



NATIONAL FINANCIAL SERVICES FEDERATION (QUEENSLAND) INC.

SUBMISSION

to

**The Minister for Fair Trading,
the Hon. Margaret Keech MP**

In response to the Discussion Paper

**“Managing the cost of consumer
credit in Queensland”**

December 2006

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NATIONAL FINANCIAL SERVICES FEDERATION (QUEENSLAND) INC.

The Hon. Margaret Keech MP
Minister for Tourism, Fair Trading and Wine Industry Development
Parliament House
Brisbane Qld 4000

Dear Minister,

The National Financial Services Federation (Queensland) Inc., whose membership of 57 corporate members represents a total of 137 payday/microlending outlets and offices throughout Queensland, is pleased to respond to the "Managing the cost of consumer credit In Queensland" Discussion Paper. The Federation is encouraged to read that the Beatty Government "is committed to ensuring that all Queenslanders have access to credit on fair and reasonable terms" and the Federation shares this commitment.

Given the content and structure of the Discussion Paper, on behalf of the membership of the Federation I am pleased to note that the Discussion Paper includes a clause indicating that it does not represent any policy of the Queensland Government.

In accepting the invitation to provide this submission, the Federation is very conscious of the importance of not only presenting its members' position, but also providing the Minister with substantial information as to the profiles of the Federation members' customers. The Federation does this in full knowledge of the fact that, as with any potential change in Government policy, there are a variety of stakeholders clamouring to be heard.

The Federation's particular concern is that those stakeholders, with their louder voices and access to microphones, whose major interest is philosophic, academic and/or focused on the very few borrowers with whom they have had any contact, do not drown out the interests of the stakeholders who should be absolutely paramount - the many citizens of Queensland who choose to borrow money outside the mainstream lenders.

The Federation is particularly aware of the fact that, above all, the Minister and her colleagues in the Beatty Government owe a primary duty to respect Queensland citizen's rights as adults with full legal standing, including the right to vote, make life changing decisions in regard to employment and marriage, and the right to make choices as to how they manage their own finances and where they borrow money.

On behalf of my membership, I am pleased to note your recent comment, that you are committed to maintaining our industry's "viability". The cost of credit, the risks associated with the provision of credit, and the Queensland community's obvious need for sources of relatively small, short term loans, makes your Review appropriate.

The Federation looks forward to contact with you during the Review period and we offer any assistance to facilitate input that is informed and provides an accurate reflection of the realities of both the industry and the community who choose, of their own free will, to be payday and microlending customers.

Yours sincerely,

ROB LEGAT

President
National Financial Services Federation (Queensland) Inc

INTRODUCTION...

Structure of the Submission

This Submission commences with an attempt to place in context all the issues that may be raised throughout the duration of the Review. Throughout the Submission, there is a reference to both payday and microlending, because both categories could be substantially affected, as a result of the outcome of this review. Members of the National Financial Services Federation (Queensland) Inc.(hereafter referred to as the Federation), offer these two categories of loans. The commonality between the two is that they involve relatively small amounts of money, for relatively short borrowing terms.

As such, the Federation believes that it is important to consider the truth about the cost of credit, its provision in the finance marketplace and needs of the majority of the customers who seek it out as an important part of their financial circumstances.

This Submission attempts to rectify the lack of objectivity demonstrated in the commentary provided before the questions in the Discussion Paper. It is hoped that the contribution made by this Submission, based on substantial research, will provide the Minister with an alternate viewpoint, to assist with well informed ministerial decisions.

The Federation asks the Minister to reflect on the fact that, whatever policy decision is taken as a result of the Review, it will affect a substantial number of people throughout Queensland. Later in this Submission, information concerning the numbers of participants in the payday/microlending industry, the number of people employed by them and the number of suppliers to the industry, will be highlighted. In the first instance, however, the Federation believes the focus should be on the tens of thousands of Queensland citizens whose lives could be significantly adversely affected by inappropriate decisions concluding the Review.

Setting the Scene

In considering the issue of payday and microlending, it might be useful to place the issue in the broader context of the consumption of financial products and services in Australia. In 2003, the ANZ National Survey of Adult Financial Literacy examined the adult use of financial products and services. Their findings were included at page 4 of the ANZ publication "Community Development Finance in Australia - A Discussion Paper", May 2004.

Significantly the ANZ research indicated, amongst other things, that:

- 71.61% of all Australian adults used "ordinary/everyday account with a bank, building society or credit union";
- 64% of all Australian adults used credit cards;
- 14% used "loan by line of credit or overdraft";
- 11% used "lease or higher purchase agreement"; and
- 18% of all Australian adults had a personal loan.

The people that the Queensland review is considering, are a proportion of that 18% who resort to payday/microloans. Significantly, as the Federation's Consumer Survey, undertaken for this submission, indicates, 88% of these payday/micro borrowers do not have access to the ANZ, or any of its colleague banks, for such personal loans.

In addition, in this context, it is of concern to note that the number of Australians receiving social security payments has increased from 11% of the population in 1966, to 32% of the population in 1998. Ref: ABS, 'Income Support Payments in Australia', 1999.

This somewhat mirrors the 34% of borrowers in the Federation's Loan Information Survey and the 22.84% of borrowers identified in the Federation's Industry Analysis Survey (detailed later in this introduction).

The Human Face of Borrowing

As the Federation's Loan Information Survey research details, later in this Submission, at any one time there are likely to be some 39,800 active loans being provided by the Queensland payday and microlending industry. These loans represent one or more people who have assessed, of their own free will, that they have a need to borrow. They choose the lender and they choose to present an application for funds. The Federation's Customer Demographics Research Project indicates that 54% of these people have dependents and 38% have relationship partners (husbands, wives, partners).

Community Consultation Forum

The NAB promoted a Community Consultation Forum, under the Chair of Reverend Tim Costello, in 2000. In March 2001, in a report published by that Forum entitled "You can bank on it", an action plan for delivering financial services to low income and vulnerable consumers was reported as the National Australia Bank Community Consultation Forum, Community Welfare – Bank Research Project. On page 6 of the Executive Summary, the Forum noted:

"A corporation providing financial services has a right to be profitable and pay dividends and a responsibility to pay taxes and ensure that it maintains prudential requirements. In addition to these responsibilities, corporations providing services essential to the attainment of individual and societal financial well-being should also have a commitment to corporate social responsibility and being good corporate citizens."

The Federation encourages a consideration of the real costs of doing business as a lender in the payday/micro lending industry, as detailed in Section 10 of this submission.

The Federation encourages a consideration of the opportunities to introduce processes and protocols that will contribute to the areas of good corporate social responsibility and good corporate citizenship, which are explored in Section 3.

The Ability to Manage Money

It is assumed, by those who know little about the industry, that the majority of the industry's loan recipients do not have the ability to manage their money. This is contradicted by the Federation's 2006 Industry Analysis, which revealed that some 93.04% of payday/microlending customers repay their loan without it becoming a bad debt (to recognise defaulters that later pay).

The Myth of Asset Accumulation and Improving Savings

There is a misplaced assumption, by academic commentators that, if the cost of borrowing was substantially reduced then borrowers, as a group, would be able to accumulate assets and save.

This assumption is fundamentally incorrect. Whether by lack of financial management education or by personal preference, the industry's customers, in large part, are not accumulators of wealth - no matter what the opportunity.

The Federation's Customer Demographics Research Project reveals that only 9% of borrowers are owner/occupiers and 63%, when offering security for their loan, offered a motor vehicle. Of those who do offer motor vehicles, 86% will be offering vehicle 10 years or older. The habits of not accumulating assets and not saving are well entrenched for many, before any contact with payday/microlenders.

There is an unfortunate demonstration of this facet of payday and micro-borrowing behaviour in what followed the Commonwealth Government's recently introduced changes to the Baby Bonus payments. There was an incredible upsurge in the number of recipients purchasing large ticket items, rather than spending the money on their child, over a period, as was intended by the Commonwealth Government's policy.

Self Worth

As the Federation is sure the Minister would appreciate, we are dealing with human beings who, as borrowers, have issues of self-worth which can be significantly impacted on by access or denial to credit. Some borrowers have emotional commitments to paying others on time, to secure essential goods and to purchase services. Whether their purchase is out of need or want, consistent anecdotal comment, from lender counter staff, supports that many see access to credit as very important to their senses of self-respect.

In addition, there are emergency and other stressful situations, including slow or periodic payment of salaries and emergency expenditures, that prompt people to seek a short term loan. These emergencies, or unexpected expenditures, leave the people in such circumstances of stress, that the worry of where to source funds, is the last thing they need to compound their problem.

Charity

In association with these concerns, there are also significant issues, for many borrowers, in the idea of having to turn to charity in their hour of need. They are capable and wish to be self-reliant but, for one reason or another, cannot get a loan from a mainstream lender. To force these people to have to turn to charity, because the payday/microlending industry has been effectively abolished, could be considered cruel.

Distrust of Mainstream Lenders

The issue of mainstream financial institutions being distrusted by the general public cannot be overlooked. This submission considers examples of why this distrust is well founded. The distrust is highlighted by the number of people who contributed to the Federation's Customer Survey (11.8% of respondents), who chose borrowing from a payday or microlender, despite never having been refused a loan by a bank (49.5%), even though they had a credit facility (or card) with a mainstream lender. This phenomena is discussed in greater detail elsewhere in this Submission.

What the Customers Say

At a general meeting of the Federation, held on Saturday 9th December 2006, the Federation Executive asked for five lenders to submit two testimonials each, for inclusion in this submission. Despite being in the middle of a busy Christmas business period and involved in assisting with other Federation research, nine lenders, incensed with the inaccuracies of recent Queensland Courier Mail stories concerning their industry, submitted a range of testimonials.

So powerful were many of the messages from the customers that the Federation has included a selection of their messages throughout the body of this Submission. In the interests of brevity, dozens of similar testimonials have had to be filed. All the many customers providing testimonials have been pleased to give permission to be contacted by the Minister's officers, should the need arise.

The Minister can be assured that she would be presented with a very different human face associated with payday/microlending, should she take the opportunity to meet these people. The generally applicable human face of the industry is not the pose of a 'pretending to be apprehensive', deliberately non-paying borrower, the subject of Courier Mail photographs.

Another Side of "John's story"

Outlined on page 13 of the Discussion Paper, there is the "practical example" of John, the man who could not afford his mobile phone bill. John, if a real person, provides a contrast to the customers' testimonials mentioned above.

However, while the Federation recognises that John has ended up owing a multiple of the 30% per month he was charged, it appears appropriate to raise the following issues:

1. Presumably, John was an adult with the legal right to enter into a contract for his mobile phone;
2. Presumably, John was provided with information by the mobile phone company as to his likely monthly bills;
3. If John borrowed from a Federation member, the Federation could be absolutely sure that John entered into his loan contract asserting that he would be able to repay the loan;
4. John, on learning of the 360% per annum interest rate, would have had every opportunity to refuse to proceed with the contract and walk out of the lender's premises.
5. When John signed the credit contract, he would have signed a Consumer Credit Code compliant contract which clearly indicated the commitment he was entering into.
6. If John had borrowed from a Federation member he would have been one of the 96.04% of customers, in the Federation's Customer Survey, who responded indicating that the fees and charges had been clearly explained.

In addition, there are a number of other relevant considerations including:

- a. Unfortunately, the "practical example" does not offer an explanation as to why John was unable to seek part-time employment to earn the \$390 he had knowingly and legally committed himself to pay;

- b. Unfortunately, there is no indication of what it cost the lender to be in a position to extend the loan. As discussed elsewhere in this Submission, it would have cost the lender a minimum of \$66 to provide that loan for John;
- c. Given the cost of providing the loan, the lender's net profit would have been 8% of the loan amount, had it been repaid by John as he had contracted to do; and
- d. We have no information as to whether this is the first time John has borrowed from a payday lender, like 18.46% of the customers in the Federation's Customer Survey, or whether he would have belonged to the 81.45% of borrowers who had borrowed at least one time before, in which case John would have had appropriate experience in regard to what a legal commitment and signing a contract, in full knowledge, actually means. He would also have had experience in employing enough self-control with his budgeting to make sure that he had enough money to pay off the loan he, as a consenting adult with complete free will, had entered into.

It is noted that no bank in Queensland and no NILS or LILS scheme, according to the criteria available to the Federation, would have lent John the money in these circumstances.

The Federation would hope that John does not constitute one of those borrowers who takes advantage of a lender, by borrowing a loan he has absolutely no intention to repay and then rushing down to Legal Aid to hide behind their well-meaning community spirit and avoid paying the loan from that point on.

The Lenders' Cost Environment

A useful measure of the costs faced by a payday/micro lender is the Ernst and Young study, commissioned by the Canadian organisation CACFS (Canadian Association of Community Financial Services Providers).

Ernst and Young found that, on average, it costs a lender \$22 per \$100 (22% of the loan amount) to make a short-term loan in Canada. The writers have considered the Ernst and Young analysis and believe, generally, that it is appropriate to apply the 22% rule in considering the Queensland industry.

As discussed elsewhere in this submission, under a 48% p.a. reducible cap, applied to a \$100 for two weeks, the gross charge a lender would be permitted to make is \$1.84 for the fortnight. Therefore, given the 22% ratio, the lender would lose \$20.16 for the pleasure of:

- a) investing a likely minimum of 30 minutes of their employee's time (note, 74% of the respondents to the Industry Analysis Survey indicated that, to interview an applicant, undertake the appropriate credit checks and process documentation took, on average, 30 minutes or more);
- b) investing an average of \$132,000 in shop fittings, signage, computer systems and the like (the average for the 32 Industry Analysis Survey respondent companies);
- c) having the \$100 in the first place to lend; and
- d) then taking an average 6.96% chance (Industry Analysis Survey) that the loan would go into bad debt status.

The Reality Behind the Loans - the 48% Inclusive Cap

The concept of 48% has become a mantra for the ill-informed. As this Submission will explore in considerable detail, there is no basis for this figure. It was chosen in a different time, in different socio-economic circumstances, in a different country. Indeed, the country that spawned it, now spurns it. It embraces an artificiality that has never worked and is currently not working anywhere in Australia.

Over the last 12 months, there have been two jurisdictions who have undertaken very substantial and professional reviews of the provision of credit, similar or identical to that which is the topic of the Minister's Discussion Paper. These Reviews have included significant contact with both lenders and borrowers. The first was the Victorian Credit Review and the second was the UK Competition Commission Home Credit Market Inquiry. These inquiries provide a very powerful foundation from which to launch a comprehensive review in Queensland.

What will Follow the Introduction of a Cap?

The indirect consequences could be substantial. Most current borrowers take out a loan to pay a debt that they cannot cover from their savings, or their discretionary income. As outlined elsewhere in this submission, these debts are varied. That means, with the effective abolition of the industry, following the introduction of any inclusive cap, there will be a chain of suppliers left unpaid and, very significantly, a massive number of vehicles without registration forced onto Queensland's roads. 11% of respondents to the Federation's Customer Survey borrow from Federation members to pay car registration. In addition, there will be over 1,000 people, each year, unable to raise essential money for rent or rental bonds. 9.45% of payday/micro-borrowers responding to the Federation's Customer Survey, may therefore face homelessness.

Security

In the Discussion Paper, little attention has been given to the issue of security, however it might be useful for the Minister to be aware that the taking of security, for payday and microloans, is a relatively "toothless" threat.

It is difficult to repossess the secured item, unless the loan recipient voluntarily surrenders it and the whole process can involve unpleasant circumstances. Further, in most instances, the value of the security is far below any outstanding money owed, plus there is the cost of chasing the non-performing borrower, hiring a repossession agent and of facilitating the sale by auction. Even if the security is repossessed, most small loan offices have no storage facility and no generous, established end market for the repossessed items.

The Federation's Loan Information Survey revealed that, for payday/microloans (where, generally, only a few hundred dollars is involved), the proportion of loans where security was required, amongst the 127 lending outlets represented in the Survey, was only 13.5%. The Survey also indicated that 33 of the 37 companies (89.19%) did not take security for payday loans and 27 of the 37 companies (72.97%) advanced microloans (personal loans of some months or more), but not necessarily all their loan book, without security.

Pawnbroking

Pawnbroking is frequently referred to as an alternative, by industry critics. While that might have been the case until 15 or so years ago, this no longer has validity. Pawnbroking was established in an era where product depreciation was a slow process, in contrast to today's throw-away society where products are superseded by new models in a matter of months. Today, there are fewer products of sufficient value to offer as security to a pawnbroker.

The writers are aware of at least 43 Queensland pawnbrokers who are also payday lenders. This is mirrored in most of the other states because many pawnbrokers cannot survive financially without a second source of income.

Queensland Legal Aid

The Federation is aware that a study has apparently been commissioned by the Minister which included as its customer sample, as of early December 2006, a total of ten borrowers sourced from contact with Legal Aid Queensland. The Federation accepts, unfortunately, that at least some of those people might have a genuine grievance with a lender. However, the Minister is invited to compare those unfortunate people's stories with the 36 that have willingly provided their stories to the Federation, which have been included in this submission and the information provided by the 465 respondents to the Federation's Customer Survey.

The involvement of Legal Aid Queensland in assisting with such research, is of considerable concern to the Federation if this is the only source of consumer information used for the study. Obviously, people who have an actual, or perceived, dispute with their lender are potentially a very biased source of factual information. Therefore such a population is totally inappropriate to be the exclusive source of a sample, which is then presented as representing borrowers as a whole.

There is also the issue of the Legal Aid Queensland's documented involvement in the precipitation of an anti-payday/microlending public campaign. An officer working with Legal Aid Queensland has apparently been providing information to the Brisbane Courier Mail to:

- denigrate the whole payday/microlending industry;
- influence those who might be in a position, or choose to seek to advise you as the appropriate Minister;
- influence public opinion; and, more seriously
- influence a Press Council complaint deliberation; and
- introduce, into the public arena, in a selective manner, information that is before, or could be before a court, involving fifteen clients of Legal Aid Queensland.

The Federation Executive has been provided with documentation unequivocally supporting the above concerns. It is assumed that the activities of this one solicitor do not constitute the authorised approach, of Legal Aid Queensland, to the making of a submission to this Review.

In view of this Submission's later comment concerning one of the Courier Mail's articles in particular, and the above circumstances, the Federation would hope that the Minister would ignore the series of articles written by Patrick Lion, that have appeared in recent months in that newspaper.

An Invitation to the Minister and Her Advisers

In Victoria, the writers initiated an invitation to the Victorian Minister's delegated Parliamentary colleague, and senior officers from the Victorian Office of Fair Trading to visit, unannounced and at random, the lending outlets represented by the writers, during the Victorian Credit Review in 2005. This invitation was enthusiastically accepted.

The Federation offers a similar invitation to the Minister and her advisers. Acceptance of such an invitation will allow the Minister and her advisers to meet customers such as those who have provided the testimonials included in this submission. There is another side to the Queensland payday and microlending industry that will not be readily observed in the offices of the Legal Aid Queensland.

The Federation's Research

To assist in the preparation of this Submission, a total of five surveys were referred to. Two had been undertaken by the Federation, prior to the Minister's Discussion Paper announcement, and the remainder thereafter.

The Federation was concerned to address the significant issue of very limited research being available in regard to Queensland's payday/microlending market.

As the Discussion Paper appropriately acknowledged:

"At present, there is only limited research available on the prevalence of high interest loans in Queensland and/or fringe credit providers generally" (p.11).

This is despite numerous efforts being made by the Federation, and its composite members, to afford government and academia with access to this raw data. Ultimately, the Federation decided that it would accumulate certain key data in an effort to stimulate further research and to cease speculation on the size of the industry. The overriding rationale behind this is that you cannot make a determination of the true extent of a problem if you do not find out the proportions involved (i.e. is it 3 out of 10 or 3 out of 1000?).

The Federation believes that it is particularly difficult for the Minister to rationally consider any policy change, without a quantifiable data resource that indicates:

1. whether the majority of payday/microborrowers believe that the cost of their credit is an issue;
2. the number of customers who use payday/microlenders;
3. the number of payday/microlenders in the market; or
4. the number of complaints generated by the payday/microlenders in Queensland, about the cost of credit.

To assist the Minister, the Federation will be alluding to the results of five separate surveys that it has commissioned to fill this knowledge gap.

The Surveys referred to are:

- Customer Survey, Nov/Dec. 2006;
- Customer Demographics Research Project, Oct/Nov 2006;
- Loan Information Survey, Oct 2006;

- 2006 Industry Analysis, Nov/Dec 2006; and
- Comparison Rates Survey, April 2006.

Brief details of each are as follows:

Customer Survey

The Federation believes that the 465 respondents to the Customer Survey provides a useful complement to the 79 borrower respondents associated with the Victorian Credit Review Survey, the 62 respondents associated with the NSW Office of Fair Trading Study, and the analysis of the 20 lenders and the 10 Queensland Legal Aid Centre clients, who were interviewed by the Centre for Credit and Consumer Law, Griffith University (commented upon at the December 7 seminar).

The 465 Customers who responded to this 24-question, self-administered Survey (except in the circumstances of two telephone lending services) live in over 100 different suburbs in Brisbane and regional centres.

The intention of the Customer Survey was to acquire, in a two-week period, near to as many respondents as possible in order to compare the results with a U.K. study. This was a survey in relation to that country's equivalent of payday lending, involving some 500 respondents, and was conducted during the last eighteen months throughout the U.K. by the U.K. Commission.

Lenders, with retail outlets in the following twenty-one lending locations, assisted with this Survey:

Beaudesert	Park Ridge
Wynnum	Calamvale
Capalaba	Loganlea
Gold Coast	Logan Village
Nerang	Waterford
Browns Plains	Waterford West
Marsden	Ipswich
Boronia Heights	Toowoomba
Greenbank	Logan
Forest Lake	Goodna
Forestdale	

The domicile of the respondents was very scattered. In general, the participating lending outlets appear to draw their customers, and therefore the respondents to this survey, from approximately six surrounding suburbs.

Customer Demographic Review

The Customer Demographic Review was a particularly interesting exercise, involving a statistical review of the data held by one multi-outlet lending group, inclusive of borrower application information and loan history. A total of 4,330 files were examined, extending over some years (please note, the writers were provided with further information which, on grounds of commercial confidentiality, have not been included to avoid competitor identification).

Loan Information Survey

In October, the Federation conducted a survey of its current members with a view to ascertaining a snapshot of the current lending levels in Queensland. Additionally, this survey was to procure information for the purposes of formalising external dispute resolution scheme negotiations.

The Loan Information Survey involved responses from 37 payday/microlending companies. At the time of the survey these companies had 15,500 active loans.

The Federation's Industry Analysis Survey

The Industry Analysis Survey involved a random selection of over half of the Federation's, then, membership - a sample of 32 companies - who were asked to answer a structured survey including 72 questions. 13 companies conducted retail outlets, 12 companies conducted both retail outlets and Internet/telephone lending and 7 companies conducting Internet and telephone lending exclusively. These companies operate a total of 73 offices and outlets.

Those companies operating retail outlets had between 1 and 29 outlets, totalling 65 outlets.

Nine companies had less than 2½ years of operation (29%), 19 companies have over 3 years, 8 have in excess of 6 years and the average is 3 years 9 months, with a range up to 10 years of involvement in the industry and a spread of employee numbers ranging from 1 to 50.

Similar dynamic growth is to be observed, throughout Australia, the United States, Canada and the UK.

This Survey involves a sample satisfactorily large enough to provide a mirror of the estimated total number of retail lender outlets in Queensland (at least 230). In regard to the exclusively telephone/Internet lenders, industry leaders have informed the writers that the seven involved undertake at least ⅓ of the Internet telephone payday/microlending in Queensland.

The Survey provides a number of useful reminders to all that seek to have influence on the regulation of payday/microlending in Queensland. First, the 32 companies surveyed make a direct contribution to the general economy of Queensland by employing 205 staff, plus managers, and using 551 suppliers. In addition, their total investment is \$7,860,000 and, at any one time, these companies have in excess of 15,000 active loans on their books. The direct and indirect economic impact of effectively abolishing these lenders should not be ignored.

Comparison Rates Review, April 2006

This survey was undertaken nationally, by the Federation, to assist in the preparation of a submission to the Comparison Rates Review authorised by the Ministerial Council for Consumer Affairs. Senior management of 276 lending outlets and agencies, across Australia, were surveyed for the submission.

The Retail Milk Price/Annual Percentage Rate (APR) Comparison Survey was conducted in Coomera, Oxenford and Helensvale and the comparison was between the different prices charged for a two litre container of full cream milk. This was conducted in preparation for this Submission to demonstrate fundamental problems associated with using a Comparison Rate to determine the cost of a loan.

Industry Profitability

As the Minister would be aware, one of the most instructive means of assessing the relative profitability of companies, when comparing companies of very different sizes and from different sectors of the economy, is the return on capital, or investment ratio. Members of the Federation find this a most useful

measure, calculating as it does the percentage return, or profit, after all expenses have been deducted from total income.

This measure assists in contradicting critics of the industry, including the NSW Office of Fair Trading, who have asserted that, because of the relatively high interest rates charged by the industry, industry participants enjoy substantial profits, well above mainstream lenders and, therefore, they could reduce their charges to the borrower.

The following table lists the return on capital earned by the 21 respondents prepared to provide this information to the Federation's 2006 Industry Analysis.

Number of payday /microlenders	Ratio %	Mainstream lender	Ratio %
3	Negative		
1	5.13		
1	6.8		
1	9.1		
1	9.62		
1	10.82		
2	12.0		
1	12.5		
		Bank of Queensland	15.8
		National Australia Bank	17.7
1	19.1		
1	19.13		
2	20.0		
		St George Bank	20.39
		Suncorp Metway	21.0
		Westpac Bank	21.0
		Coles Myer Ltd	21.9
1	22.0		
1	25.66		
1	28.0		
2	30.0		
		Woolworths Ltd	33.81 (down from 50.93 in 2005)
1	35.0		
Average	18.15	Average	19.06

* All banking/company information gathered from 2006 Annual Reports

As the above table indicates, the payday/microlending sector is not, on average, earning as much on its capital as the major banks cited. Eleven (52.4%) of the 21 payday/microlenders are earning less than the Bank of Queensland, 15 of the 21 (71.4%) are earning less than both St George and Suncorp Metway and only 6 of the 21 (28.6%) are earning more than the three banks listed.

The Federation is not aware of any government review, currently being undertaken, to determine whether or not to impose an interest and/or fees and charges cap on the major banks or supermarket chains, as listed above.

It is to be remembered that this result has to be assessed in the context that:

- the payday/microlender is involved in a segment of the financial sector which is considered high risk;
- the banks listed have totally removed themselves from any involvement in this activity;
- the banks listed have the advantage of an average of ¼ of their activities being conducted off-shore, to dissipate their risk of being totally vulnerable to Australian economic conditions; and
- the banks listed earn an average of 0.91% more on their capital than do the Queensland payday/microlending industry.

Reputation Consciousness

The Federation notes that, on p.11 of the Discussion Paper, there is a statement demanding challenge:

“Fringe credit providers tend to be smaller in size, not as well established, and less reputation-conscious than their mainstream counterparts...”

In regard to reputation, the Federation strenuously challenges the assumption implicit in this statement, believes it is inflammatory and offensive to the Federation’s members and shows a distinct lack of understanding as to how any business is run.

Question 14 of the Federation’s Industry Analysis asked respondent companies to indicate approximately how much, to date, their company had invested, per outlet, in shop fittings, software systems, signage, advertising, staff training and any other costs they would not be able to recover if they were forced to close their business tomorrow.

Only one company indicated the lowest amount being \$40,000. Most of the more successful companies indicated an investment between \$202,000 and \$268,000. The top investment was \$500,000. The average investment being \$132,000 per outlet.

The respondents indicated a potential loss, if the industry was closed, in total of \$7,260,000, for the 25 respondents that had retail outlets. With this amount of money at risk, it is useful to consider what motivates the customers to come to these outlets.

In addition, while payday/microlenders participating in the survey, in large part, cannot boast of lineages as lengthy as most of the major banks, it should not be overlooked that the companies that reported the above investment at risk included two who had been in business for less than one parliamentary term (three years), five for one parliamentary term, eight for a period of between one and two parliamentary terms, six for two parliamentary terms, and two for three or more parliamentary terms.

On the above analysis, the investment under threat and the personal time invested in establishing and running the business, are definitive motivations for being concerned about business reputation.

To this must be added the very potent fact that, in accordance with the Federation’s Customer Survey, 33.19% of all customers, borrowing from payday/microlenders, were generated by referral.

The financial vulnerability of a business that has a third of its turnover generated by referral business, is demonstrated with the following example, taken from a regional and relatively typical payday/retail business:

- To recover all fixed costs (but not variable, such as advertising), it takes this store fourteen good loans advanced per month. That means that this store must lend fifteen loans, ignoring variable costs, to start making a profit.
- The store averages twenty good loans a month.
- If the owner of this money lending store was to let the business reputation slide to the extent of no longer generating referral business, the store would lose 33.19% of its customers, which means they would do 6.6 loans less per month, i.e. they would do 13.4 loans. Almost one loan under the number they need to even cover fixed costs. This store has a well known brand and is one of the better managed stores in the industry.

To further illustrate the point, another store associated with a different corporate brand in business for “some” years, and lending payday and micro loans, has this recent performance history:

- April – 26 loans, loss \$483
- May – 36 loans, \$108 profit
- June – 44 loans, but due to end of tax year bad debt write-off, \$13,000 loss
- July – 38 loans, \$2,000 profit
- August – 34 loans, \$960 profit
- September – 52 loans, \$5,148 profit

A relatively typical story. According to the owner, on these figures a one third drop in the number of loans advanced would ensure the outlet lost money every month.

The writers would suggest that, unlike the banks, where it is the distant shareholder who ultimately suffers a decline in their net worth and the bank employees, at least for a period, continue to enjoy their regular salaries (with most CEOs continuing to enjoy a bonus each year at the shareholders’ expense), with limited exceptions, it is the payday/microlender that is investing his/her own money and seeing a dramatic diminution of net personal worth, the moment one third of his/her customers go elsewhere.

The Imperfect New South Wales Model

The Federation is aware of the Minister’s expressed concern that Queensland “should not be seen to be lagging behind the other States”. As the Minister will recall, this comment was made during a meeting with a member of the Federation in Toowoomba, on the day of that city’s Community Cabinet Meeting.

In this context, the Federation asks the Minister not to assume that the New South Wales’ model is the one to adopt, given both its incubation and its ill informed imposition on the industry.

The writers are aware that the New South Wales Minister, The Honourable Diane Beamer, is confident that the 48% inclusive cap, established for all loans from March 1, 2006 in New South Wales, has not forced lenders out of business or the industry.

According to journalist Patrick Lion, in the Courier Mail on the 26th July, the New South Wales Minister is also confident that borrowers have not been forced into a black market. Minister Beamer needs to take the opportunity to meet with the leaders of the Vietnamese-Australian criminal gangs, that provide payday and microlending services in the casinos and around the major licensed clubs in Sydney and the Lebanese-Australian gangs who provide similar services in a number of inner and western suburbs licensed clubs and hotels.

In the same article, Ms Beamer is quoted as having told the journalist "...we haven't had any problems". She is correct. The Office of Fair Trading does not have the responsibility of criminal police work and there has been a very substantial reduction in the responsibility/workload of her Office of Fair Trading. This is because the majority of lenders are no longer governed by New South Wales Legislation.

The reality is that the regime has totally forced the payday and microlending industry in New South Wales to move out from under the restrictions imposed by the Consumer Credit Code.

The New South Wales Division of the Federation has reported that a number of New South Wales lenders, and some Queensland lenders who do business in New South Wales, have been approached in recent months to provide examples of their documentation, by the NSW OFT. This review is applauded. However, any comprehensive understanding of the impact of the March 1 regime awaits the Minister's promised review at the end of the first twelve months of its implementation.

It is hoped that the New South Wales Minister's comment to Mr Lion, that New South Wales consumers who require smaller loans now enjoyed fairer short-term finance, is valid. Unfortunately, her deduction that, "so I guess it shows lenders can survive at 48% with fees and charges incorporated into that" is not valid. It is also to be hoped that there was a significant expansion in the volume of loans provided by the one new entrant to the industry who assured the Minister, in the latter part of 2005, that it could survive with a 48% inclusive cap and that the lender's documentation was compliant with the NSW regulatory regime. That lender, which announced significant losses in the second half of 2006, followed this with a publicly announced major change in its modus operandi, with a significant part of its business now outside the Consumer Credit Code. Also, it is to be hoped that the one commercial lender who made similar claims to the Minister or her Officers, has in fact entered the personal loan industry and that the Minister is aware of one large company's policy of apparently keeping within the 48%. However, this company does require borrowers to take out expensive insurance, in association with their loan.

The Minister should also be aware of circumstances associated with the very flawed New South Wales Review, in 2005, that led to the implementation of the comprehensive regulatory regime from March 1, 2006.

While it is conceded that the industry was invited and did present written submissions to that NSW Review, unlike the Victorian Credit Review in the same year, absolutely no further contact of any kind was provided to the industry. The one exception was the opportunity to telephone a very junior member of the Office of Fair Trading staff, who was nominated as the contact person and could do no more than tell one of the writers that the Office of Fair Trading was still collecting information, or encourage one or more lenders to send further written information to the Review.

That meant the review concluded with the Legislation being passed, without any personal contact between the industry, the Minister, the Minister's personal policy staff and the OFT senior policy staff. The only substantial contact the industry had with the Office of Fair Trading senior policy adviser and/or the Minister's staff, was to be granted two meetings, some several days after the Legislation had been passed in the Legislative Assembly.

The Office of Fair Trading's Senior Policy Adviser attended both post-Act meetings. At these meetings, the Officer was unable to indicate the number of complaints received about the industry, after making a very general statement that there were many. She further responded that the level of complaints was not necessarily the issue, because the sort of people the payday and microlending industry lends to were not likely to complain. Therefore, it would be anticipated that there were a considerable number of unidentified unhappy borrowers in the community.

The facts are as follows:

- i) Despite repeated requests for information, industry stakeholders were not officially made aware of the impending Legislation, or its actual, final content, prior to its introduction in the Parliament;
- ii) The New South Wales Minister refused to see any industry representatives before implementing the all-inclusive cap. This refusal continued throughout the Parliamentary debate and continues today;
- iii) The Minister's Policy Adviser on Consumer Credit admitted to an industry delegation, after the legislation had been introduced into the Lower House, that she had not read any of the industry's submissions;
- iv) The Minister's Chief of Staff admitted, to the same industry delegation, that the Minister's intention with the Legislation was to close down the industry;
- v) The same Minister's Chief of Staff indicated, to another (later) industry delegation, that his interpretation of the 48% per annum cap was that, if you lent \$100 for a month, you received \$148 in return (which is an APR of 576%);
- vi) The Minister and her ministerial staff, as well as the OFT senior policy adviser, as indicated above, were unable to provide detail of the number or type of complaints against the industry, received by the Office of Fair Trading, despite claiming that there were many.

This replicates the series of events leading up to the initial implementation of the cap in New South Wales in 2001, when another Minister was responsible for the portfolio.

At the Griffith University Centre for Credit and Consumer Law conference on "Credit Matters: A seminar on Regulating the Cost of Credit" held on 9th December 2006, the New South Wales Office of Fair Trading spokesperson, a person who is well regarded by the Federation membership, but who was on leave when the above legislation was introduced, commented in the prepared speech that she read. The Federation takes this opportunity to comment on that speech because, attending on that occasion, was the Queensland Director General of the Office of Fair Trading and a number of policy advisers whom the Federation would expect to consult with the Minister.

In the speech it was announced that the office had undertaken a survey of 62 borrowers. Unfortunately, no detail was provided as to how these borrowers were selected and none of the members of the Federation's New South Wales Division, which now represents approximately half the lenders in New South Wales, has reported any of their customers being surveyed.

The spokesperson then confirmed that the Office of Fair Trading had taken the opinion of a commercial lender (not a consumer lender and not someone from the payday/micro-lending industry), as a basis for part of their March 1 decision. The spokesperson admitted that that person had not thereafter entered the consumer market.

Comment was made in the speech of the time taken to process an application, to justify payday/microlenders' costs to the consumer. There was no recognition of fixed running costs and other business overheads, nor was there any recognition of the costs associated with the customers that are rejected after spending valuable staff time in assessment.

The spokesperson expressed a concern that "lenders accessed customers' bank accounts on numerous times on one day". Unfortunately, this statement overlooks the fact that the lenders have absolutely no control over the direct debit process. It is the customer's own bank that decides when to process direct debits and whether or not they will try the direct debit on multiple occasions.

During the speech, an assertion was made that many borrowers were facing bankruptcy. The writers believe such an assertion might be difficult to confirm, unless it could be shown that a substantial proportion of the 62 borrowers interviewed had had bankruptcy proceedings commenced against them. It also conveniently ignores the fact that it would be highly likely that the borrowers would have other debts, and it is totally uneconomic for a lender to fund a bankruptcy proceeding over a debt of a few thousand dollars, let alone for a debt of a few hundred dollars. In this context, it might be useful to note that the Federation's Loan Information Survey, which involved 4,330 customer files, extending over some years, provided not one instance of a customer either choosing bankruptcy or being made bankrupt.

Given that on no occasion has the New South Wales Office of Fair Trading attempted an audit of the financial and business circumstances of any lender in New South Wales, it was unfortunate that the spokesperson "called on" lenders to reduce their high profits and inefficient lending practices, without any substantial evidence to show this to be an accurate statement.

The spokesperson concluded her speech with a call for the banks to enter the payday/microlending market. Unfortunately, the NSW OFT continues to fail to recognise that the banks have absolutely no interest, except for some limited involvement with subsidised pilot schemes for public relations purposes, in having anything to do with payday/microlending customers.

The Belief that There are Alternatives to the Status Quo is Totally Unrealistic

The Federation is aware that a considerable number of consumer advocates continue to argue that, if the effect of the cap is to eliminate the payday lending industry, then this is an acceptable and desirable outcome, on the basis that commercial lending to low-income/high risk consumers is not socially desirable at any cost.

In the alternative, the Federation is aware that some Council of Social Services personnel have noted that such abolition would result in an immense detriment to consumers, unless alternative forms of affordable credit were made available to low-income earners.

As the Minister would be aware, the opportunities to provide alternate credit are advanced by consumer advocates as including:

1. By obliging mainstream lenders to lend to low-income consumers. The Federation notes that such an imposition would involve a major reform to current Commonwealth Legislation and Regulation. The Federation also notes that the power to do this is outside the parameters available to the Queensland Government.
2. The provision of Low Interest Loan Schemes (LILS), in which organisations such as the Brotherhood of St Laurence have been involved with the National Australia Bank and the ANZ. As this submission considers in detail in sections 7 and 8 of this paper, these opportunities, while well-meaning, are particularly limited in their scope, in the number of borrowers involved and in their pilot-scheme nature.
3. The opportunity to provide NILS (No Interest Loan Schemes). As this submission also considers in detail, in Sections 7 and 8, these worthy schemes are more numerous interstate than the LILS but, again, extremely limited in their number and in the involvement of borrowers.
4. By the imposition of outmoded and ineffective, 1930s depression-style price control, such as the imposition of a 48% cap. As substantially considered in Section 12 this opportunity, despite its apparent simplicity, does not work, just as similar attempts at price control did not work in the 1930s.
5. The imposition of a cap linked to the prevailing market interest rate. Uniting Care Wesley has argued for this approach, on the basis that it ensures that the rate remains relevant to current economic circumstances. However, such an approach demands recognition that the base interest rate may not be relevant for a payday/microlender. Given its structure is determined according to its intended use by major financial players and the government, it suffers from uncertainty, particularly as the individual consumer does not have the sophisticated support that a major financial player has, to keep abreast of changing rates, and it lacks consistency with what other States have imposed by way of the fixed 48% cap.
6. A structured cap. While this has academic appeal, as discussed in greater detail elsewhere in this Submission, such an approach raises the problem of how to determine a multitude of interest rates and what would be the circumstances to trigger each of those rates being reviewed.
7. Exemptions for the perceived “good guys”. As in New South Wales, temporary overdraft facilities extend to Commonwealth controlled ADI’s (Authorised Deposit-taking Institutions). The problem with this model is recognising to what extent the ADI’s cross-subsidise their overdraft facilities to keep costs down, to preserve this exemption, and the extent to which such exemptions distort the market. This distortion is apparent where borrowers from the prohibited sectors emigrate to the ADI’s, not because the rates are necessarily lower, or other product attributes more favourable, but only because their previous source of loans has been denied them by Legislation, and not by market forces.

Any Cap Will Add to Consumer Detriment

Any move towards replacing the status quo with a cap is against consumers’ interest. The introduction of an interest rate cap will have a negative impact on consumer detriment in the area of high interest/high cost loans. What is likely to occur is an increase in the market share for credit products or arrangements that are outside the Code, or the development of artificial contrivances protecting those operating in conflict with the Code.

Either way, there will be an increase in consumer detriment, because consumers will lose all the effective benefits and protection associated with the Consumer Credit Code.

As the Griffith University Centre for Credit and Consumer Law has identified (South Australian submission 2006), it is not possible to determine what effect caps will have on industry and consumers.

The Centre's deliberations identify a range of possible risks and stress that the underlying social problems need to be addressed. It is suggested that this may require:

1. income support;
2. education about the perils of credit use; and
3. significant assistance from the Queensland Government to introduce, State-wide and State-sponsored, strong and capable networks of NILS and LILS.

Pay Day Borrowers - The Banks Don't Want to Know

The phenomena of the banks turning their backs on low income earners is not a new one. Comment was being made in 2001.

It is useful to note that, in a letter to the, then, Commonwealth Minister for Financial Services and Regulation, The Hon. Joe Hockey, which the, then, NSW Minister for Fair Trading, the Hon. John Watkins quoted in the NSW Parliament, on the 10th April 2001, a criticism was expressed as follows:

"...you have done nothing to counter the actions taken by banks and other mainstream lenders to force the socially disadvantaged out of their branches. ...If you had really wanted to do anything to counter the damage caused by pay day lenders, you would have ensured that their financial needs were met by the institutions for which you have direct responsibility."

As an example of the banking industry's attitude, in a public statement on the 27th June, 2001, the Commonwealth Banks' Chief Executive, Mr David Murray, threatened to *"dump poor customers if the Commonwealth Bank is forced to offer low fee accounts"* (ABC TV News).

The banks are not prepared to get involved because, when they consider the costs of potential borrower assessment and add the costs of loan administration, money holding costs, repayment collection and much higher default rates, they see an unprofitable and insecure arrangement. It is a much more profitable and secure opportunity to lend to the well heeled, middle and upper classes and to the corporations.

Social Need for Short Term Loan Availability

A Federal Government, a welfare agency report and a parliamentary speech makes it clear that there is a consumer need for sources of credit for low income earners:

"For a poor person credit is often a necessity. Even basic goods and services may be beyond the immediate reach of low income earners, especially those suffering unexpected misfortune such as illness or unemployment".

...1975 (Professor Sackville) Federal Government Commission of Enquiry into Poverty, page 104.

This 30-year old concern was replicated nine years ago:

“Access to some form of credit is a prerequisite in enabling many individuals to exercise their right to basic household goods and other necessities. The use of credit for the low income earner is governed by need rather than choice”.

...Dr B. Hahn, “Just Credit – Should Access to Credit be a Citizenship Right?”, published in March 1997, under the auspices of Good Shepherd Youth and Family Service, page 15.

Severe curtailment of payday and microlenders, rather than realistic regulation of them, could have serious consequent implications.

As the Reverend The Hon. Fred Nile, MLC said in the NSW Parliament in 2001:

“If we destroy the payday lenders industry, we will force those vulnerable people straight into the hands of loan sharks. Usually the loan sharks are, in my view, perhaps not all of them but many of them, operating virtually in a criminal world. They are usually part of organised crime. Anyone who fails to pay back money to a loan shark will be physically dealt with – that is, have their arms or legs broken, or worse. None of us want to do anything to push people into the hands of loan sharks. We know they are ruthless and are operating on the edge of society...”

...Honourable members may be aware that the National Australia Bank has established a community consultation forum chaired by Reverend Tim Costello. He called on all the banks to make a one-off capital grant to a loan scheme for struggling low-income earners who find it difficult to obtain small emergency loans. As far as we are aware, the banks have not moved into this area or met that request at all. However, payday lenders have provided an opportunity.”

...Legislative Council, NSW Parliament, Thursday 21st June, 2001.

“Interestingly, customers reported that they liked the sense of independence, privacy and self esteem that comes with having access to credit otherwise denied to them by mainstream financial service providers. This is consistent with the findings of American research on the use of high cost credit by consumers”

...Dean Wilson, “Payday Lending in Victoria - A Research Report”, Consumer Law Centre Victoria Ltd, July 2002, p. 10.

This Australian experience is not dissimilar to underlying Canadian circumstances. A study by Professor Iain Ramsay, Professor of Law, Osgoode Hall Law School, Toronto, entitled “Access to Credit in the Alternative Consumer Credit Market”, prepared for the Office of Consumer Affairs, Industry Canada and Ministry of the Attorney General, British Columbia, dated February 1, 2000, identified at page i:

“...broader socio-economic factors which are relevant to understanding the growth of the alternative financial sector. During the past twenty-five years there has been a growth in income inequality, declining savings to income ratios, and increasing debt-to-income ratios. ...Significant numbers of consumers may be using credit to maintain living standards in the face of flat income. There is thus a larger group of individuals who may have problems with credit, perhaps caused by changes in circumstances such as marital breakdown or unstable employment and who may face difficulties in funding short term credit needs in the mainstream market.”

And at page 3:

"...A study in the US indicated that the bottom 40% of consumers borrowed to compensate for stagnant incomes (R. Pollin, "Deeper in Debt: The Changing Financial Conditions of US Households" (1990)(Washington: Economic Policy Institute), while in the UK the Policy Studies Institute concluded that "poorer families, on the whole, use credit to ease financial difficulties, those who are better off take on credit commitments to finance a consumer lifestyle" (R. Berthoud and E. Kempson, (1992) Credit and Debt: The PSI Report (London: Policy Studies Institute) at page 64)."

Professor Ramsay also made an important point on page i of his study when he noted:

"It would be mistaken to view this industry as a monolith or all consumers of its products as drawn from the same social background."

An article entitled "Pay Dirt" in The Economist, June 5, 1999, highlighted this fact in regard to North American borrowers. Studies quoted in that article indicated that:

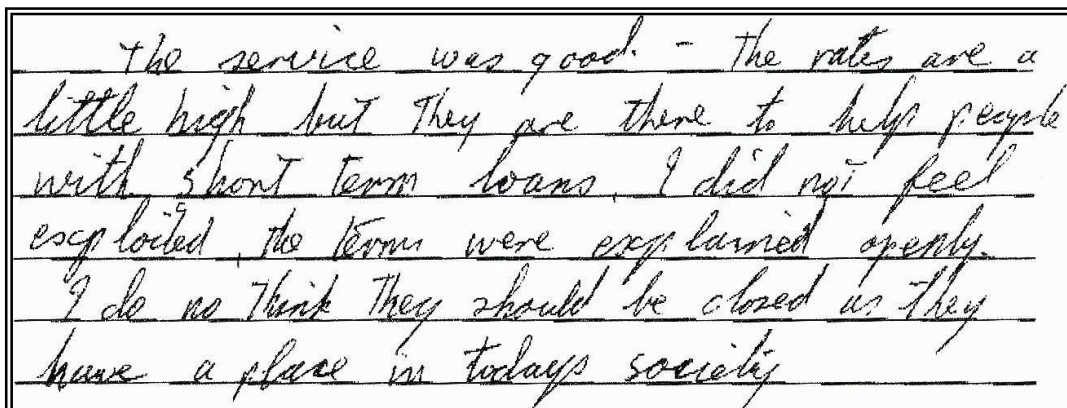
"the average user has a personal, or family income in the range of from \$20,000 to \$25,000 on the low side to \$35,000 to \$45,000 on the high side. The clientele is nowhere near the poverty line, but rather part of the self-sustaining American middle class".

Value for Money

The reference to the prevalence of high interest/high cost loans, in the Discussion Paper, embraces no consideration of value for money. The Federation believes that until we have substantial research into the perceptions of the Queensland lenders in this category, we will be arguing on a potentially false premise. In many circumstances, what one person regards as an expensive purchase another, for reasons particular to that second person, will regard such as being economic or of good value.

What the concept of high interest/high cost loans also fails to address is the net present value of a loan, to the borrower. Again, such a value may be a far more meaningful measure of true cost than the dollar value that critics of the industry ascertain as "high interest/high cost".

The Federation believes that it is most significant that 90.54% of the 465 respondents to the Federation's Customer Survey indicated that the loan they had taken out that day was, in their opinion, "reasonably priced".



The service was good. - The rates are a little high but they are there to help people with short term loans. I did not feel exploited, the terms were explained openly. I do not think they should be closed as they have a place in today's society.