NATIONAL FINANCIAL SERVICES FEDERATION (QUEENSLAND) INC.

SUBMISSION

To

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

Regarding
Consumer Credit (Queensland) Amendment Bill 2008 and
Consumer Credit (Queensland) Regulation 2008
and their fulfilment of the policy objectives
of the Queensland Government

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Submission to the Minister for Fair Trading, the Hon. Kerry Shine
Regarding
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Consumer Credit (Queensland) Regulation 2008

The Minister has called for submissions from Queenslanders on whether the Consumer Credit (Queensland) Amendment Bill 2008 ("**Bill**") and Consumer Credit (Queensland) Regulation 2008 ("**Regulation**") meet the policy objectives of the Queensland Government.

This document comprises the National Financial Services Federation (Qld) Inc's (NFSF) submission.

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Preface 1 - Executive Summary

The Queensland government has often stated its commitment to its stated policy objectives, as shown in the discussion paper of 2006, *"Managing the cost of consumer credit in Queensland"*. This comprises three stages:

1. Regulating credit by way of the Consumer Credit Code ("Code");
2. Further changes to the Code to provide better protection for consumers; and
3. Determining whether an interest rate cap should be introduced.

Stage 1 has already been completed. Stage 2 appears complete in all but final implementation. Stage 3 has been determined by the Bill and Regulation.

The Queensland government intends to implement a 48% per annum cap, including fees and charges. They have also committed to keeping industry viable. This is an obvious dichotomy; the very discussion paper that introduces the policy objectives acknowledges that it fails to keep industry viable. Page 7 of the discussion paper states:

"the [Payday Lending] Working Party [2000 by the Minister of Fair Trading] *considered whether an interest rate cap was a suitable option… concluded that it would be preferable for interest rates to continue to be set by the market. In its view, an interest rate cap of 48%…did not take into account the time, effort and expense associated with the provision of pay-day lending services."*

Despite industry viability concerns, the intended cap fails to protect Queensland consumers. International research shows that instituting caps or bans on payday and micro lending causes detriment; rather than having a positive effect.

Each element of the government's policy objective is broken down in this document and shown to be ill served by the cap. Underlying this, the detriment of the consumer, and of business is shown. The Queensland government has a requirement to act fairly and in the interests of all Queenslanders, consumers and industry alike. Both parties are failed in this instance.

The Queensland government would be well served to consider the matter in greater depth, pay attention to relevant national and international authorities on the issue and consider better methods of achieving their policy objective; including industry proposed reform. Proper, independent research should be commissioned, rather than accepting a solution that "appears to work elsewhere".

Caps are ineffective, blunt instruments that do not serve the continuing interests of any stakeholder.

Preface 2 - The Government's stated policy objectives and their elements

In the Office of Fair Trading's (OFT) November 2006 discussion paper, "Managing the Cost of Consumer Credit in Queensland", the OFT states that their policy objective is:

"*Ensuring that the fees and charges relating to the provision of the consumer credit are fair and reasonable, and in particular that vulnerable consumers are not exploited through the imposition of unfairly high rates of interest and/or excessive fees and charges.*"

This statement contains four elements:

1. That fees and charges relating to the provision of consumer credit are fair and reasonable;
2. The notion of vulnerable consumers;
3. Protection from exploitation by unfairly high interest rates; and
4. Protection from exploitation by excessive fees and charges.

The government, by the then Minister for Fair Trading, Margaret Keech, further clarified the policy objectives for the Queensland Government. In an article entitled "Lenders face cap on fees" in the Courier Mail, published Monday, 12 February, 2007, she is quoted as saying:

"I want a scheme that is fair and equitable – one that has consumer protection as its priority, but also balances the need to keep the industry viable."

This was a follow up to a speech by then Commissioner of Fair Trading, Julie Kinross, at the seminar run by the Griffith University Centre for Credit and Consumer Law in Brisbane on 7 December, 2006, where she stated:

"The concept of an interest rate cap is highly complex and the Minister is focused on finding an outcome that balances consumer welfare with the continued financial viability of legitimate lenders."

Element one of the policy objectives necessarily implies that the "fair and reasonable" fees and charges for the provision of consumer credit must be fair and reasonable for both consumers and industry. Otherwise, it fails to fulfil the Minister's stated aims.

In the interests of fairness and equity to all stakeholders, this notion of fairness and reasonableness for industry must be included because the Queensland government must represent the interests of all Queenslanders, industry participants included. Also, the initial policy statement does not state that "fair and reasonable" applies to any particular party. Rather, the fees and charges

themselves must be fair and reasonable. This all supports the notion that fees and charges must be reasonable for all interested parties.

To the Federation's knowledge, there has been no other statement by the Queensland government of what its policy objectives are in this matter.

However, in addition to these objectives, there are four further objectives that the Queensland government should embrace:

5. Consumers should have a fundamental right of access to finance models to suit their needs;
6. Consumers should be protected from "debt spirals";
7. Consumers should be afforded an economic environment that protects them from other socio-economic pitfalls; and
8. Any regulatory model should allow for industry survival provided that they subscribe to best practices models.

Element 1 - Ensuring that Fees and Charges are Fair and Reasonable

Executive Summary

a) Fees and charges must be reasonable for consumers **and** industry;
b) The proposed cap does not achieve viable rates of return for short term, small principal loans;
c) Industry expends significant effort in operation through legislative requirement;
d) Industry incurs significant risk in operation because of the nature of the market; and
e) Industry becomes massively unprofitable under the proposed cap.

As stated in Preface 2, the fairness and reasonableness of fees and charges applies to both:

1. The fees and charges that consumers must bear in terms of the amounts they must pay; and
2. The fees and charges that industry is able to charge to compensate them for the provision of the loan.

These two notions are inelastic in relation to each other. The level of one is directly related to, and commensurate with, the level of the other. There is no capacity for a gap to exist between the two.

It necessarily follows that any amount levied for fees and charges must be sufficiently low to protect consumers from overpaying for finance, and sufficiently high to enable business to meet costs and return a profit.

So the question is:

Is 48% per annum, including all interest charges, credit fees and credit charges (as provided for under sections 2(1) and 2(3) of the Regulation) fair and reasonable to consumers and lenders?

Significantly, this part of the policy objective does not refer to rates, but rather to fees and charges themselves, making it a reference to actual dollar amounts. Later in the objectives, there is a reference to rates of interest but this will be dealt with in the appropriate section. Instead, all references for this part of our submission will relate to real amounts as it is the fees and charges themselves that must be fair and reasonable.

To determine the fairness and reasonableness of a 48% per annum all-inclusive cap when related to actual dollar amounts, it must be calculated back against realistic loan scenarios. It is only by doing this that true dollar figures can be

derived and applied to the test. In support of this notion is the understanding that a percentage value is completely irrelevant until related to a set figure. Until that is done, it is a notional figure. In other words, "48% per annum of what?", since 48% by itself provides us with no information.

The NFSF represents lenders who are wholly or predominantly micro lenders and payday lenders. Our members cover a range of principal loan from $100 up to around $5,000. These loans are provided under the Consumer Credit Code. Accordingly, the NFSF's members will be required to comply with the Bill and Regulation in the provision of credit in terms of their ordinary course of business. The average amount of a payday loan across our members is $250, and the average amount of a micro loan is $1,000.

To determine the dollar value that can be realised under the proposed cap, we provide the following table. In its simplest form, we have applied 48% per annum to several sample loans without complicating the calculation with any fees or repayments (except at the end of the term). Under these simplified conditions, Table 1.1 details the maximum revenue that a lender could earn in each case.

Table 1.1

Amount of Loan	Term in Months	Total $ payable in Interest at 48% p.a.
$100	1	$4
$250	1	$10
$500	3	$60
$750	3	$90
$1,000	6	$240
$1,500	6	$360
$2,000	6	$480
$2,500	9	$900
$3,000	9	$1,080

Table 1.1 does not represent any practical degree of reality when it comes to lending in real life. Reputable lenders in our industries' sector of consumer credit do not offer interest only loans. In the past, these loans have been heavily criticised when 'loan sharks' offered them as they promoted an inescapable debt spiral for consumers. Finding themselves at the end of the term of the loan, borrowers were not able to afford to repay the principal and were forced to refinance, or 'roll over', the loan. Accordingly, it is incorrect to apply the figures in this table to any real world situation.

Instead, principal and interest reduction payments that allow total discharge over term is the best practise when it comes to the maintenance of consumer credit loans, and are the accepted conduct industry wide. Table 1.2 shows the same loans as those detailed in Table 1.1, but this time regular weekly repayments are

included to reduce the balance of the loan to zero at the end of the term. From this we see that the total amount of interest changes greatly.

Table 1.2

Amount of Loan	Term in Months	Repayment per Week (at 48% p.a.)	Total Repayments	Total $ payable in Interest at 48% p.a.
$100	1	$25.56	$102.23	$2.23
$250	1	$63.90	$255.57	$5.57
$500	3	$40.92	$531.87	$31.87
$750	3	$61.38	$797.80	$47.80
$1,000	6	$43.33	$1,126.33	$126.33
$1,500	6	$64.99	$1,689.51	$189.51
$2,000	6	$86.65	$2,252.69	$252.69
$2,500	9	$76.35	$2,977.20	$477.20
$3,000	9	$91.61	$3,572.72	$572.72

Table 1.2 shows us that on an interest reducing balance (created by the repayments), the return on each loan becomes almost half of that shown in Table 1.1.

Further to showing the dollar figure return per loan, we can take that information and show the gross rates of return to the lender for each loan when calculated under the proposed cap. Table 1.3 shows this in detail.

Table 1.3

Amount of Loan (A)	Realised Amount from Table 1.2 (B)	Dollars earned per $100 invested (C) – (B/A)*100	Percentage return on investment per annum – C/Term*12 months
$100	$2.23	$2.23	26.76% p.a.
$250	$5.57	$2.23	26.76% p.a.
$500	$31.87	$6.37	25.48% p.a.
$750	$47.80	$6.37	25.48% p.a.
$1,000	$126.33	$12.63	25.26% p.a.
$1,500	$189.51	$12.63	25.26% p.a.
$2,000	$252.69	$12.63	25.26% p.a.
$2,500	$477.20	$19.09	25.45% p.a.
$3,000	$572.72	$19.09	25.45% p.a.

From Table 1.3, we find that the gross return on investment for loans $3,000 and under is in the range of 25.45% to 26.76% gross profit annually.

We compare this level of return to other businesses that operate under similar circumstances. Payday and micro lending are retail service businesses. They operate in a retail environment, providing their products to ultimate end users and predominantly dealing with the general public. They are service providers in the aspect of the service being the use of funds for a period of time.

For this exercise, we consulted *"CCH Benchmarking Classic for Accountants"*, published by CCH Australia, 2005. This extensive document, widely used by accountants when looking at the levels of profitability for businesses, considers data from many different industries. Part of the information derived from the document is a guide to the average net profit percentages that businesses should realise before payment of principals' takings. It is against these benchmarks that businesses measure themselves to determine economy of operation. Table 1.4 shows these benchmarks:

Table 1.4

Business	**Net Profit Percentage Before Payments to Principals**
Architect	28.08%
Consulting Engineer	32.77%
Consulting Surveyor	31.18%
Financial Planner	40.41%
Insurance Broker	38.31%
Legal Practice	36.68%

Table 1.4 shows a range of net profits from 28 to 40%, with an average of 34.57%. In other words, **net** profit should be in the low to mid 30% range. **Gross** profit for payday and micro lenders under the impending cap will be in the mid 20% range (meaning there is no net profit).

Clearly, the government's impending cap will make both payday and micro lending unprofitable, placing their ability to earn far below accepted accounting benchmarks.

Of course, making a reasonable return on the investment of money by a business supposes two factors:

1. That there is a component of effort for return; and
2. That there is a component of risk for return.

Effort for Return

The Consumer Credit Code is a prescriptive document for lenders in terms of how a compliant credit contract must be framed and executed. There are a number of hoops that a lender must "jump through" to ensure that they have created an enforceable contractual arrangement and conducted themselves in

such a way that they are able to legally enforce the arrangement. Added to that, there are a number of other legislative instruments that the lender must comply with as a necessary matter of course. The Consumer Credit Code is a compulsory document for consumer credit, and it is illegal to contract out of its operation.

There are the strict Code requirements in what loan documents must contain. Part 2, Division 1 of the Code sets out what is required to create a valid consumer credit loan contract. Section 20 of the Code states that it is an offence under the Code to produce a non-compliant contract (with a 100 penalty unit fine for contravention). This standard of documentation is the same for any lender, and applies as much to a payday lender as it does to a bank.

The practical effect of this is that a lender must prepare a comprehensive, multi-page, loan contract in each and every circumstance of lending. In addition to this, the documents must originally be sourced from a competent legal practitioner at a significant cost. Changes to the documents to keep them up to date with legislative changes likewise attract expenses for their redrafting. Put succinctly; the ability of a lender to enforce the loan primarily rests on the accuracy of the loan documents.

Lenders must also keep accurate, up to date, records of all transactions on a borrower's account, including interest calculations. Although the Code is not prescriptive in how this must be done, it is necessary for the lender to have sophisticated software to deal with the requirement. Payday and micro lenders have the same level of compliance requirements as banks in this regard, so the software must be extremely accurate and complex. Most lenders cannot afford to create, and maintain, such complex software on their own due to oppressive hardware, programming and upkeep expenses and must obtain these services from a specialist software provider (at an obvious cost).

Even after the core documents and transaction ledgers are created, the way in which the loan is operated is as vitally important to ensuring its legitimacy. Failure to comply with the Code's various requirements in relation to creating, operating and enforcing a loan will lead to its non-enforceability and civil penalty.

The Code has too many references to this type of prescription to reference individually. Staff and operators of the lender must receive detailed training to ensure that they do not breach any of the numerous obligations. In addition to this, even though certain sections of the Code appear to protect lenders by creating offences for borrowers should they do something untoward; the Office of Fair Trading has refused to pursue these offences against borrowers.

For example, one of our members has received correspondence from an OFT compliance officer that they will not pursue a breach of section 47(1) of the Code where a borrower has undisputedly contravened it, citing "this provision is

intended to deter persons who may consider disposing of mortgaged goods without discharging their financial obligations and thereby causing difficulties for an unsuspecting purchaser." It is obvious from this that there is little to no concern given to the rights of lenders, thereby necessitating that the lender have the total onus of enforcing their rights.

The lender must have many operating procedures in place, from even before the borrower makes first contact (eg, the lender must comply with the advertising requirements in the Code, and provide accurate comparison rates schedules).

Because micro and payday lenders have to be more flexible in their loan approvals than more mainstream lenders (the borrowers for this industry generally are inexperienced in presenting a comprehensive loan application), it is largely not possible to have standardised criteria when judging the merits of a finance application.

This means that although basic principles can, and must, be enacted, loans managers must be capable of being greatly adaptive in their practical application. Staff must be sufficiently experienced and knowledgeable to ensure correct decisions are made to avoid lending funds to a person who cannot service a loan. Ensuring and delivering flexible and dynamic service is consuming in time and effort.

Annexure 1 to this document shows a typical checklist of actions a lender undertakes in the application process. Many of these steps are undertaken even if a borrower is not successful in their application. This list shows the standard steps taken every time an application process is commenced. It excepts unusual circumstances. Due to the highly flexible nature of the products that payday and micro lenders provide, this quite often means extra elements must be considered and satisfied.

Aside from just complying with the Code itself, there are many other requirements that lenders must comply with to avoid penalty. These directly include:

- Commonwealth Privacy Act: for the collation, use and reporting of the personal information of the borrower. This is especially important in respect of their credit history, which is accessed to help determine eligibility and affordability of a loan product. Ensuring affordability is a fundamental requirement for ethical lending;
- Commonwealth Anti-Money Laundering and Counter Terrorism Financing Act: information retention and reporting requirements. The requirements under this act, which affect all lenders, require major procedure and structural changes for business; many of which will not have had to deal with this sort of requirement before. Even banks, which have already been dealing with the old regime have had to

expend billions of dollars complying with this legislation (as relayed to us by AUSTRAC). Fulfilling their requirements under this Act will require industry to incur a great deal of cost which they will not be able to pass on to the borrower;

- Queensland Bills of Sale and Other Instruments Act and Motor Vehicles and Boats Securities Act: regarding the taking, processing and enforcing of securities for the loan;
- Queensland Duties Act: for the record retention and paying of stamp duty on dutiable loans;
- Queensland Uniform Civil Procedure Rules: in relation to the court enforcement of loan contracts and securities;
- Commonwealth Corporations Act: in regards to the carriage of operations of a corporate lender;
- Queensland Business Names Act: in regards to the carriage of operations of a non-corporate lender;
- Commonwealth taxation legislation: aside from obvious reasons, due to the heavy transactional nature of the business, massive amounts of bookkeeping and accountancy work is required to reconcile loan accounts; and
- Where lenders make use of direct debit facilities; complying with stringent bank requirements for the qualification, upkeep and maintaining a direct debit licence. This requires stringent procedures and record keeping, and incurs "pay per transaction" fees (which we note, must be included under the cap despite being paid to a third party) and monthly licensing fees.

There are many other laws and rules that a business must indirectly comply with in its operations as well.

Added to these concerns is the cost of the day to day running of a business. Micro lenders and payday lenders are "retail" businesses in that they deal directly with the public in a convenience setting. They must pay retail rents and expenses. Additionally, the Minister has stated there are around 400 lenders in Queensland, which has created a massively competitive industry environment as lenders directly compete for business. Lenders must have increased exposure through physical and advertising coverage to ensure viability.

This is an indication of what an "average" micro lender must pay per annum in operating costs. All costs can be evidenced on request:

Advertising	$ 29,936.00
Bank fees/interest	$ 2,797.33
Banking services	$ 7,800.00
Collection fees	$ 5,869.24
Direct Debit fees	$ 2,722.50

Dishonour fees (bank)	$ 6,696.00
Insurance (bulk)	$ 6,789.00
Legal fees	$ 2,600.00
Rent	$ 19,800.00
Software licensing	$ 13,000.00
Search processing	$ 7,800.00
Telephone	$ 6,969.33
Wages	$ 39,532.00
Total	$152,311.40

These amounts do not include hard costs that the lender must pay in the setup of the loan, such as search fees and stamp duty. It is important to point out, again, that those costs are required to be included in the calculation of the Formula under the impending cap.

Further, it should not be discounted that finance providers are input taxed for GST purposes. This means that they cannot pass on GST to their customers, but must bear the cost of it themselves. Most direct expenses of the office are subject to GST, which means that the lender bears an extra 10% cost over and above what most other businesses pay.

Also, these figures are given for a fully self-funded lender. If a lender must source their lending capital from a third party, the cost of doing so must be added to the above figures.

There has also been discussion over the introduction of mandatory external dispute resolution membership for lenders. The Federation supports this initiative but the Queensland government must be aware that these schemes are costly to join and operate under for lenders. It will no doubt be a requirement that lenders join an ASIC approved scheme, and ASIC is on record as saying they will not approve further schemes in the foreseeable future. The lender must pay all fees of the EDR, and it can cost upwards of $5,000 a year to retain membership. This will further drive down the profitability of industry.

So what does it actually cost to produce a loan? First, we revisit Annexure 1 and see that for every ordinary, uncomplicated loan approval there is an in depth checklist. Completion of all these steps by an experienced staff member takes over an hour. For the sake of this exercise, let's consider that it takes exactly an hour. What does 1 hour of a business' time in hard cost equate to if we boiled it down?:

-	1 hour of rent	$ 9.75
-	1 hour of wages	$ 20.49
-	1 hour of software licensing	$ 6.40

-	1 hour's worth of advertising	$ 14.73
-	1 hour's worth of insurance	$ 3.34
-	7 phone fax/calls for searches and reference checks	$ 1.54
-	1 lot of search processing by agent	$ 10.00
-	1 lot of bank transfer processing by agent	$ 10.00
-	1 credit file search	$ 4.14
-	1 REVS encumbrance search	$ 12.27
-	1 REVS encumbrance registration	$ 9.63
-	Stamp duty on $1,000 loan	$ 4.00
	INTERIM TOTAL	**$106.29**

However, the expenditure does not end there. On a 6 month loan, with weekly repayments there are 26 payments to track, receipt and transact. This involves further cost and time:

-	1 hour of wages (25 normal payments, 1 final payment)	$ 20.49
-	26 lots of $0.99 DDR processing agent's fees	$ 25.74
	TOTAL EXPENDITURE	**$152.52**

The figures given here are a very generalised simplification of the costs of establishing a loan. They do not take into account any more than a fraction of the true costs involved. They do not factor in the cost of setting up an office, buying and maintaining computers and office equipment, electricity, rent, delinquent payments, bank fees and interest, risk, due diligence, profit, tax and so on. They also do not take into account the amount of work performed on applications that are declined, which is a major cost to business. As shown above, even without these real costs, the simplified figure for establishing a loan is over $150 per hour.

Under the proposed cap a $1,000 loan over 6 months will enable a lender to generate a maximum gross return of $126.33. That's a loss of $26.19 per hour just on the figures given above. In the spirit of the APR, that equates to losing over $53,000 per year while the doors are open. The true losses will be much higher. No business can run under these conditions, and clearly demonstrates that industry cannot be run under a 48% all inclusive cap.

Risk for Return

The other side of the return equation is the risk that a lender must bear in marketing their product. A fundamental business principle is that increased risk should equal increased return. Lenders often face a unique risk in relation to other businesses in that they must bear their risk over time, without choice.

All businesses experience the same risk in the ability to sell their product, they all rely on a third party purchasing their good or service. If it is not purchased to a sufficient level, then their business will fail.

Lenders face the additional risk in that their entire product is paid for in arrears over time. It is often remarked that lending the money is the minor part of the business; the major part is ensuring that it is paid back.

Micro and payday lenders are two of the few types of lenders that will lend to borrowers with past and existing credit problems (whether it be current defaults or discharged bankruptcies). This obviously incurs an increased risk for these lenders as the borrowers have already showed a propensity to dishonour their financial obligations.

When borrowers dishonour these obligations, micro and payday lenders are restricted in their ability to recover funds. It should be noted that this is a practical restriction, not a theoretical one. In theory, these lenders have the same ability to enforce credit contracts as any other lenders. However, in these cases, there are practical constraints that make it difficult.

The first of these is that people who intentionally or ambivalently default on loans are more prevalent in this sector of the finance industry. They tend to gravitate toward the lower end of the market and make up a more significant proportion of the available borrower market than in mainstream lending. This leads to a potentially higher default rate for payday and micro lenders, and recovery costs.

Our industries' borrowers are more likely to change residence than those of larger financial institutions. This is because our borrowers are more likely to be renters than home owners, and larger financial institutions usually do not lend to people who cannot show reasonable longevity at one or two places of residence. This means that our members run a greater risk of their borrowers relocating themselves without informing their lender. It is impossible to enforce a loan contract against someone that cannot be found. Lenders must expend time and money to locate a missing debtor before being able to enforce the loan.

The security taken for our members' loans, when security is taken, is of a more 'fragile' nature than most other forms. Usually, security is taken over older motor vehicles and personal items of lesser value. These goods generally depreciate at a faster rate, are capable of being relocated (hidden) easily and are difficult to sell for a figure representing their true value. This is in comparison to newer vehicles and real estate, which is generally taken by larger mainstream lenders for consumer credit. New vehicles hold their values better than older cars, and are generally better maintained. Real

estate is seen as very secure in that it is intransient and generally appreciates in value.

The ultimate mode of recovering money under a loan contract when all else fails is action through the courts. However, this rarely gains anything for lenders but more time and expense. Borrowers generally do not have sufficient liquidity or asset backing to discharge any judgment made against them.

Micro and payday lenders face a substantial risk in their business operation; through the very nature of their product, the people they are lending to and impracticalities of recovering their return should the borrower fail to fulfil their obligations.

There is a misconception that direct debit request facilities are a "good form of security" for debts. This is untrue, as DDRs can easily be cancelled by borrowers simply by contacting their bank. Once cancelled, they are extremely hard to reinstate, even with the borrower's permission. The assertion that they help secure a lender's debt is mistaken. Rather, they are convenience tools to assist in the making of repayments.

So, is 48% per annum, including all interest charges, credit fees and credit charges (as provided for under sections 2(1) and 2(3) of the Regulation) fair and reasonable to consumers and lenders?

From the information given above, we can see that the average micro and payday loans will give a maximum return of the following amounts under the proposed cap:

Average payday loan: $250 **Return as per Table 1.2**: $5.57 in 1 month
Average micro loan: $1,000 **Return as per Table 1.2**: $126.33 in 6 months

These products will give a gross return of 26.76% p.a. and 25.26% p.a., respectively, as shown in Table 1.3 (and zero net return). Acceptable net returns are around 34% for retail service businesses. When maximum achievable gross return is still between 7 – 8% below accepted net returns, the business is clearly unviable.

No arguments will be made that the amounts payable by consumers for the exampled loans under the impending cap are unreasonable. These are obviously extremely low prices for consumers to pay for a retail product, especially when compared to the rates that they pay for other retail products.

From these meagre gross returns the lender must bear all the risk of the loan, produce a Code compliant loan, pay all the expenses of running their office

and turn a profit. On the above figures, it is hard to satisfy any one of these factors: all four is impossible.

The Victorian government's *"The Report of the Consumer Credit Review"* gives credence to this at page 108:

"It is simplistic to argue that because a small amount fixed term loan is more expensive in terms of interest (or in terms of fees and charges as a proportion of the amount borrowed) than its mainstream equivalent, it is ethically and socially objectionable and ought to be unlawful. For one thing, the cost might reflect the provider's underlying costs; and for another, it might reflect risk."

Accordingly, 48% per annum, including all interest charges, credit fees and credit charges is not fair and reasonable to lenders, and this part of the policy objective is failed.

Element 2 - Vulnerable Consumers

Executive Summary

a) Lenders do not create vulnerable consumers, consumers' circumstances do;
b) Industry operation alleviates consumer vulnerability and detriment;
c) Other classes of lender cannot adequately substitute for payday and micro lenders; and
d) Absence of payday and micro lenders will increase consumer vulnerability.

What exactly is a "vulnerable consumer"? The Government gives no specific definition, so we will use the statement that vulnerable consumers form those people that "have low incomes, poor credit histories, and/or are already in financial difficulties" as referenced in "*High Cost Loans A Case for Setting Maximum Interest Rates?*" by Nicola Howell, August 2005.

There is a presumption outside of industry that these consumers form the bulk of borrowers from payday and micro lenders. This presumption is incorrect. The Australian Financial Services Association, cited in the "*The Report of the Consumer Credit Review*" from Victoria in 2006, stated:

" 70% of micro-borrowers in Victoria are not socio-economically disadvantaged. They have substantial and continuing employment and are not borrowing in circumstances of desperation. Rather, they borrow as a matter of convenience because they have temporarily failed to budget for a current need and/or because they prefer to utilise micro-lender's services, rather than continue with, or attempt to acquire bank-provided credit cards."

All borrowers are potentially vulnerable, depending on how wide the net is cast. One viewpoint could be that the simple act of having to go to a lender to borrow money is an act of vulnerability, because it shows the person is not able to immediately satisfy their wants and needs without assistance. Taking that level of definition is extreme in today's society; most people would find it impossible to immediately bear the cost of all their requirements without some form of financial accommodation.

Another view is to determine that they are "vulnerable" because of their immediate social and economic circumstances, and making a judgment on how those circumstances classify them. This submission cannot conclusively answer the issue. It is apparent that the policy objectives have not clearly defined it either.

Clearly, at least a proportion of the customers of the payday and micro lending industries fall into this category; whatever the cause. It is also clear that they suffered these circumstances before ever engaging the services of a payday or micro lender. Lenders do not create the detrimental circumstances. If anything, they are a visible symptom that the detriment exists. The same can also be said of other "symptoms": charities, social welfare, financial counselors and mainstream lending institutions. Like payday and micro lenders, they also exist to ease the detriment by providing their services.

These arguments aside, international research has shown that the availability of payday and micro type products actively function to alleviate problems for vulnerable consumers.

In his paper entitled *"Payday Lenders: Heroes and Villains"* (2006), Adair Morse from the University of Michigan studied the effect of this type of lending on people's welfare where they are subjected to various forms of natural disaster, and then comparing key indicators in the aftermath of these occurrences. What he found was that in areas where payday lending was available, the outcomes for each indicator were more positive than for areas where payday lending was not available. He also found that different types of financial institutions cannot substitute for each other; banks cannot provide the welfare increasing services that payday lenders provide.

Likewise, the Ministry of Consumer Affairs in New Zealand, in their report *"Pacific Consumers' Behaviour and Experience in Credit Markets, with Particular Reference to the 'Fringe Lending' Market"* (August 2007), looked at the effects of "fringe credit" on people in New Zealand with Pacific heritage. It was identified that social commitments with respect to family ties can place great financial burdens on these people.

The Ministry, in its conclusion, recognised that "*payday lenders and fringe credit providers play an important role in lending for unforeseen financial difficulty such as funeral expense or illness (or lending to consumers who have difficulty in borrowing from mainstream banking institutions)."*

The report went on to specifically recognise the interest rate caps in place in various Australian jurisdictions and reject these as being undesirable. Concern was expressed that capping would encourage lenders to go underground and deny consumers the protection of the law. Without going as far as actually saying so, it could be postulated that placing caps on interest rates would increase the vulnerability of consumers.

Payday and micro lenders do not, of themselves, contribute to the vulnerability of consumers. Rather, consumers' own circumstances and actions have already brought about that state.

Many consumers can, and do, correctly use the services these lenders provide in a positive manner. But, when used incorrectly, the same as any other financial product, these loans can increase the detriment of consumers. However, this is not the fault of the lender; especially when legitimate members of the industry go to great pains to ensure the serviceability and suitability of their products with consumers. Payday and micro credit products increase the welfare of consumers when used correctly, thereby alleviating vulnerability.

Element 3 - Exploitation by Unfairly High Interest Rates

Executive Summary

a) Percentage is not an accurate measure of cost;
b) Code requirements create an unfairly negative perception of payday and micro lenders;
c) Misunderstanding of the practical application of caps is prevalent; and
d) Mainstream lenders and payday and micro lenders share governing legislation, but have little else in common.

The term "unfairly high interest rates" has yet to be clarified to any degree. However, given the proposed cap, it would be safe to assume that the Queensland government assumes that an interest rate greater than 48% per annum is "unfairly high" (forgetting for the moment that fees and charges must be included in that 48% under the proposed cap, thereby meaning that the allowable interest rate is significantly less than 48).

However, as stated under Element 1, the correct question that should be asked is "48% per annum of what?".

It is unethical and unfair to state that an interest rate is "unfairly high" without referencing it back to actual figures. Otherwise, it has absolutely no relevancy. This is easily proven by the following:

An annualised interest rate of 365% seems unfairly high compared to the average home loan rate of around 9%. However, what if, in reality, the loan is for $100 for 1 day, repaying a total of $101 (giving $1 interest)? This is, according to the Consumer Credit Code, 365% per annum. The only reason it seems unfairly high is because of the legislative requirement. In reality, it is a $1 charge.

It is not until you relate a percentage rate to an actual number that you can determine whether it is "unfair" or not. Otherwise, you're seeking to determine the answer based on looking at half of a set of facts.

The Consumer Credit Code requires that interest rates be quoted as "per annum" figures (section 15(C)). This is prejudicial against the products of the micro and payday industries as they do not offer loans on a "per annum" basis. Their terms revolve around days, weeks and months.

The Code was written with banks' products in view, not the products of the members of the Federation and their contemporaries. This is something that is readily apparent from the numerous changes that have been made to the

Code and enacted regulations solely aimed at dealing with our industries. If the Code had been drafted with an understanding of payday and micro lending then it would not have been necessary to create patches for the legislation.

It has been argued that annual percentage rates are the established norm for the finance industry. This is not true and simply glosses over the actual truth. It is only considered to be that way because the vast prevalence of banking financial products in the marketplace has created this culture. The reality is that the products of payday and micro lenders bear little to no relation to the products put out by banks, and exist in a separate industry. Therefore, despite being administered by the same Code, micro and payday loans should not be lumped in with bank products. In terms of length of term, they have more in common with pawnbroking loans. Pawnbrokers are not required to state an annual percentage rate on their loans under their governing act (Second Hand Dealers and Pawnbrokers Act (Qld)).

Micro and payday lenders are required to annualise their charges by the Code. This usually means that payday lenders must multiply their charge rates by 52 (for weeks) and micro lenders must multiply their charge rates by 12 (for months). All this succeeds in doing is presenting a skewed, inflated figure that does not bear any relevancy to the amounts of money actually involved.

Neither payday lenders nor micro lenders earn these inflated rates because their loans do not run for 1 year, let alone a multiple of that. All that is served by inflating these figures is to provide an angle for media and consumer groups to bash lenders with scary percentage rates, and for government to claim "unfairly high rates".

To illustrate this in Table format:

Table 3.1

Amount of Loan	**Term in Months**	**Figurative Amount Earned at 48%**	**Real Amount Earned at 48% p.a. (as per Table 1.2)**
$100	1	$48	$2.23
$250	1	$120	$5.57
$500	3	$240	$31.87
$750	3	$360	$47.80
$1,000	6	$480	$126.33
$1,500	6	$720	$189.51
$2,000	6	$960	$252.69
$2,500	9	$1,200	$477.20
$3,000	9	$1,440	$572.72

There is a vast difference between columns 3 and 4 in Table 3.1. It is a prevalent misconception that the rates shown under the third column will be realisable by lenders under the proposed cap. This is patently not true on the construction of the Code, and the difference between the two rates of return is up to a factor of over 21.

If there is any derision of the claim that it is a prevalent error, the reader is referred to an often quoted statement made by the New South Wales Fair Trading Minister's Chief of Staff, in the lead up to the introduction of that state's 48% cap, when he stated that he thought 48% per annum meant that you could lend $100 for a month and get back $148.

This is not the way the cap works, but this mistaken understanding persists.

To further illustrate the absurdity of labeling the rates charged by micro and payday lenders as unfairly high, it is relevant to look more closely at the correlation between these lenders and the lenders whose rates they are often compared to. For this purpose, we should look at the average rates and returns of various mainstream lenders and those provided by our members.

We compare a payday loan product (from a Federation member), two different types of micro loan product (both from Federation members), a standard car loan from a mainstream lender (Esanda) and a standard home loan from a bank (Commonwealth Bank). All the rates and fees information from Esanda and Commonwealth are easily discoverable from their respective websites.

Table 3.2

Product	Principal	Est. Fee	A.P.R.	Term	Repayment	Total Repaid	Return %
Payday	$250	$105.04	0%	1	$88.76/wk	$355.04	42.02%
Micro loan 1	$1,000	$50	240%	6	$65.00/wk	$1,677.36	67.74%
Micro loan 2	$1,000	$350	43%	9	$43.64/wk	$1,571.29	57.13%
Esanda car loan	$15,000	$250	11.28%	60	$328.23/mth	$19,943.80	32.96%
C.B.A. Home Loan	$350,000	$450	8.57%	360	$2,709/mth	$977,867.00	179.39%

In Table 3.2:

- Est. Fee = the establishment fee charged by the lender. In respect of the car loan from Esanda it includes a $5 per month account keeping fee, and in respect of the home loan from Commonwealth, includes an $8 per month account keeping fee. None of the other loans have account keeping fees;
- Term = term of the loan in months;
- A.P.R. = the annualised percentage rate as required under the Consumer Credit Code; and
- Return % = the percentage in gross profit that the lender makes on their investment, expressed as being ((Total Repaid/Principal)% - 100).

The pertinent columns to be looked at here are the "A.P.R" column and the "Return %" column. First, it is obvious that the establishment fee must be included with the APR to determine a true rate (evidenced by the compulsory comparison rate). The payday loan does not charge interest as such, but instead charges fees. The micro loans use two different models; a high interest/low fees model and a high fees/low interest model. Both of these are prevalent in the industry and cater to different types of customers.

This, however, is largely irrelevant when you consider the fact that the three types of loans with the highest APRs do not, by far, have the highest rate of return to the lender. Instead, that belongs to the home loan that is almost three times higher than the next nearest lender. This is despite the home loan having the lowest APR at 8.57%.

All of this doesn't take into account the degree of risk involved in the transaction, either. Statistically, home loan lending is far safer than the lending engaged in by the micro and payday industries. Is this an argument that banks should lower their rates? Possibly. However, it is more importantly an argument that it is unfair to label micro and payday loans' APRs as "unfairly high" when they do not come anywhere close to approaching the rates of return enjoyed by the average bank loan.

If you took the highest APR and the lowest APR and questioned the average person in the street, it would be a safe assumption to draw that they would consider 240% to be "unfairly high" and 8.57% to be "relatively acceptable". However, if you instead informed them of the figures from the "Return %" column, you would find a different response.

Table 3.2 shows that it is not the rates being charged by lenders in our industry that are unfairly high, but rather they are the victims of perception through poorly constructed and biased forms of expression. The Return % is referenced back to actual figures and gives a much truer picture of the cost of a loan; far superior to simply quoting an APR (as is the current requirement).

The Federation has recommended to the Queensland government, on numerous occasions, and at least once directly at the Minister's request, that the relevant type of cap to introduce under the Consumer Credit Code is a "total cost of credit" cap. It is the only form of cap that places a restriction of the total dollar value of a loan. This notion will be discussed further under the heading "Protection from 'Debt Spirals'".

Element 4 - Exploitation by Excessive Fees and Charges

Executive Summary

a) Lenders will be required to include third party fees under the proposed cap;
b) Short term lenders incur similar expenses for establishing loans, but cannot amortise over longer terms like mainstream lenders;
c) Caps in other jurisdictions have forced lenders to find loopholes to remain viable; and
d) ADIs charge fees exceeding comparable payday and micro lender charges, but ADIs are exempted from the Code for these.

Consumers already have a degree of protection under the Consumer Credit Code when it comes to fees and charges. Section 72 contains provisions that allow unconscionable fees and charges to be challenged, and overturned. A draft bill to change the Code will further change this to be more prescriptive in the range of fess and charges it refers to, and change the test from unconscionable to unreasonable. This is a significantly lower burden of proof.

That being said, and in similar ways to the notion of “unfairly high interest rates”, the government has not given any indication of what is considered to be “excessive fees and charges”.

It is a common notion that fees and charges should not be profit driven: a lender should derive its profit from the interest component of the loan and that the other fees and charges should be on a cost recovery basis only. This was challenged and rejected for the purposes of the Code by the Victorian Consumer Affairs Tribunal in _Director of Consumer Affairs Victoria v City Finance Loans_ *(2006) ASC 155-080; [2005] VCAT 1989*. Morris P stated in his decision that he was unable to discern an intention in the Code that profit could only be earned from interest and that fees could only be levied to recover costs. There was an acknowledgment that this does not allow a fee to breach the unconscionability test.

Whether the argument on the validity of a profit component to fees is accepted or rejected, it is readily accepted that the fees and charges applied to a credit contract are directly related to certain attendant tasks to the operation of the loan. Examples of fees and charges include establishment fees, registration fees, stamp duty, default fees and early repayment fees. These are broadly broken down into fees attributable to charges by third parties and fees attributable to actions performed by the lender.

Fees attributable to third parties are generally not called into question because of two operations:

- the understanding that fees charged by independent third parties are to be of an acceptable commercial quantum; and
- section 30 of the Code requires that these fees are not to exceed the actual amount payable (although the lender may "value add" to the service, which has been held legitimate – *Kontaxis v Hondros* *[2002] NSWCTT 752*).

Therefore, it is fees that are directly attributable to the provision of services by the lender that require discussion here (and the "value add" portion of third party fees). The Federation notes that under the Regulation fees and charges that the lender has absolutely no control over and does not receive (i.e. the third party charges) must be included in the calculation of the 48% p.a. all-inclusive cap under the Formula. This places extra pressure on the lender's ability to remain viable.

It is important to restate that all lenders whose contracts operate under the provisions of the Consumer Credit Code are required to comply with the same provisions. There is one exception to this in the form of specified products of authorised deposit-taking institutions (ADIs). This exemption is borne out in the proposed Regulation in section 2(4), where certain fees and charges for ADIs are exempted from having to comply with the proposed cap.

Whether the lender is a payday lender or a bank, they are required to produce the same standard of documents, follow the same processes, and enforce their contracts to the same standard. Their record keeping and electronic systems must be similarly robust and extensive. It necessarily follows, as well, that their level of accountability is the same.

Let's look, again, at the financial products discussed in element 3 and detailed in Table 3.2 (reproduced here):

(Table 3.2)

Product	**Principal**	**Est. Fee**	**A.P.R.**	**Term**	**Repayment**	**Total Repaid**	**Return %**
Payday	$250	$105.04	0%	1	$88.76/wk	$355.04	42.02%
Micro loan 1	$1,000	$50	240%	6	$65.00/wk	$1,677.36	67.74%
Micro loan 2	$1,000	$350	43%	9	$43.64/wk	$1,571.29	57.13%
Esanda car loan	$15,000	$250	11.28%	60	$328.23/mth	$19,943.80	32.96%
C.B.A. Home Loan	$350,000	$450 to $600	8.57%	360	$2,709/mth	$977,867.00	179.39%

The table shows a range of products that must all meet the same high standards as required by the Consumer Credit Code. However, there is a wide degree of diversity in charges. This table excepts such things as mortgage insurance, which banks often require to be paid by the borrower (and usually on the most 'vulnerable' of consumers). This insurance can cost thousands of dollars and protect the bank's investment, significantly reducing its risk, without providing any benefit for the borrower.

The Payday loan and Micro loan number 1 both have low dollar value establishment fees. The Payday loan's fee includes its total profit component for the loan and bears out the philosophy that it is a fixed fee type of lending, which does not relate to term. Micro loan number 1 has an artificially low establishment fee that does not represent the true work undertaken to establish the loan. Instead, the lender chooses to recoup part of its cost of establishing the loan as the interest component. The truth of this statement is evidenced in that this is the loan type provided by the primary author of this document, who testifies as to the correctness of the statement.

The other three loans have establishment fees ranging from $250 - $600. These more adequately reflect the true costs of establishing a consumer credit code compliant loan. In Element 1 we looked at a rough guide of what hard costs a business endures to create a loan. This did not consider all circumstances and expenses that a business must incur, nor did it give any recognition to cost recovery that all businesses undertake for work done without reward. Applications that are made but subsequently declined incur expended time, effort and expense for the lender without recompense as many lenders in our industries operate on a "no loan, no fee" basis.

The lender also takes on a significant part of the risk of the loan at this time in that an incorrectly dealt with application creates a fundamentally flawed credit product. The amount and quality of due diligence required at this stage is crucial as errors here are both costly and nigh impossible to rectify after the fact.

From these considerations, it could not be considered that this range of establishment fees is excessive. Rather, they are directly representative of the fair costs of providing a loan compliant with the Consumer Credit Code.

This causes a problem in that the Regulation requires certain fees (including establishment fees) to be included in the calculation to derive a percentage rate that must be under 48% per annum. Take the average establishment fee of $350 from the above loans, and apply that to the average micro loan of $1,000 over 6 months. Do not charge any interest rate at all (in other words, the only charge is the establishment fee). By the terms of the Formula contained in the Regulation, an answer of 123.36% is derived. This is clearly

in excess of 48%, despite the relevant authorities stating that it is a fair quantum of fees. We invite the Office of Fair Trading to do the same calculation and then answer the question, “How is 48% a fair maximum rate of return when the decided fair rate of return for an establishment fee already exceeds this rate?”

The reason why the Esanda and C.B.A. loans will not run afoul of the impending cap with their establishment fees is because they are able to amortise the establishment fee over the longer term of their loans, and the higher principal. It’s not that the dollar cost is any less, or that they’ve done more work to establish the loan. Rather, they have a greater spread of time over which to break up the charge, and a greater principal in which to disburse the cost (each dollar of principal has to bear less of the proportionate cost of the fee). Correspondingly, payday and micro lenders must perform similar amounts of work but have much shorter amounts of time, and smaller principal, to spread that cost recovery over. To add insult to injury, because their terms are less than a year, they must multiply the effects of the charge out to render them on an annual basis, giving an incorrect picture of the true cost.

In addition, the Formula in the Regulation requires that outside fees be included in the calculation. These are fees that the lender has no control over, and include searches, duties and registrations that a prudent lender would undertake in the necessary course of business. By this operation, the Formula requires that a lender further devalue their ability to make profit by being good corporate citizens.

To illustrate this, consider the following. A lender provides a loan of $500 for 1 month. As part of the establishment process, they undertake a search of the applicant’s credit file and perform a search on the applicant’s motor vehicle that is being offered as security. Immediately after settlement of the loan, the lender registers their interest in the motor vehicle and pays stamp duty under the Duties Act on the loan. These are four basic, prudent actions.

These cost (factoring in bulk discount to the lender where applicable):

Table 4.1

Action	Price
Search of credit file	$4.14
Search of REVS encumbrance	$12.27
Registration of REVS encumbrance	$9.63
Stamp Duty	$2.00

Without factoring in regular repayments, the maximum amount that may be earned for a $500 loan for 1 month is $20 ($500 x 48%, divided by 12). The

amount of these third party costs is $28.04. Simply, not only could the lender not earn a cent, they would have to pay for the privilege of providing the loan.

It could be postulated that the loan should not be secured. However, it should be noted that government has looked at this issue a number of times and has not made any such decision. The lender also incurs greater risk for unsecured loans.

Even with the costs associated with the security gone, simply doing the proper due diligence and searching a credit file eats up over 20% of the lender's maximum gross profit. When you factor in that loans such as this require regular repayments and the lender will earn less than $20 (in fact, having a gross return of around $11.16), simply performing the search eats up 37% of the gross return.

This makes the question, asked a few paragraphs earlier, of "Is 48% a fair maximum rate of return?" even more significant when it creates a situation where a lender cannot even pay a third party for necessary services.

The other side of the argument to look at is whether a situation that removes payday and micro lending from the marketplace (as the Federation asserts that the impending cap will do – see Element 1 for further details) will result in consumers paying less for their finance.

This is impossible to determine in Australia at this point in time. The only states that have implemented similar caps to the proposed Queensland one (NSW and ACT) have not closed loopholes that restrict lenders from operating. Instead, lenders in these jurisdictions either went to a promissory notes arrangement or tiered brokering. It was identified by lenders that these two options allowed them to retain commercial viability. The often repeated assertion by government that the 48% all inclusive cap is working in other states is erroneous, as lenders sought to circumvent to Code. The outcome of this is that the consumer loses a degree of protection.

The promissory notes exemption was cancelled by the operation of Consumer Credit (Bill Facilities) Amendment Regulation (No. 1) 2007, which came into effect in late November 2007. Lenders in NSW and ACT have, from anecdotal evidence passed to the Federation, either closed or moved to the tiered brokering model. This is expected to be wiped out in the near future with draft amendments to the Code being currently debated.

With no evidence of Australian consumers paying less for finance under a 48% all-inclusive cap regime, we have instead looked at research conducted abroad that has considered this issue in detail. In November, 2007, the Federal Reserve Bank of New York published a paper entitled *"Payday Holiday: How Households Fare after Payday Credit Bans"*. This paper looks

at the effects of banning payday lending, specifically in the states of Georgia and North Carolina. These states blanket banned payday lending in 2004 and 2005, respectively. The Federation maintains that the effects of the impending cap will amount to banning the lenders from operating, as they will not be able to earn enough to remain commercially viable.

One of the specific issues looked at by the Federal Reserve Bank of New York was how much households paid for their credit, pre and post ban. It considered how much American borrowers paid for pay day loans, and then correlated those figures against the charges they incurred through the banking system after the bans were put in place.

American banks offer what is called “bounce protection” which protects against cheques being dishonoured. This is directly similar to the overdraw and reference fees that Australian banks charge. The amount is roughly similar too, with American banks charging around US$30 and Australian banks charging between $35 and $50. Further, the fees charged by Australian banks for overdrawing accounts are protected under the Code by exemption. If they were subjected to the Code, it would be readily seen that their APR is up to 1,825,000% ($1 overdrawn for 1 day, at $50 bank fee: $1 x 5,000% to get to $50. 5,000% x 365 days to derive an APR of 1,825,000%).

The report finds that after the ban in Georgia was placed, consumers paid an extra $36 million dollars per year in bounced cheque fees. Preliminary results in North Carolina were remarked to be very similar. The number of returned cheques in Georgia rose 5% per 1,000 cheques above the national standard to the end of 2006 after the bans were instituted. North Carolina rose 4% (and in only half the time).

The United States’ Center for Responsible Lending projected that the bans would save households in Georgia US$154 million per year. Rather than this, the Federal Reserve Bank of New York concluded that instead of saving them this amount of money, Georgian households incurred the cost of millions of dollars per year in returned cheque fees.

The report goes on to conclude that credit under payday loans is cheaper than incurring bank fees (which are protected under the Code). Consumers in the researched American states faced even costlier credit after the bans were instituted.

Does the Formula operate to protect consumers from exploitation by excessive fees and charges? No. The reasons for this are threefold:

1. The Formula makes it impossible for small principal lenders to maintain a viable business. Community and charity based, not for profit, lenders cannot cope with the levels of demand for finance. This means that

borrowers will either have to do without, source non-compliant lenders (ie illegal) or take on credit products that do not suit their needs. Doing without will save them from fees and charges, but this is a "bullet for a headache" solution. Non-compliant lenders will more than likely charge extortionate fees and conditions on their loans, so consumers are not protected in the least. Finally, credit products that do not suit the consumers needs will be structured in a manner that may incur fees and charges that exceed amount consumers would reasonably pay for a product that does suit their needs. By definition, this is excessive fees and charges;

2. The mechanism in the Consumer Credit Code Amendment Bill 2007 to bring in the reasonableness test will protect consumers from excessive fees and charges. But this is not the instrument that we are considering here, and the Bill and Regulation under consideration can derive none of the credit;

3. The Formula will only constrain lenders that operate in the short term, small principal market because of the very nature of its deficiencies (discussed at various points in this document). It is very clear that this is the intended nature of the construct. The price restraint will not affect primary market lenders, such as banks. It is also enshrined in the legislation that the products of such lenders are exempted from having to comply. The Bill and Regulation provide no protection for consumers from excessive fees and charges in this regard; and

4. Consumers will pay more for their credit, by incurring excessive bank fees. These fees are protected by the operation of the Code. Section 2(4) of the Regulation clearly provides this.

Element 5 - Fundamental Rights to Access Suitable Finance Models

Executive Summary

a) Consumers have a fundamental right to suitable financial accommodation;
b) Mainstream lenders and pawnbrokers do not, and will not, cater to the payday and micro lending market;
c) Forcing consumers to take unsuitable financial products causes detriment; and
d) Consumers can often be excluded from mainstream lending.

If a consumer is unable to find sufficient financial accommodation to suit their needs, it is likely to be a major source of stress for them.

Many consumer rights advocates maintain that people have a fundamental right to access credit. This is a view that our members share. We take this further to include the term "suitable". Suitability relates to both the characteristics of the financial accommodation itself, and to the peculiarities of the borrower. The suitability of a financial product is almost as important as the availability itself. When a consumer is forced into taking up a financial product that does not suit their circumstances, they are especially vulnerable to falling into delinquency. This is a key concern for consumers, government and industry as a delinquent account causes trouble for all concerned.

The Federation's concern in this element is that the operation of the Bill and Regulation will remove the availability of suitable financial models for a sector of the market. Our members provide finance models from the range of $100 to $5,000, being the market below that provided by more mainstream lenders.

From a survey done of mainstream lenders' websites, we found that the minimum loan advertised was $3,000, with most lenders (including banks) having a minimum loan amount of $5,000. As discussed in Element 1, the average payday loan amount is $250 and the average micro loan amount is $1,000. No mainstream lenders had financial products advertised that catered for loans of these amounts. The simple answer to why mainstream lenders do not offer products this low is that they are unable to make an economic return on them (which these lenders readily admit).

Pawnbrokers do cater for smaller consumer loans in the market. The amounts able to be borrowed under these models directly relate to the value of the pledge. Because of the operation of the Code, and the nature of pawnbroking loans, pawnbrokers must restrict their loans in their terms and

amounts of principal. The problem here is that for a borrower to be able to access any more than a couple of hundred dollars for a pawn loan, they must be able to part with possession of an item with a large value (to be taken as the pledge). This is often not a desirable thing for a consumer to do, assuming it is possible.

This demonstrates that payday and micro lenders operate in a niche that exists between pawnbroking and mainstream lending. This niche is not occupied by any other legitimate class of lender.

Requiring a consumer to access a quantum of finance that is too little or too much with regard to the need for funding creates problems. If the borrower cannot obtain enough funds then their need for finance is not met. If the finance is their only source to satisfy the purpose of the loan, then they will have to go without. If a borrower can only source finance that provides them with too much funding, this creates an ethical problem. Higher principal loans mean higher repayment amounts, and surplus loan funds may cause consumers to be tempted into expenditure on frivolous items. If a consumer's only choice is to borrow amounts beyond their reasonable needs because of a restriction of available products, this is a direct course into over indebtedness. Even if consumers are able to access these products in the first place, they often come into trouble as the financial model is not created to suit their needs.

Another problem experienced, notably when finance is applied for at a mainstream lender, is credit exclusion. Major mainstream lenders are restrictive in their appraisals of finance applications. Consumers may find that any number of factors can lead to their application being declined.

Past and current credit problems are the leading factor in this. Whether or not a bankruptcy or payment default is current or discharged can often have little difference, and people find that while these transgressions are current on their credit file it can be extremely difficult to overcome. Past this, many lenders will ask if an applicant has ever had any such problems. To answer incorrectly can amount to an offence of fraud. So, even when these issues finally drop off a consumer's credit file, they can, and do, still continue to have effect.

A consumer can have a very clean credit history and still run into problems; by not having enough of a credit history. Mainstream lenders often want to see that a borrower has been able to successfully obtain and discharge credit contracts. If a consumer does not have a sufficient history of credit applications on their file, this can be looked at negatively. In other words, if a consumer has been "good" enough to not need finance in the past, this can be a big negative for them.

Recently, our members have been providing us with anecdotes of mainstream lenders discriminating against their borrowers. Many borrowers use payday and micro lenders as a means to re-establish their credit rating; in effect using them as a step up to the types of products provided by banks. Being prudent lenders, our members update and maintain their borrowers' credit files with respect to their loan accounts. Unfortunately, it has become evident that some banks have rejected what would otherwise appear as satisfactory applications on the basis that the credit file has shown the applicant has borrowed money from a payday or micro lender.

There is no contemporary research undertaken in Australia that explores the effects of denying suitable financial products for consumers. To date, there have been available mechanisms to enable consumers to access financial accommodation at most levels (Code compliant, or not).

Internationally. a major study was undertaken in 2004 by the United Kingdom's Department of Trade and Industry, entitled *"The Effect of Interest Rate Controls in Other Countries"*. This report looked at several foreign markets, and the effects that interest rate caps had in a broad sense. Specifically, it looked at France and Germany.

It should be noted, first and foremost, that the caps that exist in France and Germany are not as restrictive as that to be implemented by the Bill and Regulation. Both countries have specific exemptions to the cap that Queensland has included.

The DTI's research paper goes into great detail concerning the state of the credit markets in those countries. It compares the French and German markets to those of the United Kingdom and the United States of America, concluding at page 14 that there is greater diversity of credit models available where caps are not present. Indeed, in the sub-prime and sub-sub-prime markets there is only one product available in the whole of France and Germany, and this is a state owned pawnbroker in France. This shows that interest rate caps make it uncommercial to operate in these markets.

The paper also shows that borrowers shunted into mainstream products that do not suit their needs are at a serious disadvantage. Page 22 states:

"The primary determinant of the cost of credit is not the interest rate attached to the product but rather their own repayment record. It is not only by payment delinquency that the cost of credit is increased but also by patterns of behaviour."

The reports goes on to say that higher risk borrowers who are forced to use credit products designed for lower risk borrowers often find themselves bearing a larger cost of credit. They are forced into borrowing larger sums

over longer periods to be able to participate in the credit market. This gives rise to situations that increase the cost of the credit, placing borrowers in situations where they are unable to pay down balances and become trapped in long term debt cycles. This is because minimum loan values are set high and are out of scale with affordability. Borrowers find themselves in delinquency, which attracts greater costs than they would have endured using products similar to the ones provided by our members. France, in particular, is noted for borrowers using unsuitable mainstream vehicles and suffering a high incidence of default.

Element 6 - Protection from "Debt Spirals"

Executive Summary

a) Debt spirals can occur in a range of circumstances for a variety of reasons;
b) The proposed cap will not stop Debt Spirals;
c) The Federation proposes a total cost of credit cap, which will stop Debt Spirals.

"Debt spirals" exists where a borrower is unable or unwilling to fulfil the terms of their credit contract to the foreseeable point of total repayment. In other words, their outstanding amount owing will continue to increase over time, i.e. it is spiraling. The phrase is often used when referring to products such as credit cards, payday and micro loans.

Broadly, there are two causes of debt spirals. Either the credit contract was unserviceable for the borrower from the outset, or an intervening act has occurred that renders the contract unserviceable.

In the former, the lender has either failed in their duty to ensure that the borrower is able to afford the terms of their finance or there has been a form of misrepresentation by the borrower. If the lender has failed, then they should be penalised accordingly. The Federation has a firm belief that lenders must ensure that they fully ascertain a borrower's ability to repay their loan. If the borrower has misrepresented their circumstances, then this is hardly the lender's fault and no blame should be placed on them.

If an intervening act has occurred, it usually falls into one of two categories:

1. Due to a borrower's actions. This predominantly takes the form of default under the loan contract through consciously choosing not to honour it; or
2. By third party intervention. This can take the form of any number of circumstances befalling the borrower, including personal injury, death, loss of income, unforeseen expense and so forth.

In either of these two cases, the lender is an innocent party and risks financial loss.

Regardless of the cause, debt spirals amount to the same thing: an unserviceable loan. What is not commonly known, though, is that payday and micro lenders want to avoid debt spirals as much as anyone else. An unserviceable loan usually winds up not being paid. Even if it is, it is practically always at a heavily discounted rate. Lenders rely on loans being

repaid to derive their profit and fuel future lending. An increasing loan balance may look good on paper, but you can neither spend nor re-lend figures on a page.

As with most forms of finance, once problems start to occur they tend to compound. Prudent payday and micro lenders will often take action to stop this from happening. This is usually done in the form of rebating interest amounts, decreasing interest rates or suspending interest charges altogether to allow borrowers to get back on track and discharge the loan. The philosophy behind this is simple: lenders would rather receive a "little bit today, then a large amount never". But these actions are not required at law, and lenders undertake them voluntarily knowing that not only does it allow them to retain cash flow, but also increases goodwill.

While it is prevalent to find this sort of practise in payday and micro lending businesses, it is almost unheard of amongst the mainstream lenders and banks.

The issue of debt spirals is considered to be dealt with by the impending cap. However, that assertion is fundamentally flawed. The reason is that just as an interest rate is not a measure of cost, placing a cap on an interest rate does not correspondingly cap the underlying dollar amount when talking about compounding loans. The vast majority of financial products in Australia work on compounding interest models, not simple interest. So, figuratively, an unpaid loan at 1% will spiral ever upward in balance over time. An unaffordable loan at 48% is really no different to an unaffordable loan at 480% (or even an unaffordable home loan at 8%); they can't be repaid. The cap will not help the problematic borrowers who, for whatever reason, are not able to service their loans.

The only way, realistically, to stop the debt spiral is to place a dollar value cap on loans. This is exactly what the Federation has been proposing to government in excess of 12 months.

In its submission to the Queensland Office of Fair Trading Discussion Paper *"Managing the cost of consumer credit in Queensland"*, the Federation makes 15 recommendations for options that would satisfy the government's policy objectives. Option number 8 at page 44 is a total cost of credit model. This model has been accepted by the United Kingdom Competition Commission as a more appropriate model than Annual Percentage Rates. The Federation also privately recommended this model to the Fair Trading Minister, the Honourable Kerry Shine, at his invitation in late 2007.

By placing a dollar figure cap on the provision of credit, the debt spiral is stopped cold. Once the balance reaches a predetermined ceiling (for which the Federation suggests a figure of twice the total quantum of advances, i.e. a

total of interest and charges equal to the total amount of principal), then the balance cannot be increased, except through charges incurred for enforcement against security. This is the only regulatory option that fulfils the policy objectives and stops a debt spiral from occurring.

Unfortunately, the Queensland government has rejected this proposal out of hand, without seriously considering it. Once again, the Federation seriously recommends this model to the consideration of the government as a model totally workable for industry, consumers, consumer groups and government.

Element 7 - Protection from other Socio-Economic Pitfalls

Executive Summary

a) Bankruptcy rates will increase under the proposed cap;
b) Illegal lending will increase under the proposed cap; and
c) Consumer detriment through inability to obtain goods and services will increase under the proposed cap.

Consumers can suffer a number of socio-economic problems apart from not having sufficient financial accommodation. In addition to credit exclusion (see Element 5) these include:

(a) Bankruptcy;
(b) Increased illegal activity; and
(c) Flow on effects from absence of credit.

(a) Bankruptcy

Many consumer advocates claim that the introduction of the proposed cap will result in fewer bankruptcies, particularly amongst the consumers that frequent this type of product. Lenders in our industries maintain that this is incorrect, and know from personal experience that their products assist consumers in staving off bankruptcy.

We are not aware of any research undertaken on this topic in Australia. However, there are overseas authorities that have looked into this. The United Kingdom's Department of Trade and Industry, in their paper *"The Effect of Interest Rate Caps in Other Countries"*, compared the incidence of bankruptcy in the United Kingdom (which does not have a cap) with the incidence in France and Germany (which both have caps). Table 7.1 shows the difference:

Table 7.1

	Total incidence of bankruptcy amongst consumers with credit problems
U.K.	4%
France	25%
Germany	22%

The trend shown in France and Germany is echoed in the United States of America. The Federal Reserve Bank of New York published a report in November, 2007 entitled *"Payday Holiday: How Households Fare after*

Payday Credit Bans" that looked at the effect of banning payday lending in certain states.

This report considered the increase of bankruptcies, particularly in the state of Georgia, which has banned payday lending. The report refers to Chapter 7 and Chapter 13 types of bankruptcy. Chapter 13 is identified as being for filers with substantial assets to protect, which is identified as not seeming to fit the profile of payday borrowers. Rather, it expected that these consumers would use "no asset" Chapter 7 bankruptcy (possibly the equivalent of our Part IX Debt Agreements).

The Reserve Bank found that there was an increase in Chapter 7 bankruptcy of 8.5% relative to the average before the ban was put in place (an increase of 7 per 1,000). This was interpreted in the report at page 20 as follows:

"The contraction in payday credit supply caused former borrowers to bounce more checks [sic]*, thus aggravating their already marginal circumstances. To stave off bankruptcy, distressed borrowers pawned or sold assets. For those who ultimately succumbed to their financial problems, the loss of assets made Chapter 7 the natural choice. Others slipped into informal bankruptcy (defaulted without filing)."*

Similar circumstances were found in North Carolina. However, since a time period of marginally less than 2 years had elapsed since the ban was introduced, the report was treating this states results as preliminary. Nevertheless, incidences of filing for Chapter 7 bankruptcy increased after the ban.

This independent research shows that instead of decreasing the prevalence of bankruptcy, instituting interest rate caps actively increases bankruptcy for consumers unable to access fringe credit.

(b) Increased illegal activity

One of the fears that arise when laws and regulations make it too difficult to operate legally in a certain field is the increase in illegal activity. As shown in earlier Elements, the proposed cap to be brought in by the Bill and the Regulation will make the provision of Code compliant lending for small amounts unprofitable. This will have the effect of excluding all legitimate, law abiding lenders from this portion of the marketplace. What it does not do, however, is lessen or abate the need for this level of credit.

Numerous historical examples show that where legal supply is removed and demand is not satisfied, illegal supply will increase to take up the "slack". Perhaps the most noticeable example of this was prohibition of alcohol in the U.S.A. in the 1920s. Introduction of the proposed cap will be akin to the

outright banning of payday and micro lending since the intended cap is below the level of covering a lender's costs.

The United Kingdom's Department of Trade and Industry, in their paper referred to above, directly looked at the prevalence of illegal lending in jurisdictions that have imposed interest rate caps. They compare the experiences of consumers in the UK (which does not have a cap) with those of consumers in France and Germany (which both have a cap). Table 7.2 shows the results of this research:

Table 7.2

	Low income, credit impaired consumers who have admitted to using illegal lending	Low income, credit impaired consumers who have been **denied a loan** who admitted to using illegal lending
U.K.	3%	4%
France	7%	12%
Germany	8%	10%

These statistics show that there is a marked increase in illegal activity in jurisdictions that impose a cap on lenders. Illegal lending is 2.5 to 3 times more prevalent in these areas. Of particularly concern is the jump in the use of illegal lenders by consumers who have been denied a loan from mainstream lenders. In France this was a 70% increase in use by consumers.

In May 1999, the Queensland Office of Fair Trading published a report entitled *"'Fringe' Credit Provider – A Report and Issues Paper"*. This paper particularly looked at the extent of non-Code compliant lenders in Queensland, termed 'loan sharks'. This paper disclosed that they were using reprehensible tactics in the operation and enforcement of their loans. These include:

(i) Borrowers were forced to make large payments if they wanted to reduce the principal owing on their loans. These loans were termed "interest only". This led to borrowers paying large amounts of money without any reduction in principal. The report stated that one respondent to OFT's survey complained of paying over $8,000 on a $2,000 loan without any reduction in principal;
(ii) Death threats;
(iii) Threats to physical safety;
(iv) Assaults;
(v) Intimidation and intimidating language;
(vi) Refusal to recognise bankruptcy;

(vii) Threatened repossession of goods when mortgages were not entered into; and
(viii) Personal collection of payments, often by groups of intimidating men.

These actions are not acceptable. Making it unviable for legitimate lenders to participate in the market, without taking sufficient measures to cope with the constant demand for financial accommodation, will see an increase in illegal lending.

(d) Flow on effects

The use of funds by borrowers of payday and micro lenders are often on necessities or deemed necessities. Typical uses of this type of credit include:

(i) Car registration and repair;
(ii) Residential rental bonds;
(iii) Emergency travel for personal disaster;
(iv) White goods;
(v) Medical and veterinary bills; and
(vi) Phone and electricity bills.

Without funding provided by lenders such as our members, consumers would have to do without the provision of these goods and services. Likewise, the providers of these goods and services would experience a drop in turnover.

All of these examples would be of vital importance to a consumer in need. However, it is worth singling out residential rental bonds as being an area of particular importance.

The cost of renting in Queensland is experiencing massive growth, with media currently reporting that residential rents are increasing at rates that are making it more and more difficult for Queenslanders to afford housing. As a necessary part of that, rental bonds are becoming unaffordable without financial help (since rental bonds are equal to four weeks rental). To compound this issue, current renters are unable to access the bond for their current residence when moving house as landlords are not required to relinquish the funds until the premises are vacated when the lease ends. Renters are unable to finally secure a lease for a new residence (and therefore, possession) until they have paid the full bond. This creates a shortfall where renters must finance a new bond without assistance, typically in an amount upwards of $1,000. Without the ability to do so, renters have no opportunity to move residence. This can lead to situations where families are stuck in rental accommodation that is too expensive for their circumstances.

Rental amounts typically reach $300-$400 per week for Queensland families. This means they can find themselves having to fund bond amounts of $1,800-

$2,400 on short notice. Added to this, when finally moving, there are a range of expenses, including cleaning, carpet cleaning, removalists and re-connection of utilities.

Also important is the area of phone and utilities payments. Living without electricity can cause significant hardship in today's society. It may be considered that having the phone cutoff is more of a nuisance than a genuine concern. However, due to the contractual relationship required by many telecommunication companies, it is possible that a delinquent payer can find themselves with a default entry on their credit file, making it even more difficult to obtain finance in the future, especially from mainstream lending institutions.

Element 8 - Industry Survival

Executive Summary

a) The Minister for Fair Trading promised to keep industry viable;
b) The proposed cap does not achieve that and will force business out of the marketplace;
c) The market is worth hundreds of millions of dollars per annum in Queensland;
d) NILS/LILS will be unable to cover the shortfall or expand their scope; and
e) No other reasonable solution has been offered by consumer proponents.

Following the end of the submission period on the Queensland Office of Fair Trading discussion paper *"Managing the cost of consumer credit in Queensland"*, an article was printed in the Courier Mail, which quotes the former Fair Trading Minister Margaret Keech. This article, published on Monday 12 February, 2007 and entitled *"Lenders face cap on fees"*, quotes Minister Keech as saying:

"I want a scheme that's fair and equitable – one that has consumer protection as its priority, but also balances the need to keep the industry viable" [emphasis added]

This statement has not been retracted, or qualified, by the Queensland government.

The simple fact of the matter is, the proposed cap implemented under the Bill and Regulation does not keep industry viable.

From the information shown in Table 1.2, in Element 1, we see that the gross returns on the average payday loan of $250 is $5.57 in a month and the average micro loan of $1,000 is $136.33 in 6 months.

We ask:

1. Can you run a business (paying rent, staff, outgoings and yourself) investing time and money for these gross returns?
2. Can you afford to wait a month to see if you'll earn $5.57? Alternatively, can you wait 6 months to see if you'll get $126.33?
3. Can you do all this knowing that you'll bear a degree of risk that may mean you'll never achieve that gross return?

The answer to all of these questions is no.

It is not economically viable to lend these amounts under the constraints of the Consumer Credit Code for a maximum return of 48% per annum including fees and charges. Therefore, the proposed cap does not fulfil the Minister's stated aim of keeping industry viable.

So, why is it important to keep industry viable? Because there is a massive need for this level of finance for consumers in the marketplace. Federation research shows that Queensland payday and micro lenders lend around $120 million per year in Queensland. That is just the amount of loans actually given. If we consider that the average declined applications rate of 46.58% (taken from the Federation's submission to the Office of Fair Trading's discussion paper), we can see that the actual demand for finance is much higher. Factoring in the declined applications rate, the actual demand for payday and micro finance in Queensland is over $225.5 million per annum.

This level of finance is not catered to by any other form of legitimate lender. Element 5 showed that the minimum mainstream lending product in the form of a loan (as opposed to credit card) is $3,000. This is three times larger than the average micro loan and 12 times larger than the average payday loan. When $3,000 is the minimum provided (and remembering that most mainstream lender's minimum is $5,000) this creates a major gap if payday and micro lenders are forced out of the market.

In Element 2, we mentioned the paper by Adair Morse from the University of Michigan who found that different types of financial institutions cannot substitute for each other and provide welfare increasing benefits. Specifically, he stated that banks cannot provide the same benefit that payday lenders do.

These findings were echoed in the United Kingdom's 2004 Department of Trade and Industry report looking at the effect of caps in France and Germany. When caps were implemented there, it was found that borrowers were either excluded from the credit market, or quickly found themselves in trouble with credit products that were not designed for their circumstances, did not suit their needs and could not be adequately serviced.

Quite frankly, if banks could provide the service that payday and micro lenders do, and be profitable, they would. They are eminently placed to do so, have access to all the necessary documents, software and processed. They are high profile and already have custom from our borrowers. It is rare in this day and age to not have a bank account, which is especially true of welfare recipients who must have a bank account.

The simple fact is that banks have abandoned this market and show no inclination to return. It may not be the only concern, but being economically

viable is a major one. Social commentators may state that banks should be compelled to enter the market at their usual rates, but this is unrealistic. Banks are corporate entities, whose confidence and existence rely on being profit driven. It's all well and good to push "social justice", but this doesn't pay the rent or placate shareholders. ASIC corporate requirements place onuses on banks to fulfil a duty of care towards their shareholders' investments.

If it's a social justice issue, then the government should intervene and provide the loans themselves. But are they willing to find the $225 million per year to cope with the demand, plus the amounts necessary to run and maintain the operation? Not likely. Indeed, government has never stated this as being one of the solutions. The only government that has come close to date is the Victorian government, who pledged $1.5 million a year for 3 years to go into no interest and low interest loan schemes. $1.5 million versus $225 million needs no further comment.

As for no interest and low interest loan schemes in Queensland; there were 206 loans done in 2006. 206 for the whole of Queensland. This isn't even close to what a single average payday or micro lending office will do in a year, let alone what is covered by industry. Most of these schemes lend to a maximum of around $800 in any case and are extremely restrictive in their lending criteria.

Further, these schemes are often massively unprofitable. In the report by the Brotherhood of St Laurence entitled *"To their credit: Evaluating an experiment with personal loans for people on low incomes"*, despite having a low default rate of 0.9%, their scheme needed over $100,000 in subsidies and had not even achieved cost recovery.

Added to that is the fact that for most people to qualify for these types of loans their circumstances must be below what our usual accepted applicants qualify at. In other words, the people our businesses service do not qualify for NILS/LILS loans, and vice versa. In the Brotherhood of St Laurence's report, they stated (at page 7) that in order to be eligible for a loan, the applicant needed to:

- hold a healthcare or pension card;
- have been living at their current home for more than six months; and
- demonstrate they could make regular repayments.

The last condition is the only condition that is the same as payday lenders and micro lenders. Have a job and therefore no healthcare or pension card? You don't qualify. Just moved? You don't qualify. NIL/LIL schemes are restrictive because they need to be. However, this does not help slake the demand for credit. However, they have virtually no impact on servicing the demand for payday and micro loans.

In 2006, the Victoria government produced a paper entitled *"The Report of the Consumer Credit Review"*. In the review, it was identified that even if NIL/LIL schemes are expanded, they will not eliminate consumer detriment in the small credit market. The Review states, at page 100:

(a) "Unlike NILS, commercial small amount lending is not restricted to the purchase of specific products". This requirement creates inflexible credit, and borrowers are disadvantaged where they do not fit these requirements;

(b) "Unlike LILS, commercial loans are not linked to welfare status." The Review found that information they received concurred that commercial lenders lend to people that would not be eligible for a NILS or LILS loan;

(c) "Expanding NILS and LILS to cover all types of lending available through commercial small amount providers would be impractical". It was identified that, even with sufficient growth in available funds for lending, demand would expand. There would still be borrowers seeking commercial lending products; and

(d) "the benefits of NILS and LILS….include allied services such as counseling and financial advice". The Review argues that increasing the availability of funds would outreach the ability to provide these important allied services, leading to increased default rates. The report states that "any expansion of NILS and LILS should not undermine their ability to provide holistic financial services".

The Report concludes that expanding NILS and LILS to encompass the whole of the "small amount market" would require a fundamental change to the philosophy and objectives behind the programs, and that to do so is impractical.

Payday and micro lenders have not created the demand for credit. They are one of the solutions, and for the bracket up to $3,000, often the only reasonable one. Implementing a cap that forces them out of business will do nothing to remove or satisfy demand, it will only remove an important solution. That is why the industry must be kept viable, and the proposed cap does not achieve this.

Failure to find a solution that keeps industry viable will result in increased detriment for the consumers that government and consumer advocates seek to protect.

Annexure 1 – Loan Application Checklist

Application Form

- Received, completed and signed?
- Privacy Act form received, completed and signed?
- Is the applicant legally competent to apply?
  - Over 18 years of age;
  - Mentally competent;
  - In charge of their own financial affairs.
- Has the applicant provided sufficient identification to establish identity?
- Has the applicant provided copies of:
  - Driver's licence;
  - Registration papers for motor vehicle security;
  - Tenancy Agreement/Rates notice;
  - Telephone bill;
  - Electricity bill;
  - Copy of bank/credit cards;
  - Evidence of motor vehicle insurance;
  - Recent pay slips/evidence of income;
  - At least three months worth of bank statements?

Affordability

- Calculate repayments based on amount, term and payment cycle;
- Is repayment affordable based on total income and disposable income?;
- Has the applicant provided a comprehensive budget, and taken into account all items (including luxury and entertainment)?;
- Has proof of income been provided?;
- Is income fixed or likely to change?; and
- Does the applicant's documents show any problematic spending patterns likely to affect the affordability of the loan?.

Security of Applicant

- How long has the applicant resided at their current address?;
- Have they provided evidence of rent/mortgage payment currency?;
- If renting, check with rental agent;
- Are utilities up to date?;
- How long has applicant been at current place of employment?;
- If employed, check with employer for terms, length and wage details;
- Telephone character references;
- Perform credit file check;
- Has the applicant committed an act of bankruptcy?;

- Has the applicant provided satisfactory explanation of credit file defaults?.

Security for Loan

- Does evidence of registration/ownership show the applicant as owner?;
- Is there any joint ownership?;
- Is the applicant in physical possession of the security?;
- Check the physical condition of the security;
- Perform encumbrance search on security (if relevant) and check its status.

Documents

- Prepare 2 copies of precontractual loan information statement;
- Prepare 2 copies of loan contract;
- Prepare 2 copies of bill of sale;
- Prepare 2 copies of ancillary loan documents – borrowers acknowledgment, loan calculation example, statement consents etc;
- Prepare 2 copies of DDR form and DDR service agreement.

Loan creation and administration

- Explain and have signed precontractual loan information statement;
- Explain and have signed loan contract;
- Explain and have signed bill of sale;
- Explain and have signed ancillary loan documents (as above);
- Explain and have signed DDR form and DDR service agreement (if applicable);
- Register encumbrance over security;
- Disburse funds as per borrower's request and retain evidence of payment;
- Provide borrower with copies of all documents;
- Create borrower profile in loans software and enter drawdown transactions;
- Account for and disburse application fee components to third party providers;
- Account for stamp duty;
- Schedule payment times and details in loans software;
- Create physical borrower file.

Annexure 2 - List of National Financial Services Federation (Qld) Inc Members who Subscribe to this Document

2 Easy Loans
Better Loans and Finance (Browns Plains)
Better Loans and Finance (Helensvale)
Better Loans and Finance (Logan Central)
Better Loans and Finance Burpengary
Brisbane Capital Pty Ltd
Cash 4 U 2 Day
Cash Converters State Support Centre
Cash Loans Money Centre (CLMC)
Cash Smart Pty Ltd
Cash Solutions (Aust) Pty Ltd T/AS 1300cash2U
City Finance Loans and Cash Solutions
City Finance Loans and Cash Solutions (Southport)
City Finance Loans and Cash Solutions (Toowoomba)
Credit 4 U Pty Ltd
Credit 4 U Pty Ltd (Ipswich)
Credit 4 U Pty Ltd (Lutwyche)
D&K Investments (QLD) Pty Ltd
EFT Capital Aust Pty Ltd
Fast Access Finance (Aspley) Pty Ltd
Fast Access Finance (Beaudesert) Pty Ltd
Fast Access Finance (Beenleigh) Pty Ltd
Fast Access Finance (Biggera Waters) Pty Ltd
Fast Access Finance (Browns Plains) Pty Ltd
Fast Access Finance (Bundaberg) Pty Ltd
Fast Access Finance (Burleigh Heads) Pty Ltd
Fast Access Finance (Cairns) Pty Ltd
Fast Access Finance (Coorparoo) Pty Ltd
Fast Access Finance (Gladstone) Pty Ltd
Fast Access Finance (Gympie) Pty Ltd
Fast Access Finance (Hervey Bay) Pty Ltd
Fast Access Finance (Ipswich) Pty Ltd
Fast Access Finance (Logan) Pty Ltd
Fast Access Finance (Mackay) Pty Ltd
Fast Access Finance (Redcliffe) Pty Ltd
Fast Access Finance (Rockhampton) Pty Ltd
Fast Access Finance (Sunshine Coast) Pty Ltd
Fast Access Finance (Toowoomba) Pty Ltd
Fast Access Finance (Townsville) Pty Ltd
Fast Access Finance Coolangatta

Fast Access Finance Gold Coast
Fast Access Finance Pty Ltd
Fast Fix Finance Pty Ltd
Fixed Fee Finance
Horizon Services
Lightning Loans
LipJad Pty Ltd
Loans 2 Go 4
Loans by Phone Pty Ltd
Local Lenders (Caboolture)
Local Lenders (Capalaba)
Local Lenders (Redcliffe)
Local Lenders (Strathpine)
Local Lenders (Zillmere)
Lutz Finance Pty Ltd
Money Centre Capalaba
New Credit (Beenleigh) P/L
Pennywise (Goodna)
Pennywise (Ipswich)
Quick and Easy Finance
Rapid Loans Pty Ltd
Safrock Finance Corporation Pty Ltd
Smart Credit
Speedy Finance Pty Ltd
Spot Loans Pty Ltd
Spott Pty Ltd
Sunshine Loan Centres P/L
Taralake Pty Ltd
Viva Financial Solutions