

THE POLITICS OF PAYDAY LENDING REGULATION IN AUSTRALIA

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The regulation of payday lending in Australia has recently been reformed. The reforms followed a highly charged and polarised debate between the conflicting interests of consumer and welfare advocates — who argued for increased protection for payday loan borrowers — and the payday loan industry. The debate followed research findings of the adverse consequences of payday lending for low income and financially vulnerable borrowers. We analyse the political dynamic that unfolded and show how the protections proposed to be afforded to payday loan borrowers were reduced in several key respects. Our research highlights several concerns. First, key changes to the original proposals do not take account of the recommendations of consumer and welfare advocates and are more consistent with the views of the payday loan industry. Second, the increased complexity of the final form of the regulation of payday lending creates potential for regulatory avoidance and poses problems for enforcement. Third, policies to reduce reliance on payday loans have not been implemented. The result is new regulation of payday loans that may not achieve the key aim of protecting the most vulnerable borrowers from the harm that can result from these loans.

I INTRODUCTION

On 21 September 2011, the Federal Minister for Financial Services and Superannuation, the Hon Bill Shorten MP, introduced into Parliament the Consumer Credit and Corporations Amendment (Enhancements) Bill 2011 (Cth). The Enhancements Bill proposed amendments to the *National Consumer Credit Protection Act 2009* (Cth) (*'NCCP Act'*) including reforms to consumer lease lending, reverse mortgages and small amount, high interest, short-term loans. The Enhancements Bill aimed to regulate this last category, colloquially known as payday loans, through the introduction of caps on interest rates, fees and charges, and by prohibiting multiple lending and refinancing of existing loans. These legislative reforms were to be complemented by additional strategies aimed at reducing borrower reliance on payday loans, including increasing the availability of affordable credit alternatives such as microfinance and low and no interest community loan schemes.

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The Enhancements Bill was part of the second phase of consumer credit protection laws that began with the *NCCP Act*, a reform package which harmonised existing state and territory consumer credit laws, introduced a new National Credit Code and gave administrative and enforcement powers in relation to consumer credit to the Australian Securities and Investments Commission (ASIC). The Enhancements Bill responded to concerns that responsible lending obligations enacted under the earlier *NCCP Act*, and applicable to all credit providers, were insufficient to address borrower harm in the case of credit arrangements such as payday loans.

The Enhancements Bill was welcomed by consumer legal advocates, financial counsellors and welfare agencies who had long advocated increased protection for payday loan borrowers.¹ The response to the Enhancements Bill by the payday loan industry was swift and vocal, led by the industry lobby group, the National Financial Services Federation. Payday industry representatives initiated a concerted large-scale media and lobbying campaign against the Bill. Australia's largest payday lender, Cash Converters, used the names, addresses and images of thousands of customers in an online campaign. Borrowers were photographed holding signs that said 'No Cap' and the images were placed on a dedicated campaign website linked to the Cash Converters website.² The images were also used on postcards that were sent by mail to Members of the Federal Parliament. The 'No Cap' signs portrayed these borrowers as opponents of the proposed reforms that would cap the fees and interest rates payable on their loans.

In both the months before the Enhancements Bill was introduced into Parliament and while it was the subject of debate in Parliament, there was increased media attention on the harm caused by payday loans.³ The payday loan industry responded by arguing that there is strong and growing demand for payday loans in Australia and that the introduction of a cap on the allowable fees, charges and interest rates for payday loans would cause a significant number of lenders to exit the market (with arguably negative consequences for the provision of

1 The first comprehensive study of payday lending in Australia was conducted in Victoria by the Consumer Law Centre (now Consumer Action Law Centre). See Dean Wilson, 'Payday Lending in Victoria' (Research Report, Consumer Law Centre Victoria, July 2002) ('*Wilson Report*'). More recent studies include: Zac Gillam, 'Payday Loans: Helping Hand or Quicksand? Examining the Growth of High-Cost Short-Term Lending in Australia, 2002–2010' (Research Report, Consumer Action Law Centre, September 2010) ('*Gillam Report*'); Marcus Banks et al, 'Caught Short: Exploring the Role of Small, Short-Term Loans in the Lives of Australians' (Final Report, Social Policy Unit, University of Queensland, August 2012) ('*Caught Short Report*'); Financial Counselling Australia, 'What Financial Counsellors Say about Payday Lending' (Research Report, October 2011) ('*Financial Counselling Report*').

2 Cash Converters Australia, *No Cap* <<http://www.nocap.com.au/>>.

3 See, eg, Vince Chadwick, 'Pay-Day Loans No Solution for Most, Survey Finds', *The Age* (Melbourne), 13 August 2012, 3; Mike Secombe, 'Canberra is Protecting Loan Sharks. Yes, You Read Right', *The Global Mail* (online), 2 August 2012 <<http://www.theglobalmail.org/feature/canberra-is-protecting-loan-sharks-yes-you-read-right/323/>>; Ruth Williams, 'Anger over Changes to Payday Loans', *The Sydney Morning Herald* (Sydney), 25 April 2012, 4; John Rolfe, 'Having a Lend of the Poor — Shorten's Cash Conversion', *The Daily Telegraph* (Sydney), 25 February 2012, 16; Jane Searle, 'Responsible Lending Laws "Failed"', *The Australian Financial Review* (Sydney), 6 December 2011, 41.

and access to credit).⁴ The Enhancements Bill was subsequently amended and the final version, as passed by Parliament in August 2012 as the *Consumer Credit Legislation Amendment (Enhancements) Act 2012* (Cth), with its reduced protections for payday loan borrowers, indicates that the campaign undertaken by the payday loan industry was influential in shaping the final version of the Enhancements Bill.

Our purpose in this article is to document and analyse the political dynamic that unfolded regarding the regulation of payday lending. At the intersection of this debate were two conflicting interests: that of those who advocated for the protection of payday loan borrowers on the basis that these borrowers are typically more vulnerable members of society; and that of the payday loan industry. We show how, as the debate unfolded, the protections proposed to be afforded to payday loan borrowers were reduced in several key respects. In addition, the final form of the legislation is very complex which, perversely, creates opportunities and incentives for some parts of the payday loan industry to avoid the requirements of the legislation.

The structure of this article is as follows. In the second part of the article we provide the context for the regulation of payday lending. In the third part we identify the key features of payday lending in Australia. We highlight the findings of recent borrower studies that find evidence of significant financial harm caused by repeat payday loan borrowing. The findings of these studies show that payday lending has adverse consequences for low income and financially vulnerable borrowers, who make up the large majority of payday loan borrowers. In the fourth part of the article we discuss the legislative, committee and consultative history of the Enhancements Bill. A highly political and polarised debate informed the progress of the Bill. We identify the key changes to the Bill's form and content, and relate these changes to the conflicts between key stakeholders. While a number of new protections are contained in the *Enhancements Act*, certain key protections recommended in the *Regulation Impact Statement*⁵ and supported by consumer advocates were removed from the final version of the Enhancements Bill. Our research shows that the *Enhancements Act* represents a series of compromises by the government regarding the regulation of payday lending. It is therefore unclear whether the *Enhancements Act* is capable of protecting the most vulnerable borrowers from financial hardship. Of particular concern is the complexity of the requirements imposed on lenders to assess borrower suitability and how these will, in practice, be enforced.

In discussing the Enhancements Bill we explore the complexities of regulatory intervention in Australia's payday lending market, including how competing policy objectives, tensions between the interests of key stakeholders and attempts

4 Matthew Drummond, 'Payday Lenders Warn of Market Exit', *The Australian Financial Review* (Sydney), 14 March 2011, 44. Cf 'Cash Converters Says Reforms Not a Threat', *The Sydney Morning Herald* (online), 1 June 2011 <<http://news.smh.com.au/breaking-news-business/cash-converters-says-reforms-not-a-threat-20110601-1ffe9.html>>.

5 Treasury, Australian Government, *The Regulation of Short Term, Small Amount Finance: Regulation Impact Statement* (June 2011) 51, 59–60 ('*Regulation Impact Statement*').

to balance these interests shaped legislative outcomes. The debate about how to regulate payday lending in Australia also raises related and more complex policy issues including financial exclusion and the need for increased access to affordable credit alternatives. At the time the Enhancements Bill was first released, the Minister announced the reforms would be supported by complementary policies to encourage alternatives to payday loans and promote financial inclusion.⁶ A Discussion Paper was released in April 2012 and submissions were received from stakeholders.⁷ At the time of writing, no policies to promote financial inclusion have been announced by the government.

II THE CONTEXT FOR THE REGULATION OF PAYDAY LENDING

The regulation of consumer credit is undergoing substantial reform both in Australia and internationally.⁸ In the United States, Canada and the United Kingdom, varied responses to the global financial crisis have included a focus on consumer credit protection regimes.⁹ A number of countries have established new consumer protection agencies, such as the Consumer Protection Bureau in the United States¹⁰ and the Financial Conduct Authority in the United Kingdom.¹¹ Payday lending is a form of consumer credit. However, it has typically been subject to more stringent regulation than other forms of consumer credit. This is because of the vulnerability of those who are typical payday loan borrowers and the harm that can result from payday loans where such loans lead to excessive debt.

There are a variety of approaches to the regulation of payday lending. One approach is to impose disclosure obligations on lenders. A second approach is to impose interest rate caps on the loans. A third approach is to ban payday loans.

6 See the Second Reading Speech of the Enhancements Bill: Commonwealth, *Parliamentary Debates*, House of Representatives, 21 September 2011, 10 950–3 (Bill Shorten, Minister for Financial Services and Superannuation).

7 Treasury, Australian Government, 'Strategies for Reducing Reliance on High-Cost, Short-Term, Small Amount Lending' (Discussion Paper, April 2012).

8 Luke Nottage and Souichirou Kozuka, 'Lessons from Product Safety Regulation for Reforming Consumer Credit Markets in Japan and Beyond' (2012) 34 *Sydney Law Review* 129, 130–1.

9 See generally Anthony Duggan, 'Consumer Credit Redux' (2010) 60 *University of Toronto Law Journal* 687; Iain Ramsay and Toni Williams, 'The Crash That Launched a Thousand Fixes: Regulation of Consumer Credit after the Lending Revolution and the Credit Crunch' in Kern Alexander and Niamh Moloney (eds), *Law Reform and Financial Markets* (Edward Elgar, 2011) 221.

10 The Consumer Financial Protection Bureau is responsible for making rules to enhance consumer protection and enforcing these rules in order that 'consumers have access to markets for consumer financial products and services': *Dodd-Frank Wall Street Reform and Consumer Protection Act* § 1021, 12 USC § 5511 (2010). The Bureau's core functions include the making and enforcement of rules relating to consumer financial protection laws, restricting unfair or deceptive practices in the provision of consumer finance, receiving consumer complaints, research and the promotion of financial education and ongoing monitoring of markets: Consumer Financial Protection Bureau, *About Us* (15 July 2013) <<http://www.consumerfinance.gov/the-bureau/>>.

11 The Financial Conduct Authority is one of the successor agencies to the UK Financial Services Authority established under the *Financial Services Act 2012* (UK). That Act commenced on 1 April 2013. See generally Financial Conduct Authority, *Home* <<http://www.fca.org.uk>>.

All three approaches are evident in the United States. In that country, there is very limited federal payday loan regulation,¹² and, despite the recent creation of the Consumer Financial Protection Bureau, the regulation of payday lending is still largely a matter for the individual states. Some US states regulate payday lending by imposing truth in lending and other disclosure obligations, responsible lending rules or codes, and limits on the allowable amount of interest on loans.¹³ In other states, legislatures have concluded that the harm to borrowers caused by payday loans is so acute they have prohibited these loans.¹⁴ Similarly, a range of approaches to the regulation of payday lending exists across Canada's provinces (where, again, there is only limited federal regulation of payday lending).¹⁵ In the United Kingdom, payday loans are regulated no differently from other forms of consumer credit. Payday loans are not currently subject to an interest rate cap and it is possible that this position will remain unchanged as the new consumer credit regulator, the Financial Conduct Authority, has recently stated that caps could make consumers worse off by reducing the availability of credit.¹⁶ Our review of these jurisdictions finds that various approaches to regulating payday lending are evident and that governments have struggled to reconcile the competing interests of stakeholders.

Recent scholarly research in the area of behavioural economics has highlighted limitations in relying largely or exclusively on disclosure obligations to regulate consumer credit markets. Consumer credit regulatory initiatives are increasingly incorporating the insights of behavioural economics research which challenges the theory of the 'rational consumer',¹⁷ particularly in the regulation of fringe credit. This is credit that is accessed largely by low income, financially disadvantaged borrowers. We discuss why payday lending is fringe credit and the implications this has for the regulation of payday lending.

12 In relation to federal regulation of payday lending in the US, the *John Warner National Defense Authorization Act for Fiscal Year 2007*, 10 USC § 987 (2006), restricts the ability of payday lenders to make loans to military personnel and their families after an empirical survey of payday lenders revealed that lenders were deliberately targeting military bases across America. See Steven M Graves and Christopher L Peterson, 'Predatory Lending and the Military: The Law and Geography of "Payday" Loans in Military Towns' (2005) 66 *Ohio State Law Journal* 653.

13 Ronald J Mann and Jim Hawkins, 'Just until Payday' (2007) 54 *UCLA Law Review* 855, 875–7.

14 For example, in New York State, a strictly enforced interest rate cap has resulted in a total elimination of payday lending in that state. See especially Karen E Francis, 'Rollover, Rollover: A Behavioural Law and Economics Analysis of the Payday-Loan Industry' (2010) 88 *Texas Law Review* 611, 622–3.

15 For a history of the regulation of payday lending in Canada, see Mary Anne Waldron, 'A Brief History of Interest Caps in Canadian Consumer Lending: Have We Learned Enough from the Past?' (2011) 50 *Canadian Business Law Journal* 300; Stephanie Ben-Ishai, 'Regulating Payday Lenders in Canada: Drawing on American Lessons' (2008) 23 *Banking and Finance Law Review* 323, 370–6.

16 Kristine Erta et al, 'Applying Behavioural Economics at the Financial Conduct Authority' (Occasional Paper No 1, Financial Conduct Authority, April 2013) 34. The Financial Conduct Authority (FCA) also noted that interest rate caps 'have been cited as an example of regulatory failure driven by regulators' own behavioural biases'. The UK Office of Fair Trading has recently found poor compliance with consumer protection and responsible lending laws, poor industry practices relating to assessments of affordability and a heavy reliance on the refinancing of loans in the UK payday loan industry: Office of Fair Trading (UK), 'Payday Lending: Compliance Review' (Final Report, March 2013) 4. The FCA's view of interest rate caps is not necessarily inconsistent with these findings as the FCA has also signalled its support for improved disclosure of fees and charges levied on payday loans: Erta et al, above n 16, 43–4.

17 Duggan, above n 9, 695–6.

A Payday Lending as Fringe Credit

Fringe credit is a term used by legal and regulatory scholars to characterise non-mainstream credit products.¹⁸ In Australia, fringe credit refers to credit provided by non-mainstream lenders at a very high cost to borrowers relative to mainstream credit products.¹⁹ Fringe credit should not be confused with alternative credit, a category that includes no interest or low interest loans provided by welfare or community organisations.²⁰ Typical features of fringe credit are its comparatively high costs including establishment fees and interest rates, short loan terms, and the use of direct debit from borrower accounts and payment directions for repayments.²¹ Borrowers with adverse credit histories or who are unemployed are often ineligible for mainstream bank loans or credit cards. Fringe credit typically has lower eligibility requirements for borrowers, and an adverse credit history, unemployment or low income does not necessarily impede a borrower obtaining such credit.²²

Another feature of fringe credit is the greater risk of predatory or exploitative lending practices. Fringe credit is viewed as an ‘essentially ... opportunistic’ product that takes advantage of borrower vulnerability²³ including limited access to mainstream credit. Increased reliance on fringe credit has recently been linked to financial exclusion, in a major study of financial exclusion in Australia.²⁴ Financially excluded Australians are more likely to face long-term impoverishment, long-term unemployment, illness or disability, and a reduced capacity to cope with immediate financial crises including unemployment or

18 See, eg, Jim Hawkins, ‘Regulating on the Fringe: Re-Examining the Link between Fringe Banking and Financial Distress’ (2011) 86 *Indiana Law Journal* 1361.

19 National Australia Bank, ‘Do You Really Want to Hurt Me? Exploring the Costs of Fringe Lending — A Report on the NAB Small Loans Pilot’ (Research Report, March 2010) 9.

20 *Ibid.* The National Australia Bank Research Report states it is important to distinguish between fringe credit products and microfinance, as these terms may be used interchangeably depending on the source. Making this distinction is important because ‘microfinance seeks to provide fair, safe and ethical financial services for people who, because of their circumstances, are not able to access mainstream financial services’. A review of current Australian and international literature finds that very few commentators would disagree with the characterisation of payday loans as ‘fringe credit’, however one commentator has recently stated that the ‘rapid growth’ of payday lending in the US means it can no longer be considered ‘fringe’ by virtue of its ubiquity: Paige Marta Skiba, ‘Regulation of Payday Loans: Misguided?’ (2012) 69 *Washington and Lee Law Review* 1023, 1030.

21 Sally Andersen, ‘Mapping the Terrain: The Last Decade of Payday Lending in Australia’ (2011) 39 *Australian Business Law Review* 5, 7; Chris Field, ‘The Sharks Are Circling — A Report on Pay Day Lending’ (2002) 30 *Australian Business Law Review* 148, 148–9. For articles that examine the regulation of payday loans in Australia, see Therese Wilson, ‘The Inadequacy of the Current Regulatory Response to Payday Lending’ (2004) 32 *Australian Business Law Review* 193; Denise McGill, Stephen Corones and Nicola Howell, ‘Regulating the Cost of Small Loans: Overdue or Overkill?’ (2012) 30 *Company and Securities Law Journal* 149.

22 Andersen, above n 21, 10–11.

23 Justin Malbon, ‘Predatory Lending’ (2005) 33 *Australian Business Law Review* 224, 225.

24 Chris Connolly et al, ‘Measuring Financial Exclusion in Australia’ (Research Report, The Centre for Social Impact for National Australian Bank, May 2012) 6 (‘2012 Social Impact Report’): ‘Financial exclusion exists where individuals lack access to appropriate and affordable financial services and products’ including ‘a moderate amount of credit’.

unexpected expenses, for example, funeral costs.²⁵ While fringe credit accounts for only a small proportion of Australia's overall consumer credit debt, it has been assessed as having a disproportionately 'corrosive and harmful' impact on the financial and general wellbeing of the poorest and most vulnerable borrowers.²⁶

Payday lending has consistently been found to be a fringe credit product disproportionately used by low income, financially disadvantaged, borrowers. Borrower surveys in both Australia and the United States find that the majority of payday loan borrowers are financially excluded,²⁷ on low incomes, or welfare dependant, and therefore are considered vulnerable to financial hardship. The most recent survey of Australian borrowers of payday loans found that few borrowers had credit histories that included common or mainstream credit products such as bank loans, credit cards or mortgages.²⁸ This survey also found that borrowers were aware of the high cost of payday loans and acknowledged they pose significant risks to their financial wellbeing, but described them as 'a necessary evil'.²⁹ Because of the disproportionate use of payday loans by low-income consumers, some recent scholarship has advocated stricter regulation akin to the product safety regulation commonly associated with alcohol or tobacco, including the establishment of a Financial Product Safety Commission.³⁰ Proponents of extending product safety style restrictions to payday lending argue this is necessary because such loans pose an unacceptable level of risk of entering debt spirals to a borrower cohort that can least afford the high cost of these loans.

Some scholars are less critical of fringe credit, arguing that, in certain contexts, high-cost small amount loans may offer a legitimate and well regulated alternative for informed consumers who lack access to mainstream credit products.³¹ There is some support for the proposition that, when used as intended — as one-off emergency loans and repaid quickly — payday loans may assist a borrower's financial position if, for example, going without credit entirely would substantially worsen their financial position.³² The difficulty with this analysis is the consistent finding that the payday loan industry relies on repeat borrowing for a substantial

25 Chris Connolly et al, 'Measuring Financial Exclusion in Australia' (Research Report, The Centre for Social Impact for National Australian Bank, May 2011) 18, 27 ('2011 Social Impact Report').

26 Malbon, above n 23, 225.

27 *Caught Short Report*, above n 1, 15–17, 21.

28 *Ibid* 30. The authors reported that 'rather than signifying some unalloyed positive finding, the low mainstream debt burdens in the sample only reinforces that most respondents were living in poverty and did not have access to these forms of debt'.

29 *Ibid* 48, 86.

30 Oren Bar-Gill and Elizabeth Warren, 'Making Credit Safer' (2008) 157 *University of Pennsylvania Law Review* 1, 100–1.

31 Duggan, above n 9, 692.

32 Skiba, above n 20, 1027–8.

part of its business³³ and that payday loans entrench a pattern of repeat borrowing for a significant number of borrowers.³⁴

III THE AUSTRALIAN PAYDAY LOAN INDUSTRY

In this section we discuss the market for payday loans in Australia; examine who is the typical payday loan borrower; identify the key features of payday loans; discuss how these loans can cause harm to borrowers; and highlight the findings of studies that recurrent use of payday loans by low income borrowers increases the risk of financial harm and unmanageable debt, and that recurrent and repeat lending behaviours are common to these borrowers.

A Payday Lending in Australia: Growing Demand

The market for small amount personal loans from providers other than major banks and credit societies expanded rapidly in the late 1990s and coincided with a reduction in the provision of such loans by banks and credit societies.³⁵ Access to a modest amount of affordable credit is widely considered an essential financial tool, allowing borrowers to smooth the discrepancies between expenditure and income. Access to such credit is considered to be one of three key measures of financial inclusion.³⁶ The demand for credit for everyday transactions is evidenced by the high rate of credit card ownership in Australia.³⁷

For a number of Australians, personal circumstances including adverse credit histories or unemployment restrict their ability to access mainstream credit products from banks or other authorised deposit-taking institutions. The restrictions on accessing mainstream credit do not generally apply in the case of payday loans. Payday loans meet the growing demand for small amounts of cash, where assessment of borrowers is fast and few barriers to access credit exist. It is critical to understand that much of the demand for such loans is driven by acute

- 33 *Caught Short Report*, above n 1, 65–6. A review of Australian lenders confirmed that the ‘core basis’ of Australia’s payday loan industry is repeat borrowing: at 65. The centrality of repeat lending was identified in Parliamentary Joint Committee on Corporations and Financial Services, Parliament of Australia, *Inquiry into Consumer Credit and Corporations Legislation Amendment (Enhancements) Bill 2011* (2011) 60–1 [5.44]–[5.45] (*‘Consumer Credit and Corporations Joint Committee Report’*): ‘Industry data appeared to support claims that there is a high proportion of repeat borrowing among consumers ... on the basis of the [payday industry] figures provided it is clear that repeat borrowing is required to generate the rate of loans ... issued per year’.
- 34 See, eg, *Financial Counselling Report*, above n 1. This study of 341 financial counsellors in Australia found that 79 per cent of counsellors reported that payday loans ‘never’ improved their client’s financial situation: at 8. See also *Caught Short Report*, above n 1, 28, where the authors reported that half of all respondents stated that their financial circumstances had worsened since taking out a payday loan.
- 35 Andersen, above n 21, 11.
- 36 *2012 Social Impact Report*, above n 24, 11, stating that access to a basic banking product (such as a savings account), basic insurance and a modest amount of credit are the three markers of financial inclusion. A lack of access to one, or all of these, indicates that the individual is financially excluded.
- 37 Paul Ali, Cosima McRae and Ian Ramsay, ‘Consumer Credit Reform and Behavioural Economics: Regulating Australia’s Credit Card Industry’ (2012) 40 *Australian Business Law Review* 126, 126.

financial need or a cash flow crisis and where borrowers are severely restricted with respect to credit options.³⁸ One major bank has publicly acknowledged that a lack of access to mainstream finance contributes to demand for fringe credit³⁹ and that they would prefer to 'see exploitative fringe lending providers out of business'.⁴⁰

Determining the exact size of Australia's payday lending market is difficult,⁴¹ but recent estimates value the market for payday loans at worth \$800 million annually.⁴² Payday lenders vary in size, including large national chains (that may operate as franchises), smaller national chains and stand-alone lenders. Some lenders operate as dual pawn-broking and small loan businesses, while others couple their lending activities with other financial services such as currency exchange. It is difficult to reach a conclusion as to whether payday lenders compete on price. While payday loans are structurally the same across lenders, it is difficult to compare the true cost of loans offered by different lenders,⁴³ especially given the manner in which lenders operate.⁴⁴ Also, studies of Australian borrowers find that they are frequently insensitive to the costs of borrowing⁴⁵ and thus, as will be seen in the next section, the decision to borrow from a payday lender is likely to be based on the borrower's need for credit to be provided expeditiously rather than the cost of that credit. A further difficulty in assessing the market for payday loans in Australia is the recent shift from physical to online lending with an increase in the number of online lenders.⁴⁶ A number of these online lenders are corporations established outside Australia that operate in Australia under an Australian credit licence.⁴⁷

38 *Caught Short Report*, above n 1, 31, finding that over half of borrowers surveyed had adverse credit histories, less than 2 out of 5 borrowers had accessed mainstream credit previously, and the majority of borrowers thought it was likely that a bank would reject their application for credit. See also *Gillam Report*, above n 1, 63.

39 National Australia Bank, 'NAB Welcomes Commonwealth Efforts to Address Payday Lending' (Media Release, 26 August 2011) <http://www.nab.com.au/wps/wcm/connect/nab/nab/home/About_Us/8/5/11/53/>.

40 Letter from National Australia Bank to Members of Parliament, 15 March 2011, 2 <http://www.nab.com.au/wps/wcm/connect/nab/nab/home/About_Us/7/4/3/6/>.

41 Using the number of payday lending stores, estimates of the number of customers of each store and estimates of the average loan amount can lead to wide variations in estimates of the size of the payday lending market. Estimates of the size of the Australian market in 2001 ranged from \$38 million to \$200 million: Market Intelligence Strategy Centre, 'Consumer Credit Report' (Report, Department of Justice and Consumer Affairs Victoria, June 2006) 55–6.

42 Jane Searle, 'Cash in Demand', *BRW* (Australia), 23 August 2007, 36–9. While a breakdown of the figure is not provided, it, in common with similar statistics, likely represents an estimate of the annual volume of monies lent.

43 See, eg, *Caught Short Report*, above n 1, 7.

44 Andersen, above n 21, 9.

45 *Gillam Report*, above n 1, 6–7. Over half of the borrowers surveyed chose the loan because it was close to their place of residence and convenient, and only 9.4 per cent of borrowers surveyed chose the loan based on price.

46 Andersen, above n 21, 9.

47 The ultimate ownership of these online lenders is not always clear. However, one online lender operating with an Australian credit licence, but with foreign ownership, is DollarsDirect: DollarsDirect, *About Us* <<http://www.dollarsdirect.com.au/about-us.html>>.

B Payday Loan Borrowers

Payday loans are characterised by a number of Australian payday lenders as a form of emergency finance.⁴⁸ In highlighting the ‘last resort’ nature of payday borrowing, it is critical to note the evidence from Australian borrower studies that have found consumer choice is not always applicable to payday lending.⁴⁹ This is because most borrowers are not choosing payday loans in preference to other, more affordable, credit options. Rather, they use payday loans because payday loans are often the most readily accessible or only feasible credit option to meet a cash shortfall, due to borrowers’ lack of access to mainstream alternatives or impaired credit histories.⁵⁰ Australian studies have found the majority of payday loan borrowers do not have access to a credit card or mainstream bank loan and over 60 per cent have adverse credit histories.⁵¹

Studies of Australian borrowers have found that the typical payday loan is for a small cash amount of between \$100 and \$300 and is most commonly obtained to cover recurrent weekly costs of living because the borrower’s income is insufficient.⁵² The *Caught Short Report* found that the most common reasons for accessing a payday loan are to purchase food, to ‘make ends meet’, or because the borrower had no money to pay bills, including utility bills and rent.⁵³ Welfare and consumer organisations in Australia state that payday loans are inextricably linked to income insufficiency, particularly when the income is largely or solely from welfare benefits. In 2011 Financial Counselling Australia released a report detailing the results of a national survey of financial counsellors on their casework experience with payday lending over the last decade. The *Financial Counselling Report* stated:

The fundamental issue with payday lending is poverty. Too many people simply do not have enough to live on, and turn to payday lenders to make ends meet ... For these groups of people in our society, payday lending has simply exacerbated what was already a precarious financial situation.⁵⁴

The *Caught Short Interim Report* found that ‘poverty pervades the lives of most borrowers’⁵⁵ of payday loans and most ‘live in such impoverished circumstances that notions of customer choice lose meaning’.⁵⁶ Compared with the general population, payday loan borrowers are more likely to have been raised in poverty, and many are disadvantaged by physical or mental illness and disability (a

48 *Caught Short Report*, above n 1, 32. See also Evidence to Parliamentary Joint Committee on Corporations and Financial Services, Parliament of Australia, Canberra, 24 October 2011, 61 (Daniel Shteyn, Managing Director, DollarsDirect).

49 *Caught Short Report*, above n 1, vi.

50 *Ibid* vii.

51 *Ibid*.

52 *Ibid* 35. See also the studies cited at above n 1.

53 *Caught Short Report*, above n 1, 33.

54 *Financial Counselling Report*, above n 1, 15.

55 Marcus Banks, ‘Caught Short: Exploring the Role of Small, Short-Term Loans in the Lives of Australians’ (Interim Report, RMIT University, September 2011) 8 (*‘Caught Short Interim Report’*).

56 *Ibid* 4, 23.

high proportion of borrowers are dependent on disability support payments).⁵⁷ Borrowers are more likely to be unemployed, and single parents with dependent children are over-represented in the payday loan population.⁵⁸ These findings are largely consistent with earlier borrower surveys conducted in 2002 (the *Wilson Report*) and 2010 (the *Gillam Report*) by the Consumer Action Law Centre that found typical borrowers have lower incomes, are likely to be welfare recipients and are unable to access mainstream forms of credit.⁵⁹ The *Gillam Report* found nearly one quarter of borrowers had annual incomes of \$20 000 or less⁶⁰ and, despite a small shift in the demographics of borrowers compared with the *Wilson Report*, led the study authors to conclude that payday lending ‘remains deeply rooted in a low-income demographic for its core business’.⁶¹ The authors of the *Caught Short Report* concluded that the research findings about borrower demographics increase the need for stronger regulatory protection because ‘this demographic is also the most vulnerable in terms of becoming dependent on loans, entering into cycles of debt and lacking the financial education or means to improve their circumstances’.⁶² The findings of these reports contradict the claims of payday lenders that borrowers are increasingly middle income earners.⁶³

C Key Features of Payday Loans and How Payday Loans Cause Harm

There are four distinct features of payday loans in Australia: the purpose for which these loans are taken out; the cost of the loans; the payment mechanism for the loans; and the term of the loans. On their own these features do not necessarily mean that the loan in question is an unduly onerous one (for example, a loan which carries a high interest rate is not always a burdensome loan) but when all four features are present, as they are in the case of a typical payday loan in Australia, the likelihood of financial harm to borrowers is heightened.

The first feature is that the majority of payday loans in Australia are used to finance consumption, in particular the recurrent weekly costs of living including basic necessities such as rent, utilities and other bills, and food.⁶⁴ This is a corollary of the observations made above as to the demographic features of typical payday loan borrowers in Australia.

57 *Caught Short Report*, above n 1, 16, 23–4.

58 *Ibid* 15, 19.

59 *Wilson Report*, above n 1, 56–7, 67–8; *Gillam Report*, above n 1, 43, 76–7.

60 *Gillam Report*, above n 1, 53. An annual income of \$20 000 per annum in 2008 equated to a weekly income of \$384. A single person with this income falls below the Henderson Poverty Line, the accepted measure of poverty based on income in Australia: Melbourne Institute of Applied Economic and Social Research, ‘Poverty Lines: Australia — December Quarter 2008’ (Research Report, 8 April 2009) 1.

61 *Gillam Report*, above n 1, 58.

62 *Caught Short Report*, above n 1, 68.

63 See below Part IV(B). The admission by some payday lenders that payday loans are a credit option for emergency finance and that lenders service financially excluded customers undermines these claims.

64 Consumer Action Law Centre, Submission to Treasury, *Discussion Paper: Strategies for Reducing Reliance on High-Cost, Short-Term, Small Amount Lending*, 8 June 2012, 4.

The second feature is that payday loans are, compared with mainstream credit products, very expensive.⁶⁵ Payday loans carry very high establishment and other fees and, consequently, the interest rate on a payday loan (taking account of these fees and any explicit interest charged) can range from 48 per cent per annum (where caps imposed under current state legislation apply) to as high as 1500 per cent per annum.⁶⁶ As noted above, a high annualised interest rate does not, of itself, denote a burdensome loan but, in the case of payday loans, the high annualised interest rate is a function of the fees and explicit interest charged being high relative to the size of the average payday loan and also the short term of the typical payday loan. These other features increase the likelihood that a payday loan will be burdensome to the borrower. Payday lenders have argued that the interest rates⁶⁷ applicable to their loans are acceptable, although high, due to the costs of administering the loan that need to be covered and to account for the risk of default.⁶⁸ While it is difficult to assess the costs associated with making and monitoring payday loans in Australia (despite the reduced eligibility requirements that apply in practice to payday loans relative to mainstream credit products and the fact that, increasingly, payday loans are being offered online), it is possible that the high cost of payday loans can be attributed to the following factors: the low creditworthiness of typical borrowers (relative to users of mainstream credit products);⁶⁹ the demand for payday loans is often precipitated by acute financial need; and that borrowers in those circumstances are likely to be insensitive to the pricing of payday loans.⁷⁰

The cost to the borrower of a payday loan may also be increased by the lender persuading the borrower to purchase ‘consumer credit insurance’ or ‘loan protection insurance’.⁷¹ Even though the insurance premiums are paid to a third party insurer, not the lender (as it is unusual for payday lenders to also be authorised insurers), the lender has a strong incentive to sell insurance to the borrower. The lender can finance the payment of premiums, thus increasing the amount of principal lent to the borrower and, consequently, increasing the fees or interest that can be charged for advancing that principal. The insurer may also rebate

65 Ibid.

66 National Legal Aid, Submission No 19 to Parliamentary Joint Committee on Corporations and Financial Services, *Inquiry into Consumer Credit and Corporations Legislation Amendment (Enhancements) Bill 2011*, 14 October 2011, 2, cited in *Consumer Credit and Corporations Joint Committee Report*, above n 33, 72 [5.87].

67 Payday lenders often charge fees rather than interest rates but these fees are in effect interest.

68 Cash Converters, Submission to Treasury, *National Credit Reform Green Paper — Enhancing Confidence and Fairness in Australia’s Credit Law*, August 2010, 9–10. See also Aaron Huckstep, ‘Payday Lending: Do Outrageous Prices Necessarily Mean Outrageous Profits?’ (2007) 12 *Fordham Journal of Corporate & Financial Law* 203, 210–11.

69 But see the discussion of the third feature of payday loans.

70 *Gillam Report*, above n 1, 6–7. See also Andersen, above n 21, 10–11. This inelasticity of demand may also be attributable to the reduced ability or inability of borrowers to access mainstream credit and a personal preference on the part of borrowers for payday loans over mainstream credit.

71 Lenders are prohibited from requiring payday loan borrowers to take out loan protection insurance: *NCCP Act* sch 1, s 143.

part of the premiums to the lender as a commission for selling the insurance.⁷² Moreover, the riskiness of payday loans is likely to mean that premiums will be high relative to the size of the loan. There is, in addition, a question as to whether many lenders that sell loan protection insurance to payday loan borrowers are complying with their responsible lending obligations. Loan protection insurance for payday loans is, as noted above, expensive but many of the insured events — the coverage for which the borrower is paying — may not be applicable to many payday loan borrowers. Loan protection insurance is typically designed to ensure that a loan can be repaid in the event of the borrower's death or loss of income due to injury, illness or unemployment. If a borrower is unemployed and is using welfare payments to service his or her loan, the majority of the insured events will be irrelevant, the insurance will be largely unsuitable for the borrower, and the amount lent to the borrower will have been unnecessarily increased by the premiums paid in respect of those events.

The third feature of payday loans is that repayments are typically serviced by the use of direct debits from a nominated bank account. Repayments under the loan are timed to coincide with payment of a borrower's salary or welfare benefits (hence the name 'payday loans') and these repayments are made automatically to the payday lender without the further involvement of the borrower.⁷³ The effect of this is twofold: to mitigate significantly the risk of the borrower's default through the introduction of a third party, and to confer de facto priority on the payday lender, as loan repayments are made automatically ahead of the borrower's other commitments, including essential expenses such as food and utility bills. The prevalence of these direct debits and payment directions undermines the claims

72 The statutory prohibition on lenders financing the premiums payable in respect of loan protection insurance does not apply to payday loans as these loans are unsecured and for terms of less than one year: *NCCP Act* sch 1 s 144(1). In addition, an insurer can pay a lender a commission of up to 20 per cent of the premiums: at sch 1 s 145.

73 *Caught Short Report*, above n 1, 1. A payday lender will frequently require a borrower to service the loan through direct debits from the account into which Centrelink payments are made. As the Consumer Action Law Centre, Consumer Credit Legal Centre NSW and Financial Counselling Australia have jointly noted:

Requiring direct debits allows for a relatively low risk of default on payday loans, even though a typical payday loan for a typical client is likely to create financial stress. The lender has taken first stake in the borrower's income so the borrower is more likely to 'default' on their rent or groceries, than on their loan repayments. This means that lenders are currently wearing an artificially low risk of default on what would otherwise be loans too risky to issue. ... Despite improving the rate of loan repayment for lenders, direct debit arrangements carry a significant risk to the borrower of double penalties (fees imposed by both the bank and the lender) in the event that there are insufficient funds in the account. This risk is borne by any consumer using direct debit payments but is highest for those living on low incomes as is typical for payday loan borrowers.

Consumer Action Law Centre, Consumer Credit Legal Centre NSW and Financial Counselling Australia, Joint Submission to Treasury, *Discussion Paper: Strategies for Reducing Reliance on High-Cost, Short-Term, Small Amount Lending*, 7 May 2012, 19–20. See also a report by Financial Counselling Australia recently identified that large repayments can allocate up to 100 per cent of a person's benefits, leaving them with no money to live: Financial Counselling Australia, 'Centrepay: A Good Idea That Has Lost Its Way' (Report, February 2013) ii.

of payday lenders that the high cost of their loans is to cover the risk of default.⁷⁴ In addition, the prioritisation of loan repayments over essential expenses can increase the risk of repeated use of payday loans in circumstances where the original loan has been exhausted and the borrower's other income is limited.⁷⁵ The *Caught Short Report* found that direct debits could be harmful to payday borrowers, as direct debits often resulted in default or dishonour fees from both their bank and the payday lender (due, in both instances, to the account having an insufficient credit balance), increasing the need to obtain a further loan.⁷⁶

The final feature of payday loans is their short term. For borrowers with little or no savings, the critical or sole source for the repayment of a payday loan is the salary or welfare payment received on or about the maturity of the loan. The short term of a payday loan — generally of two weeks to one month — combined with the high cost of the payday loan often means that the amount that must be repaid can be very large relative to the salary or welfare payment that the borrower expects to receive when the loan falls due.⁷⁷ For low income and welfare-dependent borrowers, a repayment which consumes a significant portion of the borrower's salary or welfare payment increases the likelihood that the borrower will need to resort to another payday loan to cover expenses incurred before the next salary or welfare payment date.⁷⁸ Moreover, the high cost of payday loans may make it difficult for a borrower to repay a loan in full on maturity without resorting to another loan.

The following example, from the Consumer Action Law Centre, explains why:

assume a ... scenario where the borrower earns \$24,000 per annum after tax (that is, \$923 per fortnight), borrows \$300 over a term of 28 days, and is required to repay a total of \$405. In this scenario, fortnightly repayments would be \$202.50 per fortnight, which is 22 per cent of this borrower's income.

Alternatively, assume the borrower's income was the maximum, single adult rate of Disability Support Payment ... which equates to an income of \$748.80 per fortnight. Assuming all other factors in the scenario above remain the same, repayments for this person would be 27 per cent of income.

74 The availability of direct debits and payment directions to payday lenders — and their effect on the risks of payday lending — may also explain the rise in the number of payday lenders, in particular online lenders, in Australia.

75 *Caught Short Report*, above n 1, 8.

76 *Ibid.*

77 Consumer Action Law Centre, *Discussion Paper*, above n 64, 4.

78 *Ibid.*

In both scenarios, repaying the loan creates what is without doubt an enormous burden for a low income borrower whose entire income is likely to be required to meet necessary living expenses.⁷⁹

The presence of all four features in the case of a typical payday loan not only, as noted above, increases the likelihood of the loan in question being burdensome to the typical borrower but also increases the likelihood of repeat borrowing. The recurrent use of payday loans has been found to be a key factor leading to unmanageable debt, debt spiralling and, ultimately in the most extreme cases, bankruptcy.⁸⁰

D *Patterns of Borrowing*

The Australian borrower studies reviewed confirm that repeat and frequent use of payday loans is common and that the number of borrowers using payday loans as ‘one-off’ or single transactions is relatively low.⁸¹ For example, the *Financial Counselling Report* found that 92 per cent of the financial counsellors surveyed had clients who had multiple payday loans within the last twelve months.⁸² Of the counsellors surveyed, 79 per cent reported that payday loans, in their experience, had ‘never’ improved the financial wellbeing of their clients.⁸³ The *Financial Counselling Report* also found that the vast majority of qualitative responses from counsellors concerned the negative impacts of payday loans on the financial wellbeing of their clients.⁸⁴

Similar findings of repeat borrowing were reported in the *Caught Short Report*:

Forty four per cent of people discussed a practice of cycling — how they had immediately taken out a new loan once the previous loan had been paid out. Twenty three per cent became involved in the spiralling process of refinancing the balance of a partially paid-out loan to start a new loan, and a quarter of respondents described how they took out two or more parallel loans from the same or different lenders simultaneously.⁸⁵

79 Consumer Action Law Centre, Submission No 20 to Parliamentary Joint Committee on Corporations and Financial Services, *Inquiry into Consumer Credit and Corporations Legislation Amendment (Enhancements) Bill 2011*, 14 October 2011, 4 (citations omitted), quoted in *Consumer Credit and Corporations Joint Committee Report*, above n 33, 74 [5.91].

80 Sheryle Bagwell, ‘Bankrupt Mum Backs Protections for Borrowers’, *ABC News* (online), 21 September 2011 <<http://www.abc.net.au/news/2011-09-21/bankrupt-mother-backs-protections-for-borrowers/2909578>>.

81 *Caught Short Report*, above n 1, 43.

82 *Financial Counselling Report*, above n 1, 5.

83 *Ibid* 8.

84 *Ibid* 12. The *Financial Counselling Report* includes further details of the comments made by financial counsellors: at app 1, 17–33.

85 *Caught Short Report*, above n 1, 41 (emphasis altered).

Repeat borrowing of loans that are ostensibly meant to be for emergencies, such as a sudden cash flow crisis, is widely regarded as the most problematic aspect of payday lending.⁸⁶

These findings suggest that a significant proportion of borrowers are engaged in continuous and frequent use of payday loans. The studies conclude that for low income and financially disadvantaged borrowers, frequent and continuous borrowing materially worsens financial wellbeing.⁸⁷

There is consistent evidence that Australian payday loan borrowers are predominantly members of the community on low incomes and that the features of these loans and practices of the lenders make repeat borrowing more likely. The demand factors that largely drive the use of payday loans include financial exclusion, income insufficiency and borrower financial hardship. When faced with limited or no choice, low income borrowers resort to payday loans. In the casework experience of consumer legal advocates, community lawyers and financial counsellors Australia-wide, there is consensus that for the majority of payday loan borrowers, the product does not improve an individual's financial or general wellbeing and is likely to materially worsen it.⁸⁸

These issues set the scene for regulatory intervention and the Federal Government, in its policy analysis of payday lending in Australia, accepted that payday loans could be harmful to financially vulnerable borrowers.⁸⁹ The Minister for Financial Services, the Hon Bill Shorten MP, emphasised that ameliorating borrower harm was at the core of the proposed reforms of payday lending in Australia.

IV THE REGULATION OF PAYDAY LOANS IN AUSTRALIA

A Overview of the Reform Process

With the publication of the *Regulatory Impact Statement* and the introduction into Parliament of the original Enhancements Bill in September 2011, it was evident that the Federal Government proposed to introduce stricter regulation of payday lending and thereby protect vulnerable borrowers. The Explanatory Memorandum to the Enhancements Bill stated that further regulation of payday loans was, in particular, necessary to reduce the cost of payday loans to borrowers and address the risk of borrowers being trapped in debt through the repeated use

86 All the Australian borrower studies cited at above n 1 emphasise the risks to borrowers caused by repeat borrowing. Treasury reported that, '[t]he greater the extent of repeat borrowing (including consecutive loans) the greater the probability the borrower will be left with a significant shortfall in income, depending on the terms of their loan, to meet other recurring essential costs, such as food, utilities and transport costs': *Regulation Impact Statement*, above n 5, 21.

87 See generally *ibid.*

88 *Financial Counselling Report*, above n 1, 12.

89 *Regulation Impact Statement*, above n 5, 6–7.

of payday loans.⁹⁰ Between September 2011 and August 2012, when the final version of the Enhancements Bill was enacted, a series of amendments to the Bill occurred.

The following is a brief chronology of these amendments:

- 21 September 2011 to December 2011: following the introduction of the Enhancements Bill into the House of Representatives, the Bill was referred to the Joint Parliamentary Committee on Corporations and Financial Services ('Parliamentary Joint Committee')⁹¹ and the Senate Economics Legislation Committee ('Senate Committee').⁹² During September and October 2011 stakeholders made submissions, including giving evidence at oral hearings. The Final Report of the Parliamentary Joint Committee was released in December 2011, as was the report of the Senate Committee.⁹³
- April 2012: an amended Exposure Draft of the Enhancements Bill was released and submissions from stakeholders requested.
- April 2012: a Treasury Discussion Paper on complementary policies to reduce reliance on payday loans was released and submissions were requested.⁹⁴
- June 2012 to August 2012: an amended draft of the Enhancements Bill was tabled in Parliament and passed through both houses without any further amendments.
- September 2012: an Exposure Draft of Regulations containing matters left to regulations was released and submissions requested.
- December 2012: registration of the Regulations.⁹⁵

The cumulative effect of these changes is that the final form of the regulation of payday loans is substantially different from that originally proposed. In the following section of the article we track the changes to the key consumer protection mechanisms in the original Enhancements Bill. These are:

- The definition of a small amount credit contract, which determines the loans that are subject to the new regulation.
- The permitted fees and charges, including default fees.
- The cap on the allowable maximum interest.

90 Explanatory Memorandum, Consumer Credit and Corporations Legislation Amendment (Enhancements) Bill 2011 (Cth) 5, 10 [1.14].

91 *Consumer Credit and Corporations Joint Committee Report*, above n 33.

92 Senate Economics Legislation Committee, Parliament of Australia, *Consumer Credit and Corporations Legislation Amendment (Enhancements) Bill 2011 [Provisions]* (2011).

93 *Consumer Credit and Corporations Joint Committee Report*, above n 33; Senate Economics Legislation Committee, above n 92.

94 Treasury, 'Strategies for Reducing Reliance', above n 7.

95 *National Consumer Credit Protection Amendment Regulation (No 4) 2012* (Cth).

- Prohibitions on multiple lending and refinancing, now replaced with rebuttable presumptions of suitability.
- Further disclosure requirements for lenders, including warnings about the cost of lending.

Our research highlights several concerns relevant to the changes. First, key changes to the original proposals do not take account of the recommendations of consumer and welfare advocates, and are more consistent with the views of the payday loan industry. Second, and more specifically, changes such as the replacement of strict prohibitions on refinancing and multiple loans with rebuttable presumptions of suitability rely on lenders to always act in the best interests of vulnerable borrowers. Third, the increased complexity of the final form of the regulation of payday lending creates potential for regulatory avoidance and poses problems for enforcement.

B Contested Issues: The Parliamentary Joint Committee Debate

The original Enhancements Bill was referred to both the Parliamentary Joint Committee following its introduction into Parliament and the Senate Committee. The submissions to the Parliamentary Joint Committee reflected the starkly opposing positions of the payday loan industry and consumer and welfare organisations. In this section, we identify the major points of contention between key stakeholders. This assists in identifying the conflicting agendas of stakeholders and sets the political scene in which amendments took place.

In both the written submissions and oral evidence before the Parliamentary Joint Committee, vastly divergent opinions were given by representatives of the payday loan industry and by consumer and welfare advocates.⁹⁶ While some industry representatives acknowledged there were certain ‘rogue elements’,⁹⁷ there was almost unanimous industry opposition to the Enhancements Bill, declaring it was unnecessary to further regulate the payday loan market.⁹⁸ A review of the submissions, written and oral, finds two key points of contention. The first concerned the necessity of further and stricter regulation, principally driven by industry-challenging studies finding the majority of borrowers are low income and many are financially vulnerable and therefore in need of further protection. The second contested matter was the substantive content of the Enhancements Bill, principally driven by industry opposition to the proposed cap on fees and interest rates and restrictions on multiple lending and refinancing.

In both written and oral submissions, payday industry representatives challenged the view that a significant proportion of borrowers are financially vulnerable.

⁹⁶ Evidence to Parliamentary Joint Committee on Corporations and Financial Services, Parliament of Australia, Canberra, 24 October 2011, 69 (Mr Alan Griffin): ‘We are getting a complete disconnect between what industry is saying and, to be blunt, what the consumer movement is saying’.

⁹⁷ *Ibid* 17 (Robert Bryant, CEO, Money3 Corporation).

⁹⁸ *Consumer Credit and Corporations Joint Committee Report*, above n 33, 86 [5.135].

Industry representatives refuted the findings of the Treasury in its *Regulatory Impact Statement* and the evidence from borrower surveys that reported on the financial vulnerability of borrowers.⁹⁹ Instead, payday loan industry representatives argued that there is strong demand for loans from borrowers that need instant cash to ‘cover an unexpected expense or an unusually large purchase’ and that in accessing a loan, borrowers are ‘exercising choice’.¹⁰⁰ Although industry representatives submitted that their consumer base is increasingly middle income,¹⁰¹ they also submitted they ‘service that group of people that might be deemed financially excluded’ and those that are not served by the banks.¹⁰² They warned the Committee that the introduction of additional regulation would make lending unviable. This would result in the provision of emergency finance for financially excluded people being left solely to Government, with an industry participant stating to the Parliamentary Joint Committee: ‘the problem will not be the lenders — they will have gone; the problem will be yours’.¹⁰³

In the United States, a similar debate about the demographics of payday loan borrowers and whether borrowers are predominantly low income or impoverished has taken place.¹⁰⁴ As one US commentator has highlighted:

The question of who payday lending customers are, primarily regarding their income levels and borrowing characteristics, is in dispute between consumer advocates and the payday lending industry. An industry under constant scrutiny does not want to appear to be taking advantage of a vulnerable customer base. Instead, the industry describes its customers as middle-income consumers who need short-term credit for a temporary problem.¹⁰⁵

In a review of payday loan industry statements and arguments in the United States, it was found that industry representatives consistently argue they are servicing the ‘middle class’ in order to resist any further regulation.¹⁰⁶ They argue that payday loans are no different from, and have no greater risks to financial wellbeing, than mainstream finance and therefore do not require further, or specific, regulation

99 The representative of Cash Doctors stated that their customers are a growing demographic of financially literate, credit averse and tech savvy people ... fully employed and their net salary on average is \$40,000 per annum. About 65 per cent of ... clients have a perfect credit history, so they are free to choose from among any financial products in the mainstream industry.

Evidence to Parliamentary Joint Committee on Corporations and Financial Services, Parliament of Australia, Canberra, 24 October 2011, 16 (Gregory Ellis, Co-CEO, Cash Doctors). The representative of DollarsDirect submitted orally that customer surveys conducted ‘once in a while’ suggested that their customer base were all employed, with an annual income of \$45 000 to \$46 000 gross per year, and that many were home owners: at 61 (Daniel Shteyn, Managing Director, DollarsDirect).

100 Ibid 50–1 (Mark Redmond, Chairman, National Financial Services Federation).

101 Ibid 61 (Daniel Shteyn, Managing Director, DollarsDirect).

102 Ibid 16 (Robert Bryant, CEO, Money3 Corporation).

103 Ibid 19 (Phillip Smiles, Financiers’ Association of Australia).

104 See generally, Nathalie Martin and Ernesto Longa, ‘High-Interest Loans and Class: Do Payday and Title Loans Really Serve the Middle Class?’ (2012) 24 *Loyola Consumer Law Review* 524, 525–6.

105 Michael Kenneth, ‘Payday Lending: Can “Reputable” Banks End Cycles of Debt?’ (2008) 42 *University of San Francisco Law Review* 659, 664.

106 Martin and Longa, above n 104, 529–30.

because the borrower base is not especially vulnerable. In contrast, consumer advocates argue that payday loans are a fundamentally different financial product than bank finance, with an especially vulnerable demographic. The latter conceptualisation of payday lending is evident in the approach adopted in the original Enhancements Bill. When questioned by members of the Parliamentary Joint Committee, Treasury representatives reiterated that the purpose of the reforms is:

primarily based on equity considerations and the desirability of maximising the possibility of social inclusion for low-income or marginalised debtors ... the purpose of the reforms is to reduce the negative financial and social impacts of the relatively high cost, in dollar terms, of access to credit by those who can least afford it.¹⁰⁷

This statement reflects the recognition by Treasury officials that payday loans are predominantly used by Australians who are financially vulnerable and who therefore require additional protection.

The second contested matter in the Parliamentary Joint Committee debate was the proposed interest rate cap. During the course of the Committee inquiry, industry representatives submitted through written and oral evidence that interest rate cap restrictions on lending would make lending ‘economically unviable’ and, in the words of one industry representative, was ‘tantamount to outlawing payday lending’.¹⁰⁸ It is important to point out that, at the time of debate, payday lending was (and continues to be) a viable industry, for example in New South Wales, where payday lending was subject to an interest rate cap of 48 per cent per annum.¹⁰⁹ When questioned by the Committee members about the need for economic modelling to assess the impact of the proposed interest rate cap, Treasury representatives responded that the cap was modelled on that currently in place in New South Wales, with modifications to address the issue of avoidance.¹¹⁰ A Treasury representative stated that a cap scheme, as recommended in the *Regulatory Impact Statement*, had been assessed as the appropriate mechanism for furthering ‘the government’s objective ... to balance the social costs and improve the outcomes for vulnerable consumers while maintaining a viable industry’.¹¹¹

Industry representatives were also critical of the proposed bans on multiple lending and refinancing, stating that a significant proportion of revenue is ‘dependent, in part — whether good or bad; but this is an economic fact — on some form of rollover or refinancing opportunity’.¹¹² The industry opposition to restrictions on

107 Evidence to Parliamentary Joint Committee on Corporations and Financial Services, Parliament of Australia, Canberra, 24 October 2011, 72 (Sue Vroombout).

108 Super Nexus Pty Ltd, Submission No 24 to Parliamentary Joint Committee on Corporations and Financial Services, *Inquiry into Consumer Credit and Corporations Legislation Amendment (Enhancements) Bill 2011*, 14 October 2011, app A, 2.

109 *Credit (Commonwealth Powers) Act 2010* (NSW) sch 3 item 5(1) (repealed).

110 Evidence to Parliamentary Joint Committee on Corporations and Financial Services, Parliament of Australia, Canberra, 24 October 2011, 74.

111 *Ibid* 77 (Sue Vroombout).

112 *Ibid* 18 (Phillip Smiles, Financiers’ Association of Australia).

multiple loans, and the admission that business derives from ‘customer loyalty’,¹¹³ is at odds with the industry’s representations that payday loans are used as one-off or emergency payment options.¹¹⁴ The Chairman of the National Financial Services Federation argued that a prohibition on multiple loans would impede ‘finding a better deal with another lender ... to meet emergencies or to shop around’.¹¹⁵ A review of the industry submissions finds, unsurprisingly, considerable opposition to the Enhancements Bill. However, little evidence beyond observations as to the adverse economic consequences of further regulation of payday lending is provided in support of these submissions. In contrast, the consumer legal and welfare advocates who supported stricter regulation of payday lending cited in support of their claims such borrower surveys as the *Caught Short Interim Report* and the *Financial Counselling Report*.¹¹⁶

In December 2011, a Report, including recommendations, was published by the Parliamentary Joint Committee. The Committee agreed with Treasury and consumer advocates that further and stricter regulation is necessary to protect consumers,¹¹⁷ but was not convinced that the Bill struck an ‘appropriate balance ... between consumer protection and industry viability’.¹¹⁸ The lack of industry impact modelling was a particular concern for the Committee. The Committee recommended further consultation with industry to resolve the considerable contestation about the impact of the proposed interest rate cap and further research into the circumstances of borrowers.¹¹⁹

The Report concluded that there was insufficient evidence to ‘[presuppose] that the vulnerabilities of consumers who access short-term loans is [sic] no greater than that of the broader consumer population in Australia’.¹²⁰ Critically, the Committee accepted the oral submissions of lenders that there was a growing ‘middle class’ bracket of borrowers, considered not to have the same vulnerabilities as low income borrowers.¹²¹ The Committee was not convinced of the merits of restricting multiple loans and refinancing.¹²² The Senate Economics Legislation Committee recognised there was ‘considerable debate’ in the submissions to the Parliamentary Joint Committee and commented on ‘the lack of substance in the *Regulation Impact Statement*’ about the impact of the reforms.¹²³ The Senate Committee endorsed the Parliamentary Joint Committee’s view that the proposed regulations ‘do not strike the right balance between consumer protection and industry viability’ and agreed further stakeholder consultation was required.¹²⁴

113 Ibid 52 (Tim Dean, CEO, First Stop Money).

114 Ibid 61 (Daniel Shteyn, Managing Director, DollarsDirect).

115 Ibid 50 (Mark Redmond, Chairman, National Financial Services Federation).

116 See above n 1.

117 *Consumer Credit and Corporations Joint Committee Report*, above n 33, 118 [5.243].

118 Ibid.

119 Ibid xiv.

120 Ibid 113 [5.220].

121 Ibid 114 [5.222].

122 Ibid 115 [5.229]–[5.231].

123 Senate Economics Legislation Committee, above n 92, 16 [2.41]–[2.43].

124 Ibid 17 [2.46]–[2.47].

We now examine how the original Enhancements Bill changed in several key respects.

C The Definition of a Small Amount Credit Contract

Both the original Enhancements Bill and the eventual *Enhancements Act* regulate payday loans by reference to the amount of monies lent and the term of the loan. Central to the regulation of payday loans in the Enhancements Bill was the term ‘small amount credit contracts’ (SACCs). The term was defined in sufficiently broad terms to capture the majority of payday loans in Australia as the monies lent under a typical payday loan range from \$100 to \$300 and such loans generally have a term of two weeks to one month. The Bill defined SACCs as non-continuing credit contracts (ie where only a single advance is envisaged as opposed to the multiple advances that are available under credit contracts such as credit cards and home mortgages) where the credit provider is not an Authorised Deposit-Taking Institution (ADI),¹²⁵ the amount lent is \$2000 or less, the term of the contract is two years or less, and the borrower’s contractual obligations are not secured by a mortgage.¹²⁶ The Bill effectively introduced a two-tiered structure for payday loans. Those loans which fell within the above definition — the majority of payday loans — were subject to specific restrictions, including on the fees, charges and interest that lenders could levy, while payday loans outside the above definition were to be regulated in common with other credit contracts (and would in common with those other contracts be subject to an interest rate cap).

This simple demarcation between SACCs and other credit contracts was, however, abandoned when the amended Bill was reintroduced into Parliament on 26 June 2012. The definition of SACCs was amended to cover credit contracts with terms between 16 days and one year.¹²⁷ The reduction in the length of credit contracts covered by the definition is, for payday loans with their typical term of two weeks to a month, less significant than in the introduction of a new minimum term. In parallel with this, a new definition of ‘short-term credit contract’ (STCC) was introduced to apply to those credit contracts which would otherwise have fallen within the definition of SACCs but for their very short term of 15 days or less.¹²⁸ The amended Bill imposed an outright ban on these very short-term contracts, whether secured or unsecured, by explicitly prohibiting lenders from entering into STCCs.¹²⁹ The rationale for banning STCCs was to address the risk, associated with payday loans (and other credit contracts) with very short-terms, that the

125 Authorised Deposit-Taking Institutions are ‘corporations which are authorised under the *Banking Act 1959*. ADIs include ... banks; building societies; and credit unions’: Australian Prudential Regulation Authority, *Authorised Deposit-Taking Institutions (ADIs)* <<http://www.apra.gov.au/adi/Pages/default.aspx>>.

126 Consumer Credit and Corporations Legislation Amendment (Enhancements) Bill 2011 (Cth) sch 3 item 1 cls 5 (1)(a)–(f).

127 Consumer Credit Legislation Amendment (Enhancements) Bill 2012 (Cth) sch 3 item 2 cl 5(1)(d).

128 *Ibid* sch 3 item 1 cls 5(1)(a)–(e).

129 *Ibid* sch 3 item 13 cl 133CA(1).

burden of repayment would lead to the repeated use of this type of contract and financial hardship.¹³⁰

Finally, a third new category of credit contracts was created in the amended Bill — ‘medium amount credit contracts’ (MACCs) — with the distinction between SACCs and MACCs being the amount lent (\$2001 to \$5000), the contract term (between 16 days and two years), and the absence of any requirement that the borrower’s obligations be unsecured.¹³¹ MACCs were introduced in response to the claims of lenders that the restrictions on fees, charges and interest in the original Bill did not enable them to recoup the establishment costs of providing short-term credit. This is discussed further in Part IV(E). These definitional changes, together with the prohibition on STCCs, have all been implemented in the *Enhancements Act*.¹³²

Each loan category (aside from the STCCs, which are prohibited) attracts different responsible lending obligations and different limits on the fees, charges and interest that can be imposed by a lender. This new categorisation of permitted loans increases the complexity of the regulation of payday loans. Consumer advocates had urged Parliament to adopt a simpler system, whereby an expansive, single definition of small amount loans would enable one simplified cap on fees and costs, and responsible lending obligations, to be applied.¹³³ They were also concerned that the transition from SACCs to other credit contracts in the original Bill had the potential to distort the payday lending market and this concern may hold even more weight due to the Act’s introduction of further, new categories of credit contracts.¹³⁴

D Permitted Fees and Charges, Including Default Fees, for SACCs

Whether a payday loan falls into one loan category or the other determines the maximum fees, charges and interest that the lender can impose on the borrower. If a payday loan is a SACC, the lender was permitted by the original *Enhancements Bill* to levy only three types of fees or charges on the borrower and was

130 Supplementary Explanatory Memorandum, Consumer Credit and Corporations Legislation Amendment (Enhancements) Bill 2011 (Cth) 13 [1.47]–[1.49], 14 [1.56]; Revised Explanatory Memorandum, Consumer Credit Legislation Amendment (Enhancements) Bill 2012 (Cth) 56 [4.20]. As with the original Bill, both the amended Bill and the Act provide for the regulations to amend the definitions. This is an explicit anti-avoidance measure: Supplementary Explanatory Memorandum, Consumer Credit and Corporations Legislation Amendment (Enhancements) Bill 2011 (Cth) 14 [1.53]; Revised Explanatory Memorandum, Consumer Credit Legislation Amendment (Enhancements) Bill 2012 (Cth) 56 [4.18].

131 Consumer Credit Legislation Amendment (Enhancements) Bill 2012 (Cth) sch 4 item 22A cls 204(1) (a)–(e). Additional requirements can be prescribed by regulation: at sch 4 item 22A cl 204(1)(e).

132 *Enhancements Act* sch 3 item 1 s 5(1), sch 3 item 13 s 133CA(1), sch 4 item 22A s 204(1).

133 Some consumer advocates, including Good Shepherd and Financial Counselling Australia, stated a preference for an inclusive 48 per cent cap on all credit contracts rather than a tiered cap scheme: *Consumer Credit and Corporations Joint Committee Report*, above n 33, 79 [5.106]–[5.107].

134 Consumer Action Law Centre, Consumer Credit Legal Centre NSW and Financial Counselling Australia, above n 74, 4.

prohibited from charging interest.¹³⁵ The three allowable fees were a permitted establishment fee (which reflected the lender's reasonable costs of assessing the borrower's application for credit and the initial administration costs of providing credit),¹³⁶ a permitted monthly fee,¹³⁷ and a permitted default fee.¹³⁸ The original Bill then prescribed the maximum allowable amount of these fees and charges. The maximum allowable establishment fee was capped at 10 per cent¹³⁹ of the 'adjusted credit amount'¹⁴⁰ and the maximum allowable monthly fee was capped at 2 per cent of the adjusted credit amount (ie 24 per cent per annum).¹⁴¹ The prohibition of interest, however, did not mean that lenders were unable to be compensated for the risk of making payday loans; rather, what it meant was that lenders were unable to be compensated for that risk beyond the limits placed on the establishment, monthly fees and default fees. In addition, the Bill's approach to regulating the cost of credit to borrowers by prohibiting the charging of explicit interest on SACCs means that payday lenders are not required to disclose the fees charged by them on SACCs in the form of an annual percentage rate or other interest rate.¹⁴² It can be argued that this approach may make it more difficult for borrowers to compare SACCs with mainstream alternatives such as credit cards where the cost of credit is represented by an annual percentage rate.

Capping fees and charges is a mechanism to respond to concerns that lenders charge excessive fees for loans, whether as in-substance interest or in addition to any explicit interest charged, contributing to the high cost of payday loans with significant detrimental outcomes for borrowers with limited incomes.¹⁴³ The *Regulation Impact Statement* states that it is necessary to specify and define clearly permissible costs, in order to

135 Consumer Credit and Corporations Legislation Amendment (Enhancements) Bill 2011 (Cth) sch 4 item 4 cl 23A, sch 4 item 12 cl 31A(1). The lender is also entitled to pass on to the borrower any government fees, charges or duties payable on the credit contract: at sch 4 item 12 cl 31A(1)(d).

136 Ibid sch 4 item 12 cl 31A(1)(a).

137 Ibid sch 4 item 12 cl 31A(1)(b).

138 Ibid sch 4 item 12 cl 31A(1)(c).

139 Ibid sch 4 item 12 cl 31A(2).

140 Ibid sch 4 item 20 cl 204(1). The 'adjusted credit amount' is the amount of monies that the borrower receives under the SACC: Explanatory Memorandum, Consumer Credit and Corporations Legislation Amendment (Enhancements) Bill 2011 (Cth) 65 [5.27]. The Bill made it explicit that, for the purposes of calculating the maximum allowable fees and charges, the permitted establishment and monthly fees were not to be included in the quantum of the adjusted credit amount. In addition, if a SACC was being used to finance a prohibited payment by the borrower to the lender, the amount so applied would not be included in the quantum of the adjusted credit amount. The Bill did not explicitly exclude default fees but, given the explanation in the Explanatory Memorandum (and also the broad prohibition in Consumer Credit and Corporations Legislation Amendment (Enhancements) Bill 2011 (Cth) sch 4 item 15 cl 39A on the use of SACCs to finance payments to lenders), it is unlikely that default fees could be capitalised for the purposes of increasing the quantum of allowable fees.

141 Consumer Credit and Corporations Legislation Amendment (Enhancements) Bill 2011 (Cth) sch 4 item 12 cl 31A(3).

142 This is explicitly accepted in: Explanatory Memorandum, Consumer Credit and Corporations Legislation Amendment (Enhancements) Bill 2011 (Cth) 63 [5.15]; Revised Explanatory Memorandum, Consumer Credit Legislation Amendment (Enhancements) Bill 2012 (Cth) 66 [5.20].

143 Explanatory Memorandum, Consumer Credit and Corporations Legislation Amendment (Enhancements) Bill 2011 (Cth) 5.

address structures that have been historically used to avoid the effect of price caps in the States and Territories (for example, the artificial use of brokers to increase the amount of fees charged to the borrower or the charging of deferred establishment fees that are expressed as contingent in the contract but are payable in practice).¹⁴⁴

It was anticipated that prescribing and capping these costs would reduce the cost of borrowing, mitigate the risk to borrowers¹⁴⁵ and ‘encourage lenders to provide loans with longer terms and lower repayments’.¹⁴⁶ The Revised Explanatory Memorandum for the amended Bill stated this would be ‘likely to result in better outcomes for consumers as they are more likely to be able to afford those repayments without a significant impact on their financial position’.¹⁴⁷ The Parliamentary Joint Committee reported ‘strong support among consumer advocates for the introduction of caps on costs and the formula for calculating costs’.¹⁴⁸

In the original Bill the maximum permitted establishment fee was capped at 10 per cent of the adjusted credit amount and the maximum permitted monthly fee was capped at 2 per cent. In April 2012 the Bill was amended to increase the caps on fees and charges. The amended Bill provided for a maximum establishment fee of 20 per cent of the adjusted credit amount and a maximum monthly fee of 4 per cent of the adjusted credit amount (an increase from 24 per cent per annum to 48 per cent per annum).¹⁴⁹ In addition, the qualifying words in the original Bill that the establishment fee should reflect the lender’s ‘reasonable

144 *Regulation Impact Statement*, above n 5, 44.

145 *Ibid* 40. The *Regulation Impact Statement* stated a cap will limit the cost of credit for consumers, so that they will no longer be charged relatively high costs for these types of credit, thereby better enabling them to manage their finances. This will particularly assist those consumers who use short-term lenders who charge higher costs, and where therefore the risk of a debt spiral is greatest. It will reduce the incidence of repeat borrowings where this is the result of consumers becoming dependant on short term lenders due to the drop in income they experience when repaying a loan. This will minimise the risk of debt spirals arising from multiple borrowings: at 49.

146 Revised Explanatory Memorandum, Consumer Credit Legislation Amendment (Enhancements) Bill 2012 (Cth) 287 [11.170].

147 *Ibid*. It should be noted that these comments were made in the context of significantly increased fee caps.

148 *Consumer Credit and Corporations Joint Committee Report*, above n 33, 77 [5.100].

149 Consumer Credit Legislation Amendment (Enhancements) Bill 2012 (Cth) sch 4 item 4 cl 23A, sch 4 item 12 cls 31A(1)–(3). The amended Bill also changed the definition of adjusted credit amount. While that amount continues to represent the amount of monies received by the borrower (at sch 4 item 20 cl 204(1)) and excludes prohibited payments, the amended Bill also made it clear that all fees and charges payable, whether or not capitalised, in relation to the SACC were not to be included in the quantum of the adjusted credit amount: at sch 4 item 27 cl 204(3). Default fees would thus also be excluded. A different criterion to adjusted credit amount — credit limit — is used for determining whether or not a credit contract is a SACC (or a STCC or a MACC). The exclusions discussed here (and at above n 140) apply only to the adjusted credit amount. This raises the possibility, where a lender finances part or all of the fees and charges levied on a credit contract, that those fees and charges will be taken into account in determining whether or not the contract is a SACC but, if the contract is a SACC, will not be included in the adjusted credit amount. Treasury has stated that this issue will be resolved by future regulations which will provide that, in relation to SACCs, the credit limit will be the adjusted credit amount: Email from Christian Mikula, Treasury, to Gerard Brody, 6 June 2013, ‘Credit Limits for SACCs’ (kindly forwarded to Cosima McCrae on 13 June 2013).

costs of determining the application for credit and the initial administrative costs of providing the credit' were removed in the amended Bill.¹⁵⁰ It is stated in the Supplementary Explanatory Memorandum that 'if the credit provider's costs are less than 20 per cent of the adjusted credit amount, than [sic] they are restricted to this lower figure. It is proposed to simplify this provision, so that credit providers can charge a maximum of 20 per cent in all cases'.¹⁵¹ This appears to accept that establishment fees can be used to recover more than the reasonable costs of establishing a loan.

Consumer Action Law Centre opposed these changes, submitting that:

The benefit of the cap originally proposed ... was that it would have made the shortest term loans (which are the most harmful loans) unviable and so force the market to shift to longer term, more affordable loans. The amended cap (20 per cent establishment fee and 4 per cent monthly fee) will largely fail to achieve this result and so will be an ineffective consumer protection.¹⁵²

Consumer Action Law Centre submitted that an establishment fee of 20 per cent is equivalent to an annual interest rate of 264 per cent for a loan of one month, allowing a lender a return of \$66 for a \$300 loan. Critically, for those persons on a single pension benefit, the fortnightly repayments for such a loan constitute 20–5 per cent of their fortnightly income.¹⁵³

The amendments to the original Bill brought the caps on fees and charges closer to the recommendations of the payday loan industry, including the largest payday

150 Consumer Credit and Corporations Legislation Amendment (Enhancements) Bill 2011 (Cth) sch 4 item 12 cl 31A(1)(a). Cf Consumer Credit Legislation Amendment (Enhancements) Bill 2012 (Cth) sch 4 item 12 cl 31A(1)(a). Lenders, however, were prohibited from charging establishment fees where a SACC is being used to refinance another SACC: Consumer Credit Legislation Amendment (Enhancements) Bill 2012 (Cth) sch 4 item 12 cl 31A(1A).

151 Supplementary Explanatory Memorandum, Consumer Credit and Corporations Legislation Amendment (Enhancements) Bill 2011 (Cth) 21 [1.89]. This was repeated in Revised Explanatory Memorandum, Consumer Credit Legislation Amendment (Enhancements) Bill 2012 (Cth) 69–70 [5.39].

152 Consumer Action Law Centre, Submission to Treasury, *Amendments to the Consumer Credit and Corporations Legislation Amendment (Enhancements) Bill 2011*, 7 May 2012, 8.

153 Consumer Action Law Centre, Supplementary Submission No 20a to Parliamentary Joint Committee on Corporations and Financial Services, *Inquiry into Consumer Credit and Corporations Legislation Amendment (Enhancements) Bill 2011*, 28 October 2011, 2, quoted in *Consumer Credit and Corporations Joint Committee Report*, above n 33, 78 [5.104]. Consumer Action Law Centre, Consumer Credit Legal Centre NSW and Financial Counselling Australia, above n 74, 4–5, also submitted:

If the cap is to be increased to the 20+4 cap as is proposed, this will create two serious and unintended consequences.

The first is that the 20+4 cap creates a very rough transition between the Small Amount Credit Contract cap and the 48 per cent cap. [For example] a consumer borrowing \$2000 over 24 months (regulated by the 20+4 cap) would pay up to \$2320.00, while a consumer borrowing \$2001.00 (regulated by the 48% cap) would pay up to \$1,171.84. This is undesirable because of the increased potential to distort the market.

... The second unintended consequence is that the proposed cap on costs allows lenders to make a return that is more than twice the amount loaned (prior to the application of any default fee or other contingency expense). For example, if lenders issue a 24 month loan of \$2,000, their return will be \$2,320. This is contrary to the intent expressed in proposed section 39B of the Enhancements Bill, which prohibits lenders recovering more than twice the amount loaned when the borrower is in default.

loan industry group, who had recommended that the Government increase the establishment fee cap ‘to 25% and apply the cap only to consumers whose sole source of income is from Government benefits and where that benefit is less than \$400 per week at the time the contract is entered into’.¹⁵⁴ These amendments have now been enacted in the *Enhancements Act*¹⁵⁵ and reflect an acceptance of the payday loan industry’s view that the establishment costs for SACCs were not capable of being recouped under the caps proposed in the original Enhancements Bill¹⁵⁶ and that amendments to those caps were required for ‘a viable small amount lending industry to continue’.¹⁵⁷ Furthermore, the Revised Explanatory Memorandum explicitly acknowledges that it is necessary to deliver a ‘greater return’ to lenders on SACCs due to the establishment costs borne by those lenders.¹⁵⁸

The original Bill and the *Enhancements Act* also address the issue of the fees and charges that can be levied following a borrower’s default. Default fees are limited to an amount twice the adjusted credit amount and this cap excludes the lender’s enforcement expenses.¹⁵⁹ Given the financial vulnerability of many payday loan borrowers, the exclusion of enforcement expenses from this cap, and the significantly increased caps on establishment and monthly fees, it is possible that the default fee cap could be viewed as both a measure to discourage default by borrowers and a source of financial return for lenders.¹⁶⁰

E The Cap on the Permitted Interest for Credit Contracts other than SACCs

Another important aspect of the regulation of payday lending proposed by the original Enhancements Bill and introduced by the *Enhancements Act* is the cap on the allowable amount of interest applying to credit contracts other than SACCs.¹⁶¹

154 National Financial Services Federation, Submission to Treasury, *Amendments to the Consumer Credit and Corporations Legislation Amendment (Enhancements) Bill 2011*, 8 May 2012, 9.

155 *Enhancements Act* sch 4 item 4 s 23A, sch 4 item 12 s 31A, sch 4 items 20–6 s 204(1), sch 4 item 27 s 204(3).

156 Supplementary Explanatory Memorandum, Consumer Credit and Corporations Legislation Amendment (Enhancements) Bill 2011 (Cth) 18 [1.83], 20 [1.87]; Revised Explanatory Memorandum, Consumer Credit Legislation Amendment (Enhancements) Bill 2012 (Cth) 63 [5.13].

157 Supplementary Explanatory Memorandum, Consumer Credit and Corporations Legislation Amendment (Enhancements) Bill 2011 (Cth) 19 [1.85]. This is repeated in Revised Explanatory Memorandum, Consumer Credit Legislation Amendment (Enhancements) Bill 2012 (Cth) 68 [5.34].

158 Revised Explanatory Memorandum, Consumer Credit Legislation Amendment (Enhancements) Bill 2012 (Cth) 62–3 [5.9].

159 Consumer Credit and Corporations Legislation Amendment (Enhancements) Bill 2011 (Cth) sch 4 item 15 cl 39B(1), (3); *Enhancements Act* sch 4 item 15 s 39B. The rationale for this exclusion is that lenders are already subject to limits in the National Credit Code as to the enforcement expenses that can be recovered: Explanatory Memorandum, Consumer Credit and Corporations Legislation Amendment (Enhancements) Bill 2011 (Cth) 69 [5.51].

160 It is possible that the general law rules relating to penalties could still apply within this cap on default fees.

161 Consumer Credit and Corporations Legislation Amendment (Enhancements) Bill 2011 (Cth) sch 4 item 13 cls 32A(1), (4)(b); *Enhancements Act* sch 4 item 13 ss 32A(1), (4)(b).

SACCs are subject to the caps on fees and charges discussed above, and lenders are prohibited from charging interest on these loans. All other credit contracts provided by non-ADIs (including MACCs) are generally subject to a cap not on defined categories of fees and charges but on interest.¹⁶²

This tiered structure was contained in the original Bill¹⁶³ and was supported by consumer advocates as a workable compromise.¹⁶⁴ The original Bill prohibited credit providers from entering into credit contracts where ‘the annual cost rate’ exceeded 48 per cent.¹⁶⁵ This cost rate was calculated using the two formulae stipulated in the Bill, namely a formula enabling the interest imposed on credit contracts to be expressed as an annualised rate,¹⁶⁶ and the other a standard compound interest formula which provided the interest rate input for the first formula.¹⁶⁷

There were two important aspects to this cap. First, a deliberate decision was made to introduce an interest cap that the payday loan industry and other credit providers were already familiar with and thus already had procedures in place to deal with.¹⁶⁸ The cap provided for in the original Bill was largely identical to the former cap in New South Wales.¹⁶⁹ Secondly, the Bill introduced an explicit anti-avoidance power, allowing amounts to be prescribed by regulation to be taken into account in calculating the annual cost rate.¹⁷⁰ That rate included all fees, charges and interest payable on the credit contract (excluding government fees, charges and duties)¹⁷¹ and the anti-avoidance power allowed a quick response to

162 The interest rate cap does not apply to credit contracts where credit is provided by an ADI, and does not apply to SACCs or ‘bridging finance contracts’: *Enhancements Act* sch 4 item 13 s 32A(4). In addition, STCCs are prohibited: at sch 3 item 13 s 133CA(1).

163 See *Regulation Impact Statement*, above n 5, 42–50. The *Regulation Impact Statement* canvassed the possibility of introducing a flat cap on interest (inclusive of all fees and charges), but preferred the tiered cap on costs and fees and credit. This was because problems with setting the appropriate cap level, for all credit contracts, regardless of type or amount lent were identified. These included the potential danger of setting a cap too low (thereby harming industry) and setting a cap too high (thereby not reducing the cost to borrowers). The Statement identified that in NSW, where a flat cap was in place under the repealed State legislation, significant issues with avoidance occurred. This included lenders imposing additional fees and charges in order to recoup costs and ensure high returns on short-term loans.

164 See, eg, Consumer Credit Legal Centre (NSW) Inc, Submission No 47 to Parliamentary Joint Committee on Corporations and Financial Services, *Inquiry into Consumer Credit and Corporations Legislation Amendment (Enhancements) Bill 2011*, October 2011, 2; Financial Counselling Australia, Submission No 49 to Parliamentary Joint Committee on Corporations and Financial Services, *Inquiry into Consumer Credit and Corporations Legislation Amendment (Enhancements) Bill 2011*, 21 October 2011, 2.

165 Consumer Credit and Corporations Legislation Amendment (Enhancements) Bill 2011 (Cth) sch 4 item 13 cl 32A(1).

166 *Ibid* sch 4 item 13 cl 32B(1).

167 *Ibid* sch 4 item 13 cl 32B(2).

168 Explanatory Memorandum, Consumer Credit and Corporations Legislation Amendment (Enhancements) Bill 2011 (Cth) 66 [5.33]–[5.34].

169 *Credit (Commonwealth Powers) Act 2010* (NSW) sch 3 items 5(1), 7 (repealed).

170 Consumer Credit and Corporations Legislation Amendment (Enhancements) Bill 2011 (Cth) sch 4 item 13 cl 32B(3)(c). This is in relation to the quantum of the ‘credit cost amount’.

171 This includes establishment, monthly and (presumably) default fees: *ibid* sch 4 item 13 cls 32B(3)(a), (4)(a). The exclusions, discussed at above n 149, in relation to the adjusted credit amount apply only to SACCs and have no counterpart in relation to MACCs and other credit contracts.

attempts by payday lenders and others to circumvent the cap.¹⁷² This explicitly addressed the concern that '[t]he history of the sector in relation to State and Territory interest rate caps suggest [sic] that avoidance is common and anticipated to occur in relation to the cap on costs'.¹⁷³

Throughout the amendment process, the 48 per cent cap for credit contracts other than SACCs remained in place, with three changes. The first relates to MACCs where lenders are now allowed to charge a fee of up to \$400 in addition to the 48 per cent cap.¹⁷⁴ The category of MACCs was created to address the concerns of lenders about their ability to recoup the establishment costs of providing short term credit under the original Bill and also to smooth the transition in caps from SACCs to other credit contracts.¹⁷⁵ It remains to be seen whether MACCs have this impact or whether, as consumer advocates noted in relation to the original Bill, this new category of loans contributes to distortion in the market. That aside, a 48 per cent cap plus \$400 is a significant amount relative to even the largest MACC which is a \$5000 credit contract. Secondly, additional carve-outs from the 48 per cent cap can be prescribed for credit contracts other than MACCs to allow for flexibility in amending the cap.¹⁷⁶ This, however, should have limited impact on payday loans given the observations above concerning the amount and term of the typical payday loan in Australia. Finally, the amended Bill introduced a further anti-avoidance provision to prevent lenders from exceeding the cap through a lender increasing the interest payable during a loan's term or developing fees and charges to avoid the cap.¹⁷⁷

F The Removal of Prohibitions on Multiple Lending and Refinancing

The original Enhancements Bill contained strict prohibitions on repeat and concurrent borrowing under SACCs because of the risk of debt spiralling posed by the use of multiple SACCs.¹⁷⁸ The Bill prohibited a lender from entering, or offering to enter, into a SACC where the lender knew or was reckless as to

172 Explanatory Memorandum, Consumer Credit and Corporations Legislation Amendment (Enhancements) Bill 2011 (Cth) 67 [5.35]–[5.36].

173 Supplementary Explanatory Memorandum, Consumer Credit and Corporations Legislation Amendment (Enhancements) Bill 2011 (Cth) 14 [1.53].

174 *Enhancements Act* sch 4 item 13 s 32B(2).

175 Supplementary Explanatory Memorandum, Consumer Credit and Corporations Legislation Amendment (Enhancements) Bill 2011 (Cth) 18 [1.83]–[1.84]; Revised Explanatory Memorandum, Consumer Credit Legislation Amendment (Enhancements) Bill 2012 (Cth) 63 [5.13]–[5.14].

176 *Enhancements Act* sch 4 item 13 s 32B(2). See also Supplementary Explanatory Memorandum, Consumer Credit and Corporations Legislation Amendment (Enhancements) Bill 2011 (Cth) 23 [1.105].

177 Consumer Credit Legislation Amendment (Enhancements) Bill 2012 (Cth) sch 4 item 13 cl 32AA. See also *Enhancements Act* sch 4 item 13 s 32AA; Revised Explanatory Memorandum, Consumer Credit Legislation Amendment (Enhancements) Bill 2012 (Cth) 72 [5.51]–[5.53].

178 Explanatory Memorandum, Consumer Credit and Corporations Legislation Amendment (Enhancements) Bill 2011 (Cth) 52 [4.7]–[4.8].

whether the borrower was a debtor under another SACC.¹⁷⁹ In addition, a lender was prohibited from entering, or offering to enter, into a SACC where some or all of the credit was to refinance wholly or partly an existing SACC (whether the existing SACC was with the lender or another lender).¹⁸⁰ There was strong industry opposition to these measures, as noted in the report of the Parliamentary Joint Committee:

Industry ... argued that the proposed restriction on refinancing [and] multiple concurrent contracts ... will disadvantage, rather than assist, vulnerable consumers, and challenged the Government's conclusion that the industry can remain viable under the caps proposed. ... It was put to the committee that the Responsible Lending Obligation (RLO) requirements implemented as part of the phase one reforms are sufficient to regulate industry lending practice.¹⁸¹

Consumer advocates were unanimous that these prohibitions were critical to reducing harm to vulnerable borrowers.¹⁸² However, the Parliamentary Joint Committee was persuaded by the submissions of the payday loan industry that

a more appropriate response to consumer vulnerability would be to require short-term lenders to consider whether the proposed short-term loan or increased credit limit is unsuitable given the consumer's repayment obligations under existing credit contracts.¹⁸³

The prohibitions on concurrent loans and refinancing of loans were removed entirely in the June 2012 version of the Bill.¹⁸⁴ They were replaced with 'presumptions and obligations in relation to suitability under the responsible lending conduct provisions in Chapter 3 of the Credit Act'¹⁸⁵ that are now enacted in the *Enhancements Act*.¹⁸⁶ The removal of these two prohibitions is consistent with the recommendations of the payday loan industry.¹⁸⁷ The Revised

179 Consumer Credit and Corporations Legislation Amendment (Enhancements) Bill 2011 (Cth) sch 3 item 4 cl 133CB.

180 Ibid sch 3 item 4 cl 133CC, sch 4 item 15 cl 39A. See also Explanatory Memorandum, Consumer Credit and Corporations Legislation Amendment (Enhancements) Bill 2011 (Cth) 56–7 [4.34].

181 *Consumer Credit and Corporations Joint Committee Report*, above n 33, 86–7 [5.135]–[5.136] (citations omitted).

182 Ibid 81–2 [5.118]–[5.121].

183 Ibid 115 [5.231].

184 The primary prohibitions in the Consumer Credit and Corporations Legislation Amendment (Enhancements) Bill 2011 (Cth) sch 3 item 4 cls 133CB, 133CC were removed. Schedule 4 item 15 cl 39A of that Bill was amended by the introduction of Consumer Credit Legislation Amendment (Enhancements) Bill 2012 (Cth) sch 4 item 15 cl 39A(2)(ba). In the amended Bill, cl 39A(1) retained the prohibition on the credit provided under a SACC being used to finance payments to the lender but explicitly carved out from that prohibition the refinancing of SACCs: at sch 4 item 15 cl 39A(2)(ba).

185 Supplementary Explanatory Memorandum, Consumer Credit and Corporations Legislation Amendment (Enhancements) Bill 2011 (Cth) 14 [1.54]. See also Revised Explanatory Memorandum, Consumer Credit Legislation Amendment (Enhancements) Bill 2012 (Cth) 58 [4.29]–[4.31].

186 *Enhancements Act* sch 3 items 5, 6, 11, 12.

187 National Financial Services Federation, Submission to Treasury, *Amendments to the Consumer Credit and Corporations Legislation Amendment (Enhancements) Bill 2011*, 8 May 2012, 19–20. The Federation submitted that certain necessary actions with respect to the Enhancements Bill were required, including the complete deletion of sch 3 item 4 cls 133CB, 133CC: at 20.

Explanatory Memorandum recognises that multiple loans can increase the risk of financial harm to borrowers and lead to debt spiralling but, nonetheless, considers that presumptions rather than prohibitions are a more appropriate means of addressing that risk. This approach appears to be predicated on the view that there simply may be situations in which the refinancing of SACCs does not result in financial hardship.¹⁸⁸

In summary, a lender will be prohibited from entering into a SACC with a borrower, or suggesting or assisting the borrower to enter into a SACC (whether with the lender or another lender), where the SACC is unsuitable.¹⁸⁹ A SACC will be presumed to be unsuitable where (a) the borrower is already in default under another SACC or (b) in the 90 day period before the SACC is entered into or the assistance provided, the borrower has been a debtor under two or more other SACCs.¹⁹⁰ ASIC states lenders are expected to make 'reasonable inquiries' to determine if the presumption applies and that where these circumstances exist, the onus is on the lender to establish that the presumption is rebutted.¹⁹¹

The *Caught Short Report* found that almost 80 per cent of payday loan borrowers were Centrelink recipients¹⁹² and that borrowers who were Centrelink recipients were far more likely to be heavy, repeat borrowers.¹⁹³ This evidence raises the prospect of the presumptions of unsuitability applying to a significant proportion of payday loan borrowers.

There is a potential limit on the effectiveness of the presumption of unsuitability that relates to multiple loans. Currently, the only means by which a payday lender can determine whether a borrower has already entered into payday loans with other lenders is via the information provided by a credit reporting agency. However, not all lenders are members of these agencies and thus the information

188 Revised Explanatory Memorandum, Consumer Credit Legislation Amendment (Enhancements) Bill 2012 (Cth) 58 [4.31].

189 *NCCP Act* ss 123(1)(a), (2)(a) prohibit the provision of credit assistance in relation to unsuitable credit contracts. The Act prohibits lenders entering into unsuitable credit contracts: at ss 133(1)(a), (2)(a). It also outlines the circumstances in which a credit contract must be assessed as unsuitable: at ss 118(1), (2)(a); ss 131(1), (2)(a).

190 *Enhancements Act* sch 3 items 6, 12. There are also corresponding presumptions in respect of credit assessment: at sch 3 items 5, 11.

191 ASIC, *Regulatory Guide 209 — Credit Licensing: Responsible Lending Conduct* (September 2013) 37 [209.107] ('*Regulatory Guide 209*'). *Regulatory Guide 209* states that reasonable inquiries by a licensee will include ... asking the consumer whether the consumer is, or was during the previous 90-day period, a debtor under any other small amount credit contracts ... asking the consumer whether they are in default in payment of an amount under any small amount credit contract; and ... obtaining copies of any other small amount credit contracts under which the consumer was a debtor in the 90-day period before the assessment.

Regulatory Guide 209, above n 191, 38 [209.109]. These reasonable inquiries also include using bank statements to identify any payments made by the customer that may relate to other SACCs or whether the customer is making regular payments on other SACCs, or any regular payments made in respect of small amount credit contracts: at 38 [209.110].

192 *Caught Short Report*, above n 1, 16.

193 *Ibid* 38. The study also concluded, based on interviews with 15 lenders, that 'the core basis of most lenders' business was repeat borrowing, regardless of demographic. This conclusion is supported by the borrower interview data discussed previously where it was shown that repeat borrowing is prominent': at 65.

provided to a lender about a prospective borrower may not list all the payday loans that borrower has taken out.¹⁹⁴ In January 2013 ASIC released a Consultation Paper on the possibility of introducing a national database of loans and borrowers for small amount lenders.¹⁹⁵

Treasury stated that although the prohibition on multiple loans was removed, borrowers who were dependent on social security benefits would be protected by the introduction of a 'Protected Earnings Amount' (PEA) requirement, the form and content of which would be prescribed in the Regulations. In December 2012, these Regulations were registered, and set out the formula for providing for a PEA for 'certain classes of persons'. These are borrowers who derive at least 50 per cent of their gross income from welfare benefits paid under the *Social Security Act 1991* (Cth).¹⁹⁶ Lenders are prohibited from contracting with such persons¹⁹⁷ if repayments for a loan would exceed more than 20 per cent of the borrower's income.¹⁹⁸

A coalition of consumer advocates opposed a PEA when it was canvassed by Treasury in April 2012. The coalition stated that the complexity of a PEA for vulnerable borrowers limits its protective capacity. Specifically, the coalition stated that:

- Complex earnings calculations required to determine individual borrower PEAs could be abused either by the lender or by a desperate borrower;
- Earnings of those on low incomes vary considerably from week to week, making an accurate assessment of whether each fortnightly repayment amount will constitute 20 per cent of the borrower's total income difficult; and
- Lenders may use the PEA in place of responsible lending obligations, supplanting a more general assessment of suitability.¹⁹⁹

The coalition highlighted that 'simpler measures, such as ... a limit on total number of loans per year' are more likely to protect borrowers.²⁰⁰ The PEA is also prescriptive and does not offer protection for those borrowers who may not be

194 ASIC, *Consultation Paper 198 — Review of the Effectiveness of an Online Database for Small Amount Lenders* (January 2013) 13 [44]–[47].

195 Ibid.

196 *National Consumer Credit Protection Regulations 2010* (Cth) reg 28S(2).

197 *Enhancements Act* sch 3 item 13 s 133CC(1).

198 *National Consumer Credit Protection Regulations 2010* (Cth) reg 28S(3). The initial draft of the Regulations also specified under reg 28S(2)(a) that to meet this test, a person would also have to qualify for a pensioner concession card under s 10611ZA of the *Social Security Act 1991* (Cth). However, this would have had the impact of excluding a large number of welfare recipients, including those on Newstart, ABSTUDY, Austudy, Carer Payment (Child) and Youth Allowance from the PEA provisions. As Consumer Action Law Centre has submitted, this would have seriously undermined the purpose of the Regulations, by excluding a large number of low income welfare recipients from the PEA provisions: Consumer Action Law Centre, Submission to Treasury, *Regulations to Support Provisions in the Consumer Credit Legislation Amendment (Enhancements) Bill 2012*, 4 September 2012, 5–6.

199 Consumer Action Law Centre, Consumer Credit Legal Centre NSW and Financial Counselling Australia, above n 74, 21.

200 Ibid.

welfare recipients, but have low incomes. In light of these issues it is likely that the replacement of strict prohibitions with presumptions and a PEA will provide less protection to vulnerable borrowers.

G The Further Disclosure Requirements for Lenders, Including Warnings

The final stage of the new regulation of payday lending was the registration of the Regulations in December 2012. The Government stated that consumer protection would be enhanced through specific disclosure requirements for payday lenders. The Regulations set out the form and content of warnings that all lenders must include on physical premises²⁰¹ and on websites.²⁰² The warnings must be displayed on the front entry or window and the point at which a borrower obtains a loan.²⁰³ The warning must include the words:

Do you really need a loan today? It can be expensive to borrow small amounts of money and borrowing may not solve your money problems.²⁰⁴

The warning must also contain the phone numbers and webpage information for the free, Australia-wide financial counselling service, Centrelink, and the ASIC financial literacy and money management web resource MoneySmart.²⁰⁵

Several comments can be made about these warnings. A survey of the international literature on warnings finds little support for such generalised warnings as an effective tool against problematic borrowing in the context of payday loans.²⁰⁶ While borrowers may be alerted to the expense of borrowing, this is unlikely to dissuade borrowers who are restricted in their financial options and facing a serious cash flow crisis. The *Caught Short Report* emphasised that many borrowers in financial difficulty have conflicting attitudes to payday lending; they recognise the excessive costs and financial risks associated with borrowing but require the ease of obtaining loans during a cash flow crisis.²⁰⁷ The Consumer

201 *National Consumer Credit Protection Regulations 2010* (Cth) reg 28XXA(1)(c) specifies that warnings must be displayed that conform with the prescribed formula contained in sch 7 of the Regulations.

202 *Ibid* reg 28XXB.

203 *Ibid* regs 28XXA(1)(d)–(e). For websites, warnings must be displayed on the homepage in either a boxed icon (hyperlink) and the access point at which a potential borrower clicks that would take them through to the lender's website: at regs 28XXB(a), (e).

204 *Ibid* sch 7.

205 *Ibid* reg 28XXB. The warnings must include the following statement:

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 work out a payment plan. If you are on government benefits, ask for an advance payment from Centrelink: 13 17 94. Go to www.moneysmart.gov.au. MoneySmart shows you how small amount loans work and suggests other options that may help you.

The same warning applies for in-store and online warnings: at schs 7, 9.

206 See, eg, Francis, above n 14, 635–6, stating that warnings about the cost of borrowing may be successful in alerting borrowers to the cost of borrowing, but generalised warnings are not as effective as individualised warnings specific to the financial circumstances of individual borrowers.

207 *Caught Short Report*, above n 1, 44–52.

Action Law Centre notes from case work experience that for the typical payday loan borrower, no amount of disclosure is likely to dissuade borrowers with limited options.²⁰⁸

V ANALYSIS

In this section we identify two concerns with key aspects of the *Enhancements Act*. These are the replacement of the prohibitions on multiple loans and refinancing with rebuttable presumptions and the complexity of the new regulation of payday loans. We also discuss the need for alternative forms of credit to payday loans.

A Replacement of the Prohibitions on Multiple Loans and Refinancing with Rebuttable Presumptions

The first concern is that a regulatory regime that relies on rebuttable presumptions as opposed to strict prohibitions is problematic in light of the findings of Australian surveys of payday loan borrowers. The high rates of borrowing by low income and welfare dependant borrowers, the findings of financial detriment caused by payday loans for these borrowers and the idiosyncratic features of payday loans all point to the need for stricter regulation. In particular, there is strong evidence to suggest that multiple, repeat borrowing is the key element increasing the risk of financial distress. The evidence is that in the majority of cases, for the typical payday loan borrower, repeat borrowing is deleterious to financial wellbeing.²⁰⁹ Yet it is this very repeated use of payday loans that supports the business of lenders. It is not unreasonable to suggest that this will create a tension for lenders between providing loans and responsibly assessing low income borrowers' ability to repay. A number of consumer advocates have warned that in their case work experience there is significant avoidance of responsible lending obligations by certain payday lenders.²¹⁰

A related issue is the limited guidance available concerning key concepts underpinning the rebuttable presumptions such as what constitutes substantial hardship and what constitutes unsuitability, and what is required to rebut these presumptions. In March 2013 the UK Office of Fair Trading ('OFT') recommended not introducing prescriptive requirements for lenders to assess affordability of loans.²¹¹ An OFT investigation of payday lenders in 2012 found 'significant underlying incentives' for lenders to assess loans as affordable, when in fact they are not.²¹² This finding led the OFT to reject a proposal for a prescriptive approach to affordability assessments, on the grounds that this 'would be unlikely

208 *Gillam Report*, above n 1, 167.

209 See the studies cited at above n 1.

210 Consumer Action Law Centre, Consumer Credit Legal Centre NSW and Financial Counselling Australia, above n 74, 3.

211 Office of Fair Trading (UK), above n 16, 6.

212 *Ibid.*

to completely tackle the problem' of loans being made to borrowers who could not afford to repay them.²¹³

B Complexity of the New Requirements

The second concern is the complexity of the requirements now contained in the *Enhancements Act* as a result of the compromises made by the government during the passage of the Bill through Parliament. This complexity potentially has three effects associated with it: greater complexity increases the risks of avoidance by some sections of the industry; it increases the costs of providing the loans, a cost that will presumably be passed on to borrowers; and it presents challenges for enforcement by ASIC.

The *Enhancements Act* requires the lender to make a determination about a borrower's capacity to repay, including loan suitability. This will require a borrower to attend a payday lender with sufficient information and documentation.²¹⁴

We now outline the requirements for lenders providing SACCs in order to highlight the complexity of the requirements. The implementation of these new requirements relies on payday lenders applying the core obligations for all credit licensees in the *NCCP Act* and the further obligations specific to SACCs.²¹⁵ Chapter 3 pt 3.2 of the *NCCP Act* sets out the general rules for all credit licensees. The core obligation is to make a determination as to whether a credit contract (or consumer lease) is not unsuitable for the borrower²¹⁶ by making an assessment of suitability of that particular contract for credit for each individual borrower.²¹⁷

A contract will be unsuitable when, at the time of assessment, it is likely that:

- (a) a borrower will be unable to comply with the borrower's financial obligations under the contract, or could only comply with substantial hardship, if the contract is entered or the credit limit is increased in the period covered by the assessment;²¹⁸ or
- (b) the contract will not meet the borrower's requirements or objectives;²¹⁹ or
- (c) other circumstances specified in the regulations apply.²²⁰

213 Ibid.

214 There is a risk that a borrower who is seeking to obtain funds quickly from a payday lender will not have this information readily at hand, particularly if the borrower is responding to the way in which many payday loans are promoted (ie as a form of emergency finance that is readily accessible and quickly obtainable).

215 See Notes 3, 12 and 22 in *Regulatory Guide 209*, above n 191, 4–5 [209.1], 12 [209.20], 22 [209.53].

216 *NCCP Act* s 129.

217 Ibid ss 128(c)–(d).

218 Ibid s 131(2)(a). There is a presumption of hardship if the only means of meeting the obligations under the contract involves 'selling the consumer's principal place of residence' unless the contrary is proven: at s 131(3).

219 Ibid s 131(2)(b).

220 Ibid s 131(2)(c).

To make this assessment the lender must make reasonable inquiries and take steps to verify:

- (a) the borrower's requirements and objectives in relation to the credit contract;²²¹
- (b) the borrower's financial situation;²²² and
- (c) any other steps prescribed by the regulations to verify any other matters prescribed by the regulations.²²³

ASIC considers these to be the minimum requirements for inquiry and verification, but these do not limit any other steps that would otherwise be regarded as 'reasonable' in the circumstances.²²⁴ ASIC advises that what constitutes reasonable inquiries is 'scalable' depending on the circumstances of the borrower and the particular credit contract under consideration.²²⁵

The scalability of assessment means that, in certain circumstances, more extensive inquiries will be required. Factors pointing to a need for more extensive inquiries include:

- (a) the potential impact on the borrower, for example, where a potential negative impact will be relatively serious. This includes where the size of the loan is large relative to the capacity to repay, including where a borrower has limited income;
- (b) where the borrower has limited capacity to understand English;
- (c) where the borrower has conflicting objectives; and
- (d) where there is an apparent discrepancy between the borrower's objectives and the product.²²⁶

ASIC expects lenders to be able to 'demonstrate that [they] have adequate processes in place to ensure that [they] make reasonable inquiries'.²²⁷ However, the compliance processes in place will vary for each credit business.²²⁸

221 Ibid s 130(1)(a).

222 Ibid ss 130(1)(b)–(c).

223 Ibid ss 130(1)(d)–(e).

224 *Regulatory Guide 209*, above n 191, 12–13 [209.22].

225 Ibid 12 [209.19].

226 See Table 3: 'Factors Relevant to the Scalability of the Reasonable Inquiries and Verification Obligations': ibid 13. ASIC states that reasonable inquiries '[d]epending on the circumstances' could include: the consumer's current amount and source of income, including whether this is casual, full or part-time and what proportion is sourced from social security payments; what fixed expenses the consumer has (eg, rent, existing debts, child support payments, insurance); variable expenses; discretionary expenditure; the extent to which the current credit will be used to pay an existing debt; a consumer's credit history; circumstances, including age or number of dependants; the consumer's assets; reasonably foreseeable changes in the financial circumstances of the borrower; and geographic factors (including remoteness): at 16–17 [209.32].

227 Ibid 18 [209.35].

228 Ibid 18 [209.36].

To verify these matters, lenders could use, but are not limited to, the following sources of information:

- (a) payroll receipts or confirmation of employment;
- (b) financial statements, business bank statements, income tax returns, statements from personal accountants (for self-employed borrowers);
- (c) credit reports;
- (d) information or reports from other credit providers; and
- (e) bank account or credit card records.²²⁹

From 1 March 2013 additional requirements to the above core obligations apply for providers of SACCs.²³⁰ Lenders must:

- (a) inquire about whether the borrower is currently in default under an existing credit contract; or
- (b) has been a debtor under two or more SACCs in the last 90 days.

If either circumstance applies, then it is presumed that the borrower could only comply with the borrower's financial obligations under the relevant contract with substantial hardship, unless the contrary is proved.²³¹

In order to determine whether either presumption trigger applies, ASIC states that lenders are expected to include in their inquiries and verification processes the following:

- (a) verbally asking the borrower if they are, or were, a debtor under an SACC in the last 90 days;
- (b) verbally asking the borrower if they are in default of any SACCs;
- (c) obtaining copies of any SACCs from the last 90 days;
- (d) identifying payments on account statements provided that may relate to repayment of SACCs;
- (e) certifying whether payments are currently being made under another SACC; and

229 Ibid 20 [Table 4: Examples of the Types of Information You Could Use to Verify a Consumer's Financial Situation].

230 Ibid 7 [209.10] Table 1, item 2, Note 1. See also *NCCP Act* s 118(3A)(b).

231 The Revised Explanatory Memorandum to the final version of the Enhancements Bill states [t]he effect of the presumptions is that, unless the contrary is proven, a consumer would be considered to be in substantial hardship. The provisions therefore place an onus on a licensee to establish that the short term credit contract was suitable for the consumer. ... The presumptions have effect in this way as the operation of the responsible lending obligations means that a loan can be unsuitable because it results in substantial hardship, even if it meets the consumer's requirements and objectives. The use of presumptions, rather than a prohibition, allows for greater flexibility and acknowledges that there may be situations where a refinance would not result in financial hardship (such as where it results in lower repayments that the consumer can afford).

Revised Explanatory Memorandum, Consumer Credit Legislation Amendment (Enhancements) Bill 2012 (Cth) 58 [4.30]–[4.31].

- (f) making a credit history report.²³²

In addition, the lender will need to make sure their inquiries include questions to determine whether the borrower is a ‘prescribed’ person,²³³ being a person who derives at least 50 per cent of their income from payments under the *Social Security Act 1991*.²³⁴ If the borrower is such a person, then a prohibition applies if, under the credit contract proposed, the amount due in any repayment cycle (fortnightly repayment cycle) would constitute more than 20 per cent of the borrower’s gross income.²³⁵

ASIC advises that SACC providers must therefore make reasonable inquiries about:

- (a) the source/s of a borrower’s income; and
- (b) what proportion of the borrower’s income is constituted by payments under the *Social Security Act 1991*.²³⁶

The lender must then calculate, by reference to the contract and the borrower’s current and anticipated income and expenditures, whether each repayment for the credit contract under consideration would constitute more than 20 per cent of this income for each repayment cycle.

ASIC states that as there is no definition of ‘substantial hardship’ in the *NCCP Act*, ASIC does not intend to provide a definitive formulation. Rather, it is expected that case law on the meaning of substantial hardship will develop.²³⁷ However, ASIC provides some guidance, in the form of a non-exhaustive and non-conclusive list of factors, about what information the credit provider should take into account when conducting their assessment:

- (a) the money the borrower is likely to have after living expenses are deducted from their after-tax income;
- (b) the source of the borrower’s income (including whether this income is in part or partially derived from benefits paid under the *Social Security Act 1991*);
- (c) the consistency and reliability of the borrower’s income;
- (d) whether the borrower’s expenses are likely to be higher than average (for example, the borrower lives in a remote area);
- (e) other debts and liabilities;
- (f) the buffer between a borrower’s disposable income and repayments; and

232 *Regulatory Guide 209*, above n 191, 38 [209.109]–[209.111].

233 *Enhancements Act* sch 3 item 13 s 133CC.

234 *National Consumer Credit Protection Regulations 2010* (Cth) reg 28S(2).

235 *Ibid* reg 28S(3). See also *Regulatory Guide 209*, above n 191, 23 [209.58].

236 *Regulatory Guide 209*, above n 191, 23 [209.60].

237 *Ibid* 33 [209.93].

- (g) whether the borrower will need to sell assets (for example, a car) to meet the repayments.²³⁸

ASIC advises that each credit provider must develop individual systems for identifying whether the credit contract will cause substantial hardship. ASIC advises that benchmarks can be useful in this process and include, but are not limited to, assessing whether the disposable income of the borrower is:

- (a) such that they cannot realistically meet the cost of living for themselves or their dependents; or
- (b) below an objective indicator such as the Henderson Poverty line; or
- (c) below the maximum level of government benefits.²³⁹

This summary of the requirements now imposed on payday lenders indicates that to comply with the new regulations, lenders will need to make complex and often lengthy inquiries and borrowers will need to bring extensive documentation when applying, a significant change from current practice. In addition, lenders need to understand and apply complex definitions. This is in the context of the typical payday loan being \$100 to \$300.²⁴⁰ In this environment, there is significant potential for lenders to confront conflicting incentives — providing loans as quickly and with the lowest administrative costs as possible, and complying fully with the complex requirements where this means a slower and more expensive loan approval process.

There are important issues concerning the possible effects of the complexity of the new regulatory framework for payday loans. The first effect is that compliance with the new requirements will increase the costs of doing business for lenders. It is likely that these costs will be passed on to borrowers, particularly given the lack of evidence as to strong price competition among payday loan providers and the relative inelasticity of borrower demand.²⁴¹

The second effect is that the increased complexity heightens the risk of avoidance by some parts of the industry and may also, due to compliance costs and the difficulties associated with the enforcement of a complex regulatory framework, create incentives for avoidance. There is evidence that some payday loan providers have developed techniques to avoid state consumer credit regulations. The *Regulation Impact Statement* highlighted that in Queensland and New South Wales some payday loan providers have avoided the state regulation by including contractual terms to avoid the statutory definition of a credit contract and requiring borrowers to purchase additional goods as a precondition to obtaining a loan.²⁴² More complex regulation may in fact be counter-productive to lender compliance if what is in practice required by lenders is difficult to understand and time consuming and expensive to implement.

238 Ibid 33–4 [209.95].

239 Ibid 35 [209.100].

240 *Caught Short Report*, above n 1, 35.

241 See the text accompanying above n 71.

242 *Regulation Impact Statement*, above n 5, 46.

The third potential effect of the increased complexity is that this will increase ASIC's costs of enforcement as it is required to monitor compliance with these requirements. It should be noted that this is an area in which particular importance is placed on enforcement by ASIC because payday loan borrowers are highly unlikely to commence private litigation where they believe there has been a contravention of the requirements by a lender given the typically small amount of a payday loan and the high cost of litigation.

C Need for Alternatives to Payday Loans

Given the findings of the harm caused by payday lending,²⁴³ there is an obvious need for viable alternatives to these types of loans. Consumer advocates have, in particular, noted that for financially vulnerable borrowers, the use of payday loans may substantially worsen their financial circumstances, rather than alleviating the financial stress of the borrowers.²⁴⁴ As noted earlier in this article, these borrowers may find that, having taken out one payday loan, they need to resort to another payday loan to cover essential expenses or simply to assist with the repayment of the original loan. Reliance on payday loans can be reduced by increasing the availability of short term credit alternatives such as no interest and low interest community loans, microfinance programmes and special use programmes. These alternatives, in sharp contrast to payday loans, are designed to change positively the financial circumstances of vulnerable borrowers.

In April 2012, a Discussion Paper was released by the Treasury that canvassed policy responses to reduce the reliance on small amount, high cost loans.²⁴⁵ Submissions were sought, and closed in May 2012. The paper discusses the relationship of payday lending to financial exclusion and a number of suggested policies.²⁴⁶ These include changes to emergency financial relief provided through Centrelink,²⁴⁷ improving access to hardship provisions for borrowers in financial difficulties,²⁴⁸ and strategies to expand and improve access to alternative credit schemes.²⁴⁹ At the time of writing, no government policies have been announced to reduce the reliance of vulnerable borrowers on payday lending.

VI CONCLUSION

The *Enhancements Act* represents a series of political compromises following a highly charged and polarised debate framed by the conflicting interests of consumer and welfare advocates, who argued for increased protection for payday

243 See generally the studies cited at above n 1.

244 See generally above n 1.

245 Treasury, 'Strategies for Reducing Reliance', above n 7.

246 Ibid 1–4.

247 Ibid 10.

248 Ibid 9–10.

249 Ibid 11.

loan borrowers, and the payday loan industry. The debate unfolded following research findings of the adverse consequences of payday lending for low income and financially vulnerable borrowers who are the majority of payday loan borrowers and evidence of the significant harm caused by repeat payday loan borrowing.

The Federal Government has stated that the *Enhancements Act* still provides ‘significant protections for consumers’.²⁵⁰ However, consumer and welfare advocates are sceptical that the *Enhancements Act* will have a substantive impact on the status quo and are particularly concerned that the removal of the prohibitions on multiple loans and refinancing will not reduce the current levels of debt spiralling.²⁵¹ These proposed prohibitions — aimed at some of the most harmful aspects of payday loans — have been replaced by rebuttable presumptions.

The result of the political compromises is a new regulatory framework that is highly complex, and this complexity has led to troubling issues such as increased risk of avoidance of the new requirements. Also of importance, given the strong link between financial exclusion and payday lending, is the lack of meaningful progress on the development of alternatives to payday loans. Together, these issues may mean that the new regulation of payday lending will not achieve the key aim of protecting the most vulnerable borrowers from the harm that can result from payday loans.

250 Commonwealth, *Parliamentary Debates*, House of Representatives, 26 June 2012, 8020 (Bill Shorten, Minister for Financial Services and Superannuation). The Minister noted that the measures contained in the Bill had been a ‘hotly contested area of public policy debate’ but that the amendments enable a ‘balance between allowing a viable and regulated credit industry ... and at the same time providing safeguards to protect the interests of these consumers’.

251 Consumer Action Law Centre, ‘Credit Enhancements Bill a “Win” for Payday Lenders’ (Media Release, 26 June 2012) 1:

The Government had previously announced a weakening of a comprehensive cap on fees and interest (cost cap), but we had hoped this would be offset by “complementary measures” which would effectively address the unsafe aspects of this type of lending. Instead we have a cost cap set at the level proposed by Australia’s biggest payday lender — the cost of loans will come down, but short term loans will still have interest rates that most Australians would consider outrageous — up to 240% per annum. And we’ll continue to see borrowers fall into debt traps because the proposed measures to guard against the harm of repeat borrowing are inadequate.