



# **NATIONAL FINANCIAL SERVICES FEDERATION**

## **PROPOSAL**

to

**The Minister for Fair Trading,  
the Hon. Kerry Shine MP**

In response to a request by the Minister to provide a proposal for an effective and workable regulatory regime for Queensland microlenders

**October 2007**

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## INTRODUCTION

As the Minister will recall, this proposal is presented in accordance with the Minister's request, during the ministerial meeting with a delegation from the National Council of the National Financial Services Federation (NFSF) on Thursday October 18<sup>th</sup>, 2007.

The proposal is designed to present an appropriate structure of regulation, which will balance consumer protection with the continuation of a viable and legitimate Queensland microlending industry.

It is hoped that the Minister and his Cabinet colleagues will have the opportunity to closely examine the contents of this proposal and that there will be an opportunity for the ALP Parliamentary Caucus to consider it, as part of its forthcoming deliberations on the regulation of microlending in Queensland.

The Minister, his Cabinet colleagues and his other Parliamentary colleagues will be involved in arriving at decisions that the Federation understands will have a major impact on regulatory thinking in the Northern Territory, Tasmania, South Australia and Western Australia in the near future. They will also have an impact on Victoria, New South Wales and the Australian Capital Territory in the longer term, when a long foreshadowed, total review of the Consumer Credit Code commences.

The National Council of the NFSF invites the Minister to consider the following issues that constitute the current regulatory environment. The specific proposals follow.

### **The Socio-Economic Environment**

1. Queensland borrowers of relatively small, short term and often unsecured loans do not have financial industry borrowing opportunities apart from the Queensland microlending industry. The banks, building societies and credit unions withdrew from the market years ago.
2. 83.3% of Queensland borrowers have indicated that they would have nowhere else to go for their small loans, if the Queensland microlending industry was to be effectively abolished.
3. 90.5% of Queensland borrowers do not regard their microloan as being expensive.

### **The Industry Critics**

1. Industry critics repeatedly refer to the actuarially discredited Comparison (percentage) Rate as a measure of cost, when Queensland borrowers measure cost according to the total cost of credit (69.7% of borrowers do not even consider the comparison rate when taking out a loan).
2. Industry critics, particularly Patrick Lions of the Courier Mail and Loretta Kreet, Legal Aid Queensland, and some academics from the Griffith University Law School Centre for Consumer Law, have facilitated a campaign based on ten legal aid clients, whose legitimacy was never fully investigated, one case that came before the Court, inaccurate statistics (repeating unfounded urban myths) and inadequate interstate research in excess of ten years' old. The NFSF's research has involved surveys of over 4,000 customers nationwide, including 465 from Queensland, conducted between October 2006 and February 2007.
3. Despite frequent invitations, no critic has visited a microlending outlet and talked to customers, to see what really goes on.

## The Political Reality

1. As opposed to the situation in Victoria during that state's Credit Review, no Queensland Parliamentarian has visited a microlending outlet and talked to customers to get their constituents' viewpoints.
2. Just under 200,000 Queenslanders borrowed from the industry as a whole in 2006. 92,000 of those Queenslanders borrowed from NFSF members.
3. In the Minister's electorate alone, the highest profile microlenders report lending an aggregate of \$3.5 million in 2006.
4. The much touted alternatives of No Interest and Low Interest loans were able to help just 205 borrowers in the whole of Queensland, in 2006. This is well under half the loans advanced by the smallest lender in the Minister's electorate. Further, the requirements of Social Security recipient status exclude the majority of Queensland borrowers from access to such loans.
5. The Federation's 122 member outlets were involved in a total of 3 complaints to the Office of Fair Trading in 2006. All three were resolved without prosecution. The average number of complaints, over Federation lenders' total operational years, is just one Office of Fair Trading complaint per 13 years.

## The Economic Reality of a 48% Inclusive Cap

1. Under a 48% inclusive cap, the average \$250 unsecured loan
  - for a term of 4 weeks;
  - with fortnightly repayments;
  - with 11-14 pages of mandatory Consumer Credit Code documentation;
  - with mandatory credit checks;
  - involving 1.5 hours of staff time for the first time borrower;
 will generate a gross amount, for interest fees and charges, of just \$6.67.
2. The 1.5 hours of staff time, for the above loan, will cost \$26.20 (Clerical Award, Level 3), without factoring in:
  - rent for a High Street shop front;
  - advertising;
  - office administration;
  - stationery, etc.; and
  - funding borrowers who default (3-12%).
3. One major Queensland lender, with a head office in Brisbane and outlets across Australia, has calculated that, for loans between \$200 and \$5,000, the above costs average \$139 per loan.

In these circumstances, the industry will go broke if it attempts to continue lending under the Consumer Credit Code, with a 48% inclusive cap.

## 48% Cap, Inclusive of Fees and Charges, Discredited

1. This so called "solution" to regulating microlending in Queensland, has failed in New South Wales and the Australian Capital Territory. The microlending industry, in those jurisdictions, has been forced to re-structure

its method of doing business and now operates under Commonwealth legislation, which means New South Wales and Australian Capital Territory borrowers no longer have the protection of the Consumer Credit Code.

2. Five highly respected, major overseas studies have recently rejected the concept of any cap at all:
  - The Asian Development Bank, the Philippines
  - The UK Competition Commission
  - The Consultative Group to Support the Poor (CGAP), Washington DC
  - The Federal Reserve Bank of New York
  - The NZ Ministry of Consumer Affairs.
3. Two interstate studies have rejected the concept of the 48% inclusive cap, without substantial further research:
  - Victoria - the MISC Australia Consumer Credit Report for the Victorian Department of Justice, Consumer Affairs
  - South Australia - "Consumer Credit and Investment Schemes", a report of the Economic and Finance Committee, South Australian Parliament.
4. The only substantial Queensland study, "Pay Day Lending - A Report to the Minister for Fair Trading", carried out in 2000 by a working party of the OFT, totally rejected the concept of the 48% inclusive cap.
5. In Canada the 60% cap, imposed some years ago, has been recently removed.
6. In Victoria, the cap imposed on pawnbrokers was removed in 1998, because it had driven business underground, compromised the Victorian Police Force and placed the consumers at the hands of those operating outside the legislation.

## **OPTIONS AND RECOMMENDATIONS**

Given the international and national studies finding against a 48% inclusive cap and the failure of the New South Wales and ACT cap regimes to maintain control of lenders under the Consumer Credit Code, the NFSF proposes that the Minister's objective of imposing an effective regulatory system can be achieved by the introduction of one of the following three Options:

### **Option 1**

**The introduction of a total cost of credit limit - not exceeding the amount borrowed.**

The NFSF has been informed that OFT compliance officers and senior Queensland Financial Counsellors would welcome this option, because it provides a very easily measured and assessed criteria. Time consuming calculations, based on a lender's documented formula and comparisons with transaction listings, are replaced with a simple comparison between the total amount advanced and the total amount paid for the loan, inclusive of all interest, fees and charges.

Such an impost would apply, regardless of the term of the microloan, or its subsequent default history and would thereby prevent a borrower debt spiral. This safety net provides a unique benefit to borrowers, that is not available under any interest rate cap regime. Interest fees and all ascertainable charges, at the time the loans was entered into, would be included in the total

cost and only independent third party costs associated with debt collection would be excluded.

Such a regime would allow a wide range of competitive loan products to suit consumer choice, while maintaining an umbrella of total cost protection.

This concept was favourably commented on in the abovementioned UK Competition Commission Report.

**OR**

### **Option 2**

**The introduction of a 48% cap on interest rates, excluding fees and charges, plus an associated “unreasonableness” test.**

The Victorian regime, which has existed for many years, was re-endorsed with the Victorian Government’s Consumer Credit Review in 2005-6.

A Queensland regime could also have the considerable advantage of the inclusion of the recently proposed Ministerial Council of Consumer Affairs “reasonableness” test.

Subject to clarification of the criteria, the NFSF believes that this test is a useful addition to the “unconscionable” provisions currently included in the Consumer Credit Code. Such clarification would usefully include the Courts being mandated to review the fees and charges incurred by borrowers from other microlenders and major finance companies and banks, when reviewing a particular lender.

The test of “reasonableness” would allow a Court to assess fees, charges and profitability associated with any loan, in accordance with the underlying cost of establishing, administering, monitoring and, where necessary, recovering a loan, together with the wholesale costs facing lenders in acquiring money to on-lend.

**OR**

### **Option 3**

**The introduction of a 48% cap on interest in conjunction with a cap on the total cost of fees and charges, so that such fees and charges do not exceed the principle loan amount.**

This option attracts positive elements of both a cap on interest and cap associated with the total cost of fees and charges, but would be expected to limit financial products and consumer choice.

**AND**

***regardless of the Option adopted above, the inclusion of the following recommendations, in the regulatory package:***

### **Recommendation A**

**The introduction of an External Dispute Resolution scheme.**

Such a scheme provides a no-cost and very convenient mechanism for borrowers to, informally, present their case to an independent arbitrator, where unjust or unreasonable lender conduct is alleged to have occurred. Under the

contractual relationship between lender and scheme, the lenders would be contractually obliged to comply with the decision.

The existence of such a scheme would not deny the right of the borrower to seek assistance from the Office of Fair Trading, or the Courts, if the borrower was dissatisfied with the arbitrator's decision.

Elements of such a scheme to include:

- Application to all Queensland microlenders
- Joining such a scheme to be one of the conditions of a lender's licence
- All costs to be borne by the lender
- Borrowers to be encouraged to make application to the scheme, before seeking Office of Fair Trading assistance
- Office of Fair Trading to maintain a register of schemes and members, with a mandatory obligation on lenders to notify the OFT of their membership.

The NFSF has spent 12 months researching this issue and will be pleased to facilitate the introduction of such a scheme to all microlenders.

This concept was endorsed by the South Australian Minister for Consumer Affairs this past week.

**AND**

### **Recommendation B**

#### **The introduction of a self-funded Licensing Scheme, applicable to all Queensland microlenders.**

Such scheme to embrace a "fit and proper" character test, with pre-determined, clear criteria. This concept embraces the better elements of the licensing schemes in place in Western Australia and Victoria, as well as that proposed for South Australia.

The licensing scheme would allow the Office of Fair Trading to easily identify credit providers, which is not the case at present. As a consequence, such identification would improve the Government's ability to enforce compliance with the Consumer Credit Code.

Under a licensing regime, the Office of Fair Trading would have a considerably improved opportunity to communicate with all lenders and to ensure that they are fully informed as to changes in Government policy and regulation. This would provide a model of effective communication between industry and Office of Fair Trading, such as that which exists in Victoria.

Elements of licensing to include:

- Annual renewals
- Financial status
- Previous issue or refusal of any Government licence
- Exclusion if found guilty of an offence involving dishonesty
- Financial viability
- Knowledge of the Consumer Credit Code provisions
- Knowledge of the Fair Trading provisions
- Mandatory national Police check

- Appropriate references
- A strict range of fines, suspensions and exclusions, plus revocations of licenses for breaches of the Consumer Credit Code and the Licensing provisions
- Encouragement to join an industry representative body, with an acknowledged Code of Conduct
- Public display of the Licence.

**AND**

### **Recommendation C**

**The establishment of a Ministerial Liaison Committee, providing the Minister with Consumer Credit industry and consumer advice and information.**

This was planned by the Office of Fair Trading in 2001.

Such committee to be modelled on the South Australian 2006 Ministerial Task Force on Consumer Credit, which included representation from the Australian Finance Conference, A member of the Australian Bankers' Association, consumers, Office of Fair Trading, a Ministerial Adviser, a Government Backbencher and a representative from the National Financial Services Federation.

The continuing existence of such a committee would forge an invaluable link to industry, which would provide a major impetus for the introduction of effective consumer and industry education campaigns.

### **IMPLEMENTATION OF REGULATION**

The following is suggested for adoption:

#### **1. No retrospectivity.**

The avoidance of retrospectivity in the implementation of any provision recognises that many loans, negotiated under the current regulatory regime, will have been determined by contracts involving terms and conditions which may extend for a period after the introduction of the new Regime.

#### **2. A transition period of six months.**

Such recognising the dislocation, for both borrowers and lenders, which can result from hasty introduction, particularly given the forthcoming Christmas and New Year holiday season.

Further, the practical necessity of recognising that any new regulatory regime will have a potentially major impact on the following:

- Product redesign
- Business remodelling
- Business capital structure
- Product funding
- Price modelling
- Contract redrafting
- Direct Debit Authority redrafting and APCA/BECS approval

- Legal opinion and compliance sign off
- Indemnity planning and impact statement
- Computer software redesign
- Insurance liability/indemnity
- Staff training and education
- FSR training and licensing
- Customer notification, disclosure and education
- Advertising and marketing
- Debt collection where new arrangements are entered into
- Development of EDR policy and compliance
- Alignment of any related and non related entity/ies not regulated under the auspicious of the UCCC products and services to meet any new disclosure or assignment of fees and or charges as being an Interest charge
- Business windup/ appointment of Administrators.

## **CONCLUSION**

In summary, we strongly recommend the adoption of Option 1 and the inclusion of the three recommendations as the new regulatory regime.

All three Options avoid the unfortunate circumstance, as has occurred in NSW and the ACT, where no microlender is able to lend under the Consumer Credit Code and consumers have lost the Code's protection.

We appreciate the opportunity to present this proposal, for the Minister's consideration.

## **National Council National Financial Services Federation**

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