made to introduce a database:
 - What information should be included in the database?
 - Who should manage the database (a third party or government agency)?
 - How should the database be funded?
 - Should reporting of key information be mandatory or voluntary?
 - Should SACC providers be required to check the database and, if so, when should this obligation be triggered?
 - Should SACC providers be charged a fee for accessing the database and, if so, should the fee be included in the cap?
 - Who should be permitted to access and amend information on the database?
 - What mechanism should be available to ensure that the database was accurate?
 - How should the database interact with the other responsible lending obligations?

Question 11: Additional provisions for SACCs (TOR 2.2)

The terms of reference require consideration of whether any additional provisions relating to SACCs should be included in the Credit Act.

- Are there any additional provisions relating to SACCs that should be included in the Credit Act taking into account the objective of the legislation? For example, are there any provisions that have been effective in other jurisdictions that could be introduced?

Question 12: Anti-avoidance provisions (TOR 2.2)

- Are stakeholders aware of any avoidance practices in relation to the Credit Act? If so, provide details of these practices and the scope (if known).
- Should any additional anti-avoidance provisions be included in the Credit Act?
 - If so, should there be any distinction between business model avoidance and internal avoidance?

Question 13: Documentation of suitability assessments (TOR 2.2)

The Credit Act requires lenders to make an assessment that the proposed SACC is not unsuitable.

- How do SACC providers currently meet the requirement to make a suitability

assessment and what records of the decision-making process are maintained?

- What is the most efficient and effective way to document suitability assessments? Is it possible to use the same steps for actual compliance and demonstrable compliance?
- Should SACC providers be required to document the assessment? Please consider whether such a requirement could lead to greater transparency.

Question 14: Comparable consumer leases (TOR 3)

The Credit Act applies different obligations to transactions according to whether or not the product is structured as a credit contract or a consumer lease.

- Which leases could be considered comparable with SACCs?
- Should there be greater consistency in the regulatory requirements that apply to SACCs and comparable consumer leases? Please consider:
 - the similarities between the consumer bases for SACCs and comparable consumer leases;
 - the similar economic outcomes of SACCs and comparable consumer leases;
 - ASIC evidence¹ which suggests that the effective interest rate for some consumer leases is substantially greater than the maximum allowed for SACCs under the caps;
 - the effect of introducing new regulatory requirements on the viability of the consumer leasing market and the availability of consumer leases; and
 - the impact of the distinction based on whether or not the consumer has a right or obligation to purchase the leased goods.

Please provide data, such as evidence as to the effect of any cap on the viability of businesses currently providing comparable consumer leases or evidence of where the absence of any cap is causing financial hardship to consumers.

Question 15: Applying SACC provisions to comparable consumer leases (TOR 3)

- As SACC and comparable consumer lease providers market to a similar consumer base, should the same provisions apply?
- Should there be additional disclosure requirements for comparable consumer leases, such as a requirement to disclose:
 - the purchase or cash price of the leased good;
 - the amount the consumer will pay in excess of the purchase or cash price;

¹ ASIC Report, Cost of consumer leases (September 2015).

- the cost of credit in dollar terms;
- the cost of credit as an interest rate; and
- the cost of other services financed through the rental payments (apart from the cost of hiring the goods, such as a warranty or delivery)?

Please consider the cost of complying with any such additional disclosure requirements against the benefit of providing additional information to consumers.

- If greater consistency between SACCs and comparable consumer leases is considered warranted, which SACC provisions should be extended to those leases?
 - Would the SACC provision need to be modified when applied to comparable consumer leases?

Question 16: Cap on costs for consumer leases (TOR 3)

- If a cap on consumer leases that are comparable to SACCs was introduced, how should the cap apply?
 - The cash price of the good is used as the basis for applying the cap on costs. Should the approach for sales by instalment also be used as a basis for applying the cap to leases that are comparable to SACCs? If so, how should the cash price of the good be defined?
 - If not, what alternative approach could be used to determine a cap on costs for leases?

SECTION 1: SMALL AMOUNT CREDIT CONTRACTS

Role and characteristics of small amount lending

Small amount credit contracts (SACCs) are loans of up to \$2,000 where the term of the contract is between 16 days and 12 months.

SACCs are generally used by low and middle income consumers. Many of the consumers who use SACCs are excluded from mainstream forms of credit with up to 25 per cent of those borrowers having incomes below the Henderson Poverty Line.²

Access to credit may alleviate hardship by expanding a household's options and allowing the household to smooth expenditure during periods of income or consumption shock. On the other hand, loan access may exacerbate hardship among individuals.

From the consumer perspective, a key issue for the review will be making sure that the regulatory settings enable consumers to access credit, while ensuring consumers are treated fairly and do not have excessively large debt burdens.

From the industry perspective, a key issue for the review will be to ensure that the regulatory settings foster innovation, minimise regulatory compliance costs and allow the industry to remain viable.

Feedback sought – Competing objectives

Question 1:

- How is the need to protect consumers balanced with the need to ensure that the industry remains viable and consumers can still access credit?

² Parliamentary Joint Committee on Corporations and Financial Services' *Inquiry into the Consumer Credit and Corporations Legislation Amendment (Enhancements) Bill* (2011), p.61.

Contracts regulated by the Credit Act which are relevant to the review¹



¹ **Contracts that are not regulated by the Credit Act include pawn broking arrangements, employee loans and certain consumer leases (indefinite consumer leases, employment-related leases and leases for a fixed period of 4 months or less).**

² **The focus of the review is on consumer leases which are comparable to SACCs.**

Table 1: Regulatory obligations under the Credit Act for different types of contracts³

Type of contract	Contract definition	Maximum costs	Responsible lending obligations: General	Additional obligations
Small amount credit contracts (SACCs)	<p>Amount borrowed: Less than \$2,000</p> <p>Term: Between 16 days and 1 year</p>	<p>The provider cannot charge interest, and can only charge a maximum establishment fee of up to 20% of the amount of credit and a maximum monthly fee of 4% of this amount (for a 12-month contract, the maximum amount that can be charged in fees is equivalent to 68% of the amount of credit)</p> <p>No establishment fee can be charged where the contract refinances an existing small amount credit contract</p> <p>On default: The consumer cannot be charged more than twice the amount of credit (including the amount already paid)</p>	<p>The provider must assess whether the consumer can afford the repayments, on the basis of reasonable inquiries</p> <p>The product must meet the consumer's requirements and objectives</p>	<p>Procedural requirement: Bank statements must be obtained for 90 days</p> <p>Presumptions: The contract is unsuitable if the consumer:</p> <ul style="list-style-type: none"> • is already in default under an existing small amount credit contract; or • has been a party to two or more small amount credit contracts in the past 90 days <p>Additional disclosure: There must be a warning statement on the provider's website</p> <p>Protection for Centrelink recipients: Repayments cannot exceed 20% of income</p>
Medium amount credit contract (MACCs)	<p>Amount borrowed: Between \$2,001 and \$5,000</p> <p>Term: Between 16 days and 2 years</p>	<p>Cap: The provider can charge interest and fees provided the amount charged does not exceed a maximum cost calculated as the sum of interest charged at 48% and a fee of \$400</p>	<p>As for small amount credit contracts</p>	<p>No additional obligations</p>

³ The table is extracted from ASIC's report, *Cost of consumer leases (September 2015)*, p.9.

Type of contract	Contract definition	Maximum costs	Responsible lending obligations: General	Additional obligations
All other credit contracts (including rental agreements with a right or obligation to purchase)	All other credit contracts	Cap: The provider can charge interest and fees provided the amount charged does not exceed a maximum cost calculated as the sum of interest charged at 48%	As for small amount credit contracts	No additional obligations
Consumer leases	<p>Fixed term contracts of greater than 4 months</p> <p>The consumer pays more than the cash value of the goods</p> <p>There is no right or obligation to purchase the goods</p>	There is no cap	As for small amount credit contracts	No additional obligations

Current regulatory framework

The Credit Act sets out the requirements for SACCs, medium amount credit contracts, credit contracts generally and consumer leases (refer to Table 1 - Regulatory obligations under the Credit Act for different types of contracts).

SACC providers are required to comply with:

- the core obligations for credit licensees in the Credit Act including the obligation to ensure that a credit contract is not unsuitable; and
- further obligations specific to SACCs including the restrictions on repeat borrowing and the additional protection for consumers who receive Centrelink benefits.

This regulatory framework results in a greater amount of complexity for SACC providers than for credit providers offering other products.

Feedback sought — Complexity

Question 2:

- Could the current regulatory regime be simplified in a way that provides consumers with the same, or a higher level of, protection while reducing the regulatory burden on industry?

The Credit Act contains sanctions for conduct in breach of obligations including:

- civil penalty breaches – where ASIC must prove there was non-compliance with the provision on the balance of probabilities;
- criminal breaches – these have a higher onus of proof as ASIC must prove the breach of the law beyond reasonable doubt;
- infringement notices – as an alternative to civil proceedings ASIC can also issue infringement notices where it has reasonable grounds to believe that an entity has contravened a provision. The maximum fine that can be imposed is calculated as a percentage of the maximum penalty that a court could impose for contravention of that provision. If the entity pays the infringement notice it discharges its liability for the contravention.

For example, a breach of the requirement to make reasonable inquiries of a consumer's financial situation has a maximum civil penalty of 2,000 penalty units (penalty units are currently \$180 each so the maximum penalty is \$360,000). This provision is also an infringement notice provision with the current maximum penalty of \$9,000 for an individual or \$45,000 for a body corporate.

Table 2: Sanctions for breaching the small amount credit contract (SACC) obligations in the Credit Act

Obligations	Maximum penalties	Maximum infringement notice	Other sanctions*
<p>Maximum Costs</p> <p>SACCs: charging in excess of a maximum establishment fee of up to 20% of the amount of credit and a maximum monthly fee of 4% of this amount (s31B of the Credit Code)</p>	<p>Criminal penalty: 100 penalty units (max penalty of \$18,000 per breach)</p>	<p>Individual: 20 penalty units (\$3,600)</p> <p>Body corporate: 100 penalty units (\$18,000)</p> <p>(If the conduct also falls within s24 of the Credit Code)</p>	<p>Borrower is not liable to make the payment and may recover any payment already made.</p>
<p>Medium amount credit contracts (MACCs): charging above 48% cap and a fee of \$400 (s32A of the Code, see s32B of the Credit Code)</p>	<p>Criminal penalty: 50 penalty units (max penalty of \$9,000 per breach)</p> <p>However, if the conduct also falls within s24 of the Credit Code –</p> <p>Criminal penalty: 100 penalty units (max penalty of \$18,000 per breach)</p>	<p>As above</p>	<p>The provision of a credit contract that imposes costs exceeding the maximum cost is void to the extent it does so and the borrower may recover prohibited amounts already paid.</p> <p>(If the conduct also falls within s23 of the Credit Code)</p>
<p>Other credit contracts: charging above 48% cap (s32A of the Credit Code)</p>	<p>As above</p>	<p>As above</p>	<p>The provision of a credit contract that imposes costs exceeding the maximum cost is void to the extent it does so and the borrower may recover prohibited amounts already paid.</p> <p>(If the conduct also falls within s23 of the Credit Code)</p>
<p>Responsible lending obligations</p> <ul style="list-style-type: none"> • Obligation to assess unsuitability (ss 115 and 128) • Reasonable inquiries and verification (ss 117 and 	<p>Civil penalty: 2,000 penalty units (max penalty of \$360,000 per breach)</p>	<p>Individual: 50 penalty units (\$9,000)</p> <p>Body corporate: 250 penalty units</p>	<p>None</p>

Obligations	Maximum penalties	Maximum infringement notice	Other sanctions*
130) including for SACCs Obtaining and considering account statements for preceding 90 days (ss 117(1A) and 130(1A)).		(\$45,000)	
Additional obligation for SACCs Presumptions: The contract is unsuitable if the consumer (ss 118(3A) and 131(3A)): <ul style="list-style-type: none"> is already in default under an existing SACC; or has been a party to two or more SACCs in the last 90 days. 	Civil penalty: 2,000 penalty units (max penalty of \$360,000 per breach)	Individual: 50 penalty units (\$9,000) Body corporate: 250 penalty units (\$45,000)	None
Additional disclosure: Requirement to display a warning statement (s133CB and regulations 28XXA, 28XXB, 28XXC and 28XXD)	Civil penalty: 2,000 penalty units (max penalty of \$360,000 per breach) Criminal penalty: 50 penalty units (max penalty of \$9,000 per breach)	N/A	None
Protection for Centrelink recipients: Repayments cannot exceed 20% of income (s133CC and regulation 28S)	As above	N/A	None

* In relation to civil penalties, where the court has made a declaration of contravention of a civil penalty provision the court may order a pecuniary penalty payable to the Commonwealth up to the maximum number of penalty units referred to in the provision for a natural person, or 5 times the maximum number of penalty units referred to in the provision for a body corporate, partnership or multiple trustees (s167).

In relation to criminal offences, s4B(3) of the Crimes Act 1914 (Cth) allows a court to impose on a body corporate convicted of an offence a fine of not greater than 5 times the maximum that court could impose on an individual convicted of that offence.

A court is also able to make other orders including injunctions, compensation orders and adverse publicity (div 1, Part 4-2). ASIC can also take administrative action, including for breaching the credit legislation, to:

- suspend, cancel or vary credit licences (div 6, Part 2-2); and/or
- ban persons from engaging in credit activities either for a specified period or permanently (Part 2-4).

The value of a penalty unit is given in section 4AA of the Crimes Act 1914 (Cth) and changes from time to time. The above maximums are calculated on the basis of the penalty unit of \$180, which applies to contraventions and offences committed on or after 31 July 2015.

Feedback sought — Sanctions

Question 3:

The Credit Act imposes three types of sanctions - civil penalty breaches, criminal breaches and infringement notices.

- Is the current sanctions regime working?
- Are there any enhancements that could be made to the sanctions regime to make it more effective?

SECTION 2: DISCUSSION POINTS ON SPECIFIC SACC PROVISIONS

Obligation to obtain and consider bank account statements (TOR 1.1)

Explanation of the law

Subsections 117(1A) and 130(1A) of the Credit Act require SACC providers to obtain and consider bank account statements that cover at least the immediately preceding period of 90 days.

The obligation to obtain and consider bank account statements operates in conjunction with the responsible lending obligations imposed on all credit providers. The responsible lending rules require credit providers to make reasonable inquiries into the consumer's financial circumstances including their income and expenditure. Bank statements are one way of obtaining this information, although there may be other ways.

Rationale

The obligation to consider bank account statements seeks to ensure that SACC providers comply with the responsible lending obligations and do not offer consumers contracts which are 'unsuitable'. It was introduced in light of particular risks associated with SACCs and concerns that SACC providers needed greater statutory direction when meeting the responsible lending obligations.

The obligation is designed to ensure that SACC providers verify a consumer's actual income and expenses. Verification may also include other steps and may involve the use of benchmarks to test the reliability of the information.⁴

ASIC's current understanding of industry compliance

ASIC's 2015 review of the practice of SACC providers (Report 426: *Payday lenders and the new small amount lending provisions*) found that most SACC providers complied with the obligation to collect bank account statements.

However, ASIC found that some lenders were not making adequate use of bank account statements. For example, some SACC providers were not making further inquiries when the information in the bank account statement conflicted with information previously provided by the consumer. ASIC's report also raised concerns that some SACC providers did not make adequate inquiries about whether the consumer had more than one bank account.

Further, ASIC found that consumers were providing lenders with access to their internet banking portals and noted some risks around the security of this data and how it was being used and stored.

⁴ See ASIC Regulatory Guide 209 *Credit licensing: Responsible lending conduct*.

Feedback sought — Obligation to obtain and consider bank statements (TOR 1.1)

Question 4:

The law currently requires SACC providers to consider a consumer's bank account statements for at least the preceding 90 days.

- Is the requirement to obtain and consider bank account statements necessary given the broader responsible lending obligations?
 - Are there more effective ways to obtain information about the financial situation of a SACC customer? If so, specify the alternative ways for obtaining information and whether the alternative is simpler, cheaper, or provides more useful information.
- Is it appropriate for SACC providers to use bank account statements for purposes other than complying with the responsible lending obligations, such as for marketing?

Restrictions on repeat borrowing (TOR 1.2)

Explanation of the law

There is a presumption that a SACC is unsuitable if either:

- the consumer is in default under another SACC; or
- in the 90-day period before the assessment, the consumer had two or more other SACCs.

If a consumer satisfies one of these conditions, the SACC provider must presume the consumer is in substantial hardship and should not lend to the consumer. This presumption can be rebutted. In other words, if the SACC provider has sufficient evidence to prove that the consumer is not in substantial hardship and the further loan is not unsuitable, the SACC provider may lend to the consumer.

The rebuttable presumption, also known as a presumption of unsuitability, supplements the responsible lending obligations that apply to all licensed credit providers.

Rationale

The rebuttable presumption is designed to protect consumers from becoming caught in debt spirals when the consumer takes out a new SACC.

Before the presumptions were introduced, there were reports of a significant number of consumers caught in debt cycles. For example, the Community Action Law Centre's Caught Short report found that 23 per cent of respondents used SACCs to refinance the balance of a partially paid-out loan.⁵

⁵ Consumer Action Law Centre, Caught Short (August 2012), www.uq.edu.au/swahs/news/CaughtShortFinalReport.pdf.

The *Consumer Credit and Corporations Legislation Amendment (Enhancements) Bill 2011* (the Enhancements Bill) was initially drafted to prohibit SACC providers from providing a SACC to a consumer who was in default or had an existing SACC. This ban was relaxed to a rebuttable presumption in the final legislation to provide greater flexibility in cases where, for example, refinancing would lower the consumer's repayments and not result in financial hardship.

ASIC's current understanding of industry compliance

ASIC's Report 426 found that SACC providers have generally either:

- treated the presumption as a prohibition;
- used the presumption as a trigger to make further inquiries; or
- relied on the responsible lending practices and ignored whether a presumption was triggered.

In approximately 62 per cent of the 288 files reviewed by ASIC, the lender entered into a loan with a consumer who triggered one of the presumptions of unsuitability. ASIC found that lenders were keeping little evidence of attempts to rebut the presumptions, therefore, making it difficult to assess compliance with the presumption.

ASIC found SACC providers were still allowing consumers to use SACCs as part of the monthly budget, despite triggering the presumption of unsuitability. The majority of files reviewed in ASIC's Report 426 indicated that the consumer had taken out two or more SACCs with the same SACC provider within the review period.

The report noted that SACC providers often determined whether a consumer had a SACC with another SACC provider by asking the consumer. SACC providers appeared to experience difficulty verifying a consumer's assurance that the consumer did not have another SACC.

Feedback sought — Restrictions on repeat borrowing (TOR 1.2)

Question 5:

There is a presumption that a SACC is unsuitable if either the consumer is in default under another SACC or in the 90-day period before the assessment the consumer had two or more other SACCs.

- How do SACC providers determine whether a prospective customer has a SACC with another SACC provider or is in default under another SACC?
- Is a restriction on repeat borrowing necessary to protect consumers?
- Is a rebuttable presumption or a bright-line test (e.g., an outright ban or a limitation on the number of SACCs that a consumer can take out in a certain period of time) more effective? When responding, please consider:
 - the degree of protection afforded to consumers;
 - the complexity for SACC providers who are making a decision to grant a loan;

- the cost of complying with the requirement; and
- the flexibility afforded to SACC providers and whether this flexibility is desirable.
- Would the objective of limiting a debt spiral through repeat borrowing be assisted by requiring SACC providers to rely on a recognised prescribed benchmark, such as the Household Expenditure Measure or Henderson Poverty Index (with or without an added margin)?
 - If so, do stakeholders have any views on which benchmark should be used?
 - How should a benchmark be used? For example, should the use of a benchmark replace the need to make inquiries about a consumer’s expenses or the rebuttable presumption?
 - What is the likely cost or saving of requiring SACC providers to use benchmarks?

Ban on short term credit contracts (TOR 1.3)

Explanation of the law

There is an outright ban on a provider offering a credit contract which has a term of 15 days or less irrespective of whether the credit contract is secured. These contracts are referred to as ‘short term credit contracts’.

Restrictions were introduced that prohibited licensees from:

- suggesting that a consumer apply, or assisting the consumer to apply, for a short term credit contract or an increase to the credit limit of a short term credit contract (section 124A);
- entering into a short term credit contract (section 133CA); or
- increasing the credit limit of a short term credit contract (section 133CA).

Rationale

Before the ban on short term credit contracts was introduced, there was a concern that a significant percentage of consumers who entered into short term credit contracts were on low incomes, and that the short period of the loan meant that the repayment consumed a disproportionate amount of the consumer’s income for that pay period, resulting in financial hardship and a debt spiral.

ASIC’s current understanding of industry compliance

ASIC’s Report 426 noted that industry has taken steps to comply with the ban on short-term credit contracts.

ASIC has identified that some lenders are entering into SACCs which require repayment via a single payment. Although not a breach of the ban on short term credit contracts, this practice may cause consumers hardship, particularly where the consumer has little or no savings.

Feedback sought — Ban on short term credit contracts (TOR 1.3)

Question 6:

The Credit Act prohibits loans with a term of 15 days or less.

- Has the prohibition on short-term lending been effective in preventing lenders from offering loans with a term of 15 days or less?
- Has the prohibition on short-term lending had any unintended consequences that mean it should be changed? If so, please provide examples of these consequences.

Warnings (TOR 1.4)

Explanation of the law

SACC providers must provide a warning to consumers who contact the SACC provider via telephone, internet or their shopfront. The warning must be in the following terms:

It can be expensive to borrow small amounts of money and borrowing may not solve your money problems.

Check your options before you borrow:

- ***For information about other options for managing bills and debts, ring 1800 007 007 from anywhere in Australia to talk to a free and independent financial counsellor.***
- ***Talk to your electricity, gas, phone or water provider to see if you can work out a payment plan.***
- ***If you are on government benefits, ask if you can receive an advance from Centrelink: Phone: 13 17 94.***

The Government's MoneySmart website shows you how small amount loans work and suggests other options that may help you.

While the warning must be displayed in a specified format, there are no requirements in relation to the prominence of the warning when displayed on a website.

Rationale

When the requirement to display a warning was introduced, there was a lack of awareness of the alternatives to SACCs. The warning statement was designed to increase the understanding of alternative ways to meet expenses.

ASIC's current understanding of industry compliance

ASIC's Report 426 found that many SACC providers were making a genuine attempt to display the warning statement on websites. In particular, some SACC providers included a link to ASIC's MoneySmart website in the warning statement, even though this is not required by legislation. ASIC found that where the warning statement included a hyperlink, consumers were much more likely to visit MoneySmart.

Nevertheless, ASIC's report raised some concerns about warnings statements that were displayed on websites including that:

- statements were placed at the bottom of a webpage requiring a consumer to scroll down to access it;
- there was no requirement for the consumer to acknowledge that they had read the statement; and
- other website material sometimes detracted from the prominence of the statement (e.g., similar font colouring or pop-up boxes covering warning statements).

ASIC raised concerns that SACC providers who had shopfronts with multiple entrances were not displaying warnings at all of the entrances.

ASIC's report also found that some warning statements included other information which detracted from the key messages in the statement.

Feedback sought — Warnings (TOR 1.4)

Question 7:

The Credit Act requires SACC providers to provide a specific warning statement to consumers.

- Are the warning statements effective? Could the statements be improved? When responding, please consider:
 - the content of the warning; and
 - the manner in which it is displayed.
- Should SACC providers be required to include a hyperlink to the MoneySmart website when warnings are displayed on webpages?

Cap on costs (TOR 1.5 & 1.6)

Explanation of the law

SACC providers are only permitted to charge:

- establishment fees, which do not exceed 20 per cent of the 'adjusted credit amount' (which is the amount of credit provided under the contract excluding the establishment fee and monthly fees);
- monthly fees which:
 - are payable on a monthly basis starting on the day the contract is executed; and
 - do not exceed 4 per cent of the 'adjusted credit amount';
- direct debit fees in some circumstances;
- government fees, charges or duties payable in relation to the contract; and

- if a consumer defaults, certain default and enforcement fees.

There is a separate cap that applies to default fees. This cap limits the total amount recovered to twice the 'adjusted credit amount'. SACC providers are also subject to the general restrictions on default fees that apply to all credit providers, namely, that the default fees must reflect the SACC provider's loss.

Enforcement fees are the actual cost of recovering the money. They are excluded from the cap but must be reasonable, having regard to the actual costs incurred by the credit provider.

In 2013, ASIC issued Class Order 13/818 (CO 13/818) to deal with two issues relating to fees and charges that could be levied by SACC providers. CO 13/818 was intended to provide temporary exemptions pending the development of regulations.

CO 13/818 provides exemptions allowing:

- some credit contracts that would otherwise be a medium amount credit contract (MACC) (more than \$2,000) to be treated as a SACC if the credit under the contract is more than \$2,000 because of amounts of fees and charges that are included in the credit contract. This enables the credit provider to comply with the caps on costs applying to SACCs rather than MACCs; and
- fees or charges incurred by the SACC provider for direct debit processing to be levied on the consumer in addition to the cap on costs.

Rationale

The caps were designed to balance the need to protect consumers from high fees and being caught in a debt spiral against the need to ensure the industry remains viable.

Other credit contracts are subject to a flat cap of 48 per cent on interest. However, it was considered that a flat cap may have threatened the viability of the SACC market as 48 per cent is a small amount in dollar terms for small amounts of money over a short term.

The current level of the cap was set following inquiries undertaken by the Parliamentary Joint Committee on Corporations and Financial Services and the Economics Legislation Committee in 2011.⁶

ASIC's current understanding of industry compliance

ASIC's Report 426 found that the industry had a good understanding of the cap on costs and was generally complying with it. ASIC also noted that it was generally seeing less avoidance around the cap on costs than had previously been seen with interest rate caps.

However, ASIC did identify issues around some SACC providers extending the term of SACCs, or front loading the contract with higher repayments for a set term and then reducing the repayments for the end period of the loan. This type of activity has the potential

⁶ Parliamentary Joint Committee on Corporations and Financial Services' *Inquiry into the Consumer Credit and Corporations Legislation Amendment (Enhancements) Bill* (2011); Economics Legislation Committee's *Inquiry into the Consumer Credit and Corporations Legislation Amendment (Enhancements) Bill* (2011).

to maximise the amount of monthly fees charged in circumstances where this may not have been consistent with the consumer’s requirements and objectives.

For example, ASIC identified ‘... practices where payday lenders set the loan term on credit contracts of 12 months or more in circumstances where the relevant file indicated that the consumer requested a shorter loan term of well under 12 months.’ ASIC noted that ‘... this seems to be an attempt to ensure, even if the consumer pays out the loan earlier than the term, the lender still recovers 12 months’ worth of monthly fees.’

Examples of SACC structures for a \$500 loan

Loan term	4 month contract	12 month contract
Fees	\$100 + \$80 = \$180	\$100 + \$240 = \$340
Total repayment	\$680	\$840

ASIC has noted that most SACC providers are charging consumers a fee for direct debit services with some lenders utilising complex corporate structures to suggest it is not the credit provider charging the fee. ASIC has seen examples of consumers being charged up to \$3.50 per transaction.

Feedback sought — Cap on costs (TOR 1.5 & 1.6)

Question 8:

The Credit Act currently caps establishment fees at 20 per cent of the credit amount, monthly fees at 4 per cent of the credit amount and the total fees payable in default to twice the credit amount.

- The policy intention in respect of the rate at which the cap on cost was set was to provide adequate protection to consumers and continue to allow the SACCs industry to operate. Do stakeholders think the cap has broadly met this objective?
 - When providing a submission, please provide data, such as evidence that it is not viable for businesses to operate or evidence as to how the amount of the cap is causing financial hardship to consumers.
 - ASIC Class Order 13/818 granted temporary exemption from the cap for certain medium amount credit contracts (MACCs) and allowed small amount credit contracts (SACCs) providers to exclude fees charged for direct debit processing from the caps. Should the temporary exemptions provided by Class Order 13/818 be made into regulation?

Protection for Centrelink customers (TOR 1.7)

Explanation of the law

There is a power in the Credit Act to make regulations to prescribe certain requirements for repayments under SACCs. This power was used to make regulation 28S of the **National Consumer Credit Protection Regulations 2010** to cap the amount of the repayment for consumers who receive at least 50 per cent of their gross income from payments under the **Social Security Act 1991**.

For these consumers, the total amount of the repayments under all their SACCs, during the term of the proposed SACC, must not exceed 20 per cent of the consumer's gross income for each 'payment cycle of income'.

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

Rationale

This regulation was introduced to mitigate the risk of consumers who are dependent on Centrelink payments becoming trapped in a debt cycle.

The Enhancements Bill that was introduced into Parliament did not include this regulation-making power because a ban on multiple loans was considered to be a simpler and more effective mechanism for providing consumer protection.

When the ban was relaxed to a rebuttable presumption, the regulation-making power and the cap were introduced to protect consumers who receive 50 per cent or more of their gross income from Centrelink payments.

ASIC's current understanding of industry compliance

ASIC's Report 426 found that SACC providers had systems in place to comply with this obligation and did not raise any compliance issues with this requirement.

Feedback sought — Protection for Centrelink customers (TOR 1.7)

Question 9:

The Credit Act caps the amount of repayment for consumers who receive 50 per cent or more of their gross income from Centrelink payments to 20 per cent of the consumer's gross income.

- Is the protection for consumers who receive 50 per cent or more of their income under the *Social Security Act 1991* working effectively?
- Do any additional groups of consumers need to be subject to specific protection in relation to SACCs? For example, should the provisions be extended on a similar basis to other persons whose income is less than a specified amount or recipients of payments under the *Veterans' Entitlements Act 1986*?

National database of small amount credit contracts (TOR 2.1)

The Credit Act imposes responsible lending obligations on SACC providers to consider:

- whether the consumer can afford to meet the repayments under a SACC without suffering substantial hardship;
- whether the consumer has been a party to two or more other SACCs in the previous 90 days;
- whether the consumer is in default under another SACC; and

- if the consumer is receiving at least 50 per cent of their income from Centrelink, whether the total repayments from all SACCs exceeds 20 per cent of the consumer's income.

The review is required to consider whether a SACC database would enhance the capacity of SACC providers to meet these obligations by providing them with access to more comprehensive and accurate information.

A SACC database may improve the capacity of SACC providers to comply with the responsible lending obligations and determine whether a particular consumer is at risk of being caught in a debt spiral. A SACC database may also improve ASIC's capacity to monitor trends and practices in the SACC market.

A database should be designed so that it does not breach any of the provisions in the *Privacy Act 1988* (the Privacy Act). The risk of breaching the Privacy Act only arises if the database contains new categories of information that are not permitted to be held in the Australian credit reporting system under Pt 111A of the Privacy Act, such as information on a consumer's income and Centrelink benefits.

Any decision regarding the introduction of a SACC database would also need to consider the cost impact to SACC providers.

The comprehensive credit reporting regime (CCR) provides an alternative source of information for SACC providers. Prior to the introduction of the CCR in March 2014, the credit reporting regime was focused on sharing 'negative' credit events, such as an individual's history of defaults. The CCR introduced a voluntary 'positive' credit regime where positive information, such as loan repayment history could be shared.⁷

The introduction of the CCR brought Australia into line with comparable countries. Many OECD countries have some form of 'positive' credit reporting, either via a public credit register or private reporting body, reflecting the benefits of more comprehensive credit reporting.

A robust CCR regime could obviate the need for a SACC database, however, the CCR has only been in place for a relatively short period of time, and the major banks are still in the process of working to participate in the regime.

Feedback sought — National database (TOR 2.1)

Question 10:

The review is required to consider whether a SACC database would enhance the capacity of SACC providers to meet the responsible lending obligations by providing them with access to more comprehensive and accurate information.

- Is there sufficient information currently available for a SACC provider to meet the responsible lending obligations?
- If not, would a database or alternatives such as comprehensive credit reporting be a

⁷ See Financial System Inquiry Final Report (2014), p.190.

more effective way to meet the responsible lending obligations?

- If a SACC database is considered an effective method to meet the responsible lending obligations, please comment on:
 - the cost of a database;
 - any privacy concerns;
 - the advantages and disadvantages of having multiple databases operating in parallel;
 - whether a database would assist SACC providers to discharge the responsible lending obligations; and
 - the effect of the comprehensive credit reporting (CCR) regime, including whether or not additional information could be obtained through a SACC database that would not be available through CCR.
- If a recommendation was made to introduce a database:
 - What information should be included in the database?
 - Who should manage the database (a third party or government agency)?
 - How should the database be funded?
 - Should reporting of key information be mandatory or voluntary?
 - Should SACC providers be required to check the database and, if so, when should this obligation be triggered?
 - Should SACC providers be charged a fee for accessing the database and, if so, should the fee be included in the cap?
 - Who should be permitted to access and amend information on the database?
 - What mechanism should be available to ensure that the database was accurate?
 - How should the database interact with the other responsible lending obligations?

Additional provisions for SACCs (TOR 2.2)

The terms of reference require consideration of whether any additional provisions relating to SACCs should be included in the Credit Act. Any additional provision must fall within the Commonwealth's existing powers (TOR 8).

The objective of the Enhancement Bill, which introduced the SACC provisions, was to provide adequate protection for consumers while ensuring the industry remained viable. There may be additional provisions which could be included in the Credit Act to allow the legislation to better achieve its objectives. For example, additional provisions may support the overriding objective by:

- enhancing consumer protection; or
- providing greater certainty for industry and reducing compliance costs.

Two broad areas that stakeholders may want to consider are:

- whether or not the sanctions regime could be changed to better meet these two objectives; and
- noting that the issues raised by SACCs are not unique to Australia, whether any approaches in overseas jurisdictions provide models that could be applied here.

Feedback sought — Additional Provisions for SACCs (TOR 2.2)

Question 11:

The terms of reference require consideration of whether any additional provisions relating to SACCs should be included in the Credit Act.

- Are there any additional provisions relating to SACCs that should be included in the Credit Act taking into account the objective of the legislation? For example, are there any provisions that have been effective in other jurisdictions that could be introduced?

Two specific issues that have been previously raised by stakeholders are:

- an anti-avoidance provision; and
- specific provisions outlining how SACC providers should document the decision that a SACC was not unsuitable.

Anti-avoidance provisions

In 2012, consultation was undertaken on a general anti-avoidance provision with the exposure draft of the National Consumer Credit Protection Amendment (Credit Reform Phase 2) Bill 2012 but the bill was not enacted. The approach taken in the bill was:

- to prohibit a person from beginning or carrying out a scheme for the purpose of avoiding the application of a provision of the Credit Act; and
- to determine whether a scheme had this purpose on the basis of objective factors, rather than the subjective intentions of the person engaged in the scheme.

The response from stakeholders raised concerns about the broad scope of the draft provision as it was addressing two different types of avoidance practices:

- ‘Business model avoidance’ where a provider structures the products so that the products fall outside the scope of the Credit Act and are not subject to any of the requirements in the Credit Act.
 - An example of this type of avoidance is the use of sham pawn broking transactions to avoid caps under the previous state legislation, where an item with a nominal value was apparently pawned.

- 'Internal avoidance' of the Credit Act where the provider offers a regulated credit contract or consumer lease but structures the contract or includes certain terms to avoid a requirement in the Act.
 - An example may be lessors deliberately providing finance through leases rather than as a credit contract to avoid the caps that apply to credit contracts.

The two types of avoidance operate quite differently in terms of the providers, product design and consumer outcomes, and may, therefore, need to be considered in different ways.

It is noted that in the absence of a further referral of legislative power from the states, the scope of any Commonwealth anti-avoidance law would depend on existing Commonwealth powers under the Constitution (for example, the corporations power and the power to regulate inter-state trade and commerce).

Feedback sought — Anti-avoidance provision (TOR 2.2)

Question 12:

- Are stakeholders aware of any avoidance practices in relation to the Credit Act? If so, provide details of these practices and the scope (if known).
- Should any additional anti-avoidance provisions be included in the Credit Act?
 - If so, should there be any distinction between business model avoidance and internal avoidance?

Documentation of suitability assessments

The Credit Act requires lenders to make an assessment that the proposed SACC is not unsuitable. There are no requirements to document this assessment.

ASIC's Report 426 found that there were inconsistencies in the approach taken by SACC providers when recording why the presumption was rebutted and that some SACC providers did not record reasons. As a consequence, SACC providers may be unable to establish the facts relied upon to argue that a contract was not unsuitable.

Feedback sought — Documentation of suitability assessments (TOR 2.2)

Question 13:

The Credit Act requires lenders to make an assessment that the proposed SACC is not unsuitable.

- How do SACC providers currently meet the requirement to make a suitability assessment and what records of the decision-making process are maintained?
- What is the most efficient and effective way to document suitability assessments? Is it possible to use the same steps for actual compliance and demonstrable compliance?
- Should SACC providers be required to document the assessment? Please consider whether such a requirement could lead to greater transparency.

SECTION 3: CONSUMER LEASES AS ALTERNATIVES TO SMALL AMOUNT CREDIT CONTRACTS (TOR 3)

Explanation of law – consumer leases in general

The Credit Act applies different obligations to transactions according to whether or not the product is structured as a credit contract or a consumer lease. In summary:

- If the person who leases the good has a 'right or obligation to purchase the good', the transaction is deemed to be a sale by instalment and regulated in the same way as a credit contract under section 9 of the Credit Code (a section 9 lease).
- If the person who leases the good does not have a 'right or obligation to purchase the good', the transaction is regulated as a consumer lease under Part 11 of the Credit Code (Part 11 consumer leases).

A consumer lease is only regulated by Part 11 of the Credit Code if:

- the amounts payable under the lease exceed the cash price of the leased good;
- the lease term is for more than four months or for a defined period; and
- the lease is not an employment related lease (such as a novated lease or a lease paid via a salary sacrifice arrangement).

The regulatory requirements that apply to Part 11 consumer leases are less onerous than the requirements for credit contracts, including consumer leases which are deemed to be sales by instalment. For example, Part 11 consumer leases are not subject to a cap on costs.

More particularly, disclosure requirements for comparable consumer leases are more limited than the requirements for SACCs. SACC providers must disclose the cost of credit but lessors are not required to disclose the purchase price of the leased good or the amount the consumer will pay in excess of this price.

Rationale

The legislation adopts a definition of consumer leases that is based on the form of the contract (whether or not the consumer has a right or obligation to purchase the good), rather than the substance of the contract. This approach was inherited from the previous uniform state laws and it was initially adopted because it was easier to apply and provided greater certainty. At the time the state legislation was developed consumer leases which did not provide a right or obligation to purchase the good were considered to be functionally different from credit contracts because the consumer did not have the benefit of ownership at the end of the lease.

The rationale for a different regulatory outcome for leases which provide the consumer with a right or obligation to purchase the good (by deeming them to be credit contracts) is that these leases are functionally the same as credit contracts. In both cases the consumer makes a regular payment and can become the owner of the leased good.

Relationship between SACCs and consumer leases

The consumer protection associated with regulated consumer leases does not vary with the value or term of the lease. A 12 month lease for a good with a cash price of \$500 is regulated in the same way as a four year lease for a good with a value of \$10,000.

In contrast, the consumer protection that applies to credit contracts does vary with the size and term of the contract. A 12 month loan for \$500 is regulated differently to a four year \$10,000 loan.

Therefore, while some regulated consumer leases are likely to be comparable to SACCs others will not. For example:

- A 12 month lease for a \$500 fridge is likely to be comparable to a SACC.
- A 48 month lease for a \$60,000 car is not likely to be comparable to a SACC.

The focus of this review is on consumer leases that can be considered comparable to SACCs in that, in general terms, they are leases of relatively low value goods (for example, less than \$2,000) and are predominately used by consumers who are excluded from mainstream forms of finance or payment for those goods (or who self-exclude). However, while the value of the good under a comparable lease is prima facie likely to be similar to that of a SACC, the term of a comparable lease may be longer than that of a SACC, and can often extend beyond one year to three years or more.

Similar consumer bases

The consumer base for SACCs and comparable consumer leases is similar. Evidence suggests that a large portion of comparable consumer leases is taken out by consumers that are excluded from mainstream sources of finance, such as personal loans and credit cards.

The *Report of the independent review of Centrepay* found that, as at March 2013, Centrelink recipients had approximately 118,700 consumer leases for household goods, with the average fortnightly rental payment of just under \$76.⁸ The total payments under these leases in 2013 were expected to exceed \$200 million.

Where the consumer holds a lease and is in receipt of government benefits, then, as with SACCs, making relatively small payments through deductions from the Centrelink benefit can have a significant impact on the consumer's other expenditure.

Similar economic outcomes

Comparable consumer leases are often structured so that the consumer has the benefit of owning the good at the end of the lease without having a legal 'right or obligation to purchase the good'. This is done at no cost or nominal cost to the consumer, for example, lessors may give the consumer the right to:

- purchase a similar good for a nominal amount;

⁸ Report to the Secretary of the Department of Human Services, Australian Government, June 2013, available at www.humanservices.gov.au/corporate/publications-and-resources/centrepay-review/.

- make an offer to purchase the good which can be rejected or accepted by the lessor (but in practice is almost invariably accepted by the lessor);
- direct the lessor to gift the leased good to another person;
- continue to hold the good without taking ownership; and
- extend the term of the lease.⁹

In instances where the consumer has the benefits of owning the good at the end of the lease, the economic outcome of a comparable consumer lease and a SACC is the same. In both cases, the consumer makes regular ongoing payments for a period of time and has legal or effective ownership of the good at the end of the period.

Potential consequences of different regulatory treatment

The regulatory requirements that apply to Part 11 consumer leases are less onerous than the requirements for consumer leases which have a right or obligation to purchase the good. Given that SACCs and comparable consumer leases have similar markets and economic outcomes, this difference in regulation creates a risk that:

- Consumers may be adversely affected by paying higher amounts for a lease than a credit contract;
- Providers of SACCs may be operating in a market that is not competitively neutral.

Current industry practices

ASIC recently published a report (*Report 447 Cost of consumer leases for household goods*) that examined the costs charged to consumers by lessors.¹⁰ The report used data from two different sources:

- the advertised price of the total costs charged by nine lessors for 20 common household goods based on data collected by the Royal Melbourne Institute of Technology in April 2015 (RMIT market survey data); and
- ASIC's findings on the contracted price costs charged by two of the lessors in RMIT's market survey in 69 leases entered into between March 2014 and February 2015 with consumers in receipt of Centrelink payments (Centrelink recipient data).

ASIC's key findings from the RMIT market survey data were:

- The amounts charged by different lessors for the same goods varied significantly. ASIC reviewed four lease arrangements for identical goods and found a broad variation in the cost:
 - in dollar terms – with the difference ranging from \$228 to \$1,094; and

⁹ This section is based on *Consumer leases and consumer protection: Regulatory arbitrage and consumer harm* by Ali, McRae, Ramsay and Saw (2013).

¹⁰ <http://www.asic.gov.au/about-asic/media-centre/find-a-media-release/2015-releases/15-249mr-asic-finds-the-cost-of-consumer-leases-can-be-as-high-as-884/>

- when expressed as an interest rate (in one case the interest rates under two leases for identical goods were 25.9 per cent and 85.3 per cent).
- There was no consistency in the amounts charged relative to the value of the good being leased, and consumers could pay significantly more given the difference in cost between the cheapest and most expensive leases. For example, 18 leases were identified for household goods with a retail price of \$479–\$500 with a term of one year. Across these 18 leases:
 - the lowest fortnightly rental payment was \$21 with a total cost over the term of the lease of \$546; and
 - the highest fortnightly rental payment was \$49.90 resulting in a total cost of \$1,297.40 (or an additional \$751.40).

ASIC's key findings in relation to Centrelink recipients were:

- Centrelink recipients were more likely to be charged more than the maximum payable under a SACC. A review of four leases found that Centrelink recipients were charged:
 - between \$556 and \$2,462 more than would be permitted under a SACC; and
 - between two and five times more than the maximum amount that a provider of a SACC could charge.
- Centrelink recipients were more likely to be charged costs that were high when the cost was expressed as an interest rate:
 - in 20 out of 39 leases with a two-year term, more than five times the retail price of the leased goods—the equivalent of an interest rate of more than 248 per cent; and
 - in one case, a cost equivalent to an interest rate of 884 per cent.

The report also found that low-priced leases are available for basic household goods. For example, consumers can lease goods, such as washing machines, dryers, fridges and freezers for less than \$20 a fortnight on a lease with a one or two year term and, therefore, make total payments of less than \$520 and \$1,040 respectively to obtain these goods.

The report also referred to the fact that ASIC had concerns about the low standards of conduct by some lessors in this market sector, given that, between February 2013 and June 2015, it had taken enforcement action against lessors resulting in 10 public outcomes¹¹.

¹¹ A list of the 10 enforcement actions is in the Appendix to the Report.

Feedback sought — Comparable consumer leases (TOR 3)

Question 14:

The Credit Act applies different obligations to transactions according to whether or not the product is structured as a credit contract or a consumer lease.

- Which leases could be considered comparable with SACCs?
- Should there be greater consistency in the regulatory requirements that apply to SACCs and comparable consumer leases? Please consider:
 - the similarities between the consumer bases for SACCs and comparable consumer leases;
 - the similar economic outcomes of SACCs and comparable consumer leases;
 - ASIC evidence¹² which suggests that the effective interest rate for some consumer leases is substantially greater than the maximum allowed for SACCs under the caps;
 - the effect of introducing new regulatory requirements on the viability of the consumer leasing market and the availability of consumer leases; and
 - the impact of the distinction based on whether or not the consumer has a right or obligation to purchase the leased goods.

Please provide data, such as evidence as to the effect of any cap on the viability of businesses currently providing comparable consumer leases or evidence of where the absence of any cap is causing financial hardship to consumers.

Applying SACC provisions to comparable consumer leases

Some of the requirements that apply to all credit contracts (including SACCs) are more extensive than the requirements that apply to Part 11 consumer leases. For example, the disclosure requirements that apply to consumer leases differ from the disclosure requirements that apply to credit contracts in the following ways:

- Lessors are not required to disclose either the purchase or cash price of the leased good or the amount the consumer will pay in excess of this price. By comparison, a consumer borrowing a sum of money to purchase a good is informed of the amount of credit being provided to purchase the good and the amount payable in excess of this figure (whether as interest or fees).
- Lessors are not required to disclose the cost of credit as an interest rate.
- Lessors are not required to separately disclose amounts payable for warranties or insurance when these costs are bundled with the rental payments.

The following provisions apply to SACCs but do not apply to comparable consumer leases:

¹² ASIC Report, Cost of consumer leases (September 2015).

- the caps on the establishment fees and monthly fees;
- the requirement to obtain and consider a consumer's bank account statements over the past 90 days;
- the requirement to display a warning statement on the alternatives available;
- the requirement that a consumer who defaults must not be charged an amount that exceeds twice the amount of the loan; and
- protection for specific groups of consumers such as those who receive 50 per cent or more of their income from Centrelink.

It may be the case that the different legal structure of leases and credit contracts will result in differences in the way the above provisions might apply. For example, a warning statement for consumer leases could assist consumers to consider other options before taking out a lease in the same way as the SACC warning statement. However, any such warning could specifically refer to the consumer lease information on ASIC's MoneySmart website.

Feedback sought — Applying SACC provisions to comparable consumer leases (TOR 3)

Question 15:

- As SACC and comparable consumer lease providers market to a similar consumer base, should the same provisions apply?
- Should there be additional disclosure requirements for comparable consumer leases, such as a requirement to disclose:
 - the purchase or cash price of the leased good;
 - the amount the consumer will pay in excess of the purchase or cash price;
 - the cost of credit in dollar terms;
 - the cost of credit as an interest rate; and
 - the cost of other services financed through the rental payments (apart from the cost of hiring the goods, such as a warranty or delivery)?

Please consider the cost of complying with any such additional disclosure requirements against the benefit of providing additional information to consumers.

- If greater consistency between SACCs and comparable consumer leases is considered warranted, which SACC provisions should be extended to those leases?
 - Would the SACC provision need to be modified when applied to consumer leases?

Regulating the maximum amount lessors can charge

Credit providers offering SACCs are subject to a cap on costs that does not allow them to charge interest and limits the amount of fees charged. Other categories of credit contracts are subject to a different cap (as set out in section 1 under the heading ‘Current regulatory framework’).

To consider a cap on costs for lessors, it may be necessary to identify a method that provides lessors with certainty in relation to applying the cap on costs. One possible approach could be to use the approach that is currently required for leases that are deemed to be sales by instalment. In such transactions, the charge for providing credit is calculated as the difference between the total cost of hiring the good and the cash price of the good. The cash price of the good or service is defined in section 204 of the National Credit Code as:

- the lowest price that a cash purchaser might reasonably be expected to pay from the supplier; or
- if the goods or services are not available for cash from the supplier or are only available for cash at a reasonably similar price to the price paid by a consumer who buys the good on credit —the market value of the goods or services.

In some instances it would be straightforward to identify a cash price for the good which is leased, for example, where a retailer offers the good for sale or lease. There may be other instances where the cash price may be less certain (such as where the good is second-hand).

Feedback sought — Cap on costs for consumer leases (TOR 3)

Question 16:

- If a cap on consumer leases that are comparable to SACCs was introduced, how should the cap apply?
 - The cash price of the good is used as the basis for applying the cap on costs. Should the approach for sales by instalment also be used as a basis for applying the cap to leases that are comparable to SACCs? If so, how should the cash price of the good be defined?
 - If not, what alternative approach could be used to determine a cap on costs for leases?