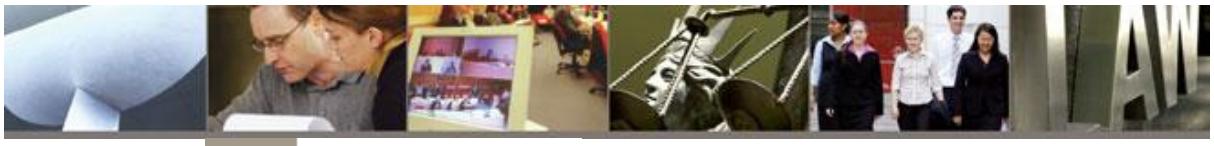

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Phase Two of the National Credit Reforms Examining the Regulation of Payday Lenders

A Queensland University of Technology Survey and Report by:

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1. Scope of the study

In this study we seek to analyse the adequacy of the current regulation of the payday lending industry in Australia, and consider whether there is a need for additional regulation to protect consumers of these services. We examine the different regulatory approaches adopted in comparable OECD countries, and review alternative models for payday regulation, in particular, the role played by responsible lending. The study also examines the consumer protection mechanisms now in existence in Australia in the *National Consumer Credit Protection Act 2009* (Cth) (NCCP) and the National Credit Code (NCC) contained in Schedule 1 of that Act and in the *Australian Securities and Investments Commission Act 2001* (Cth).

A further study is planned by way of a consumer survey in 2011 to examine issues including consumer demographics, responsible lending practices, disclosure and the use of rollovers in the current payday loan industry. The survey is intended to be undertaken in three states which, prior to the full implementation of the NCCP, had different regulatory regimes – Queensland (which had and continues to have an interest rate cap), Western Australia (which had a licensing regime) and South Australia (which had no specific payday regulation) - in order to construct a more complete holistic understanding of the payday lending industry then and now in Australia.

The research project is being conducted with funding from the Department of Justice and Attorney-General (Qld) by way of a grant from the Legal Practitioner Interest on Trust Account Fund Scheme to the CCCL as well as funding from the National Financial Services Federation (NFSF). In addition the Queensland Office of Fair Trading as well as the NFSF and its members have provided in-kind support and relevant data.

1.1 Sources of Literature on Payday Loans

The literature on payday lending has been sourced from consumer advocates, industry bodies, government reports and academia.

Although generally the literature provides a heavily polarized perspective on the payday loan industry and how best it should be regulated, with consumer advocates and industry bodies on opposite sides of the 'regulatory fence', all commentators agree that the payday loan industry is providing an economic service to borrowers that is heavily in demand and is not available in the mainstream credit market. This is demonstrated in part by the phenomenal growth of the payday loan industry over the past decade, fuelled by strong consumer demand for small-amount short-term credit that is not adequately served by traditional mainstream lenders.[1] Nevertheless, this type of borrowing is highly controversial and not yet well understood.

For the most part, the issue in debate within the literature is not whether payday lending should be allowed to continue within the credit industry, but the method by which and the extent to which it should be regulated, and what role responsible lending or interest rate caps should play

[1]Cash Converters, *Review of Australia's Consumer Policy Framework* (February 6 2008)(Submission to the Productivity Commission Inquiry); Pat Stobaus, *Background Paper on Payday Lending* (2009) (West Heidelberg Legal Community Legal Service) 1**;** Dean Wilson, *Payday Lending in Victoria- A research report* (2002) (Consumer Law Centre of Victoria) 34.

in this regulatory regime. There are two broad schools of thought: the consumer advocates who see evidence of market failure requiring regulation; and industry supporters who deny that any such market failure exists and see regulation in the form of interest rate caps as a shift towards paternalism and interference by Government with the free operation of markets.

Consumer advocates argue that payday companies engage in predatory lending practices that take advantage of lower income groups who are unable to gain access to lower priced alternative sources of credit, exploiting these vulnerable consumers by charging unconscionably high rates of interest and encouraging spirals of consumer debt.[2] As a result, they argue that strong regulation, including the use of interest rate caps and the banning of rollovers, is needed to curb these predatory lending practices. At the same time, many acknowledge that totally curtailing payday lending may actually be a harmful public policy for some low-income consumers who lack viable alternatives in a moment of great need. [3]

Industry supporters and representatives counter these claims by arguing that pay day loans provide real economic benefits to borrowers and meet an unsatisfied need for smaller consumer loans ignored by more traditional lenders. Consumers are not exploited, but rather use pay day loan services by choice.[4] Furthermore, they warn that over-regulation, or regulation which involves capping, may result in a failure to be able to maintain current competition and availability in the market, which in turn could result in demand driving business offshore or into black markets without government regulation (a situation currently occurring in the online gaming industry). As a result they argue that to address concerns about process, public policy should be concerned with eliminating barriers to entry and promoting competition rather than limiting or otherwise restricting the industry and its availability.[5]

1.2. Gaps in the research

In recent years some Australian jurisdictions have introduced legislation to limit the cost of credit by means of caps on interest rates. Details of this are provided in 5.1.1- 5.1.4 of this Study. Our review of the literature has shown that there has been no evaluation of interest rate caps as a regulatory response in the Australian jurisdictions which have them in comparison to those jurisdictions that do not. For example, we know that there has been some avoidance of the cap in Queensland, but overall, we do not know whether there are fewer high cost loans, or the impact of the caps on borrowers or lenders or on the development of alternative products.

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[2] Dean Wilson, *Payday Lending in Victoria- A research report* (2002)(Consumer Law Centre of Victoria) 11, 33; Robin Scott MP, *Small Amount Lending Inquiry 2008: Report to Tony Robinson MP Minister for Consumer Affairs* (2009) (Department of Justice Consumer Affairs Victoria) 6; L. Petschler, 'How to borrow @ 972% p.a.' (2001) *Consuming Interest*, 6, 9.

[3] Dean Wilson, *Payday Lending in Victoria- A research report* (2002) (Consumer Law Centre of Victoria) ; Government of South Australia: Office of Consumer and Business Affairs, *Payday lending in South Australia - options to increase consumer protection*, *Discussion Paper* (2006) 3.

[4] P. Syrvet, 'The Quick and the Debt', *The Bulletin*, 6 February 2001, 31; Australian Financial Services Association (AFSA), *Submission to Queensland Minister of Fair Trading*, (September 2001) 18-20; Dean Wilson, *Payday Lending in Victoria- A research report* (2002) (Consumer Law Centre of Victoria) 33.

[5] Government of South Australia: Office of Consumer and Business Affairs, *Payday lending in South Australia - options to increase consumer protection*, *Discussion Paper* (2006) 3.

We do not know if there is in practice a difference between the cost of credit to payday borrowers in jurisdictions with caps compared with jurisdictions without such a cap.[6]

Further, while much of the literature argues there is a need to adopt a regulatory approach to stem 'predatory lending,' the extent to which the problems have now been resolved under the new *National Consumer Credit Regime* remains untested. Therefore the extent to which the problems highlighted in the literature will remain is uncertain. Further research on whether the new obligations will meet the concerns that interest rate cap regulation was designed to address, thus avoiding the need for price regulation, is needed.[7] Appendix A to the literature review contains a comparative table highlighting this matter further. Our further research outlined in 1 of this Study is designed to meet these gaps.

Other significant gaps include the absence of any recent study into the size of the industry, in terms of numbers and economic value, and into the costs incurred by lenders of making payday loans. With many of the substantial studies in this area being conducted in early 2000, and industry expanding at a significant rate in Australia during this period, much of the data provided is currently out of date. Further detail on this is provided at 2.2.1 and 2.2.2 of this Study.

2. Background to the Payday lending Industry

2.1 What is payday lending?

The term "payday lending" as used in this study refers to the practice of lending small amounts of cash to consumers for short periods of time (less than 62 days, and typically 2-4 weeks until the borrower's next pay day) in exchange for a fee.[8] It is called 'payday lending' because the money is theoretically lent on the security of the borrower's next pay cheque.[9] In Australia, lenders commonly derive security of payment by obtaining a direct debit authority from the borrower that effectively allows first call over the borrower's income in their bank account.[10] Payday loans in Australia do not generally involve post-dated personal cheques, as is the case in

[6] Ms Nicola Howell, Lecturer, Queensland University of Technology identified and thus described this gap in her paper "Research Proposal: The impact of interest rate cap regulation in Australia" for the CCCL Program, February 2010 p 7. We acknowledge Ms Howell's valuable contribution to this material.

[7] Ms Nicola Howell, Lecturer, Queensland University of Technology identified and thus described this gap in her paper "Research Proposal: The impact of interest rate cap regulation in Australia" for the CCCL Program, February 2010 p 7.

[8] Karen Sampford, *Regulating Pay Day Lending : The Consumer Credit (Queensland) Amendment Bill 2001*(QPL June 2001) 1; Dean Wilson, *Payday Lending in Victoria- A research report* (2002) (Consumer Law Centre of Victoria) 11; Government of South Australia: Office of Consumer and Business Affairs, *Payday lending in South Australia - options to increase consumer protection*, *Discussion Paper* (2006) 1.

[9] Karen Sampford, *Regulating Pay Day Lending : The Consumer Credit (Queensland) Amendment Bill 2001*(QPL June 2001)1; Dean Wilson, *Payday Lending in Victoria- A research report* (2002) (Consumer Law Centre of Victoria) 11; Government of South Australia: Office of Consumer and Business Affairs, *Payday lending in South Australia - options to increase consumer protection*, *Discussion Paper* (2006) 1.

[10] Karen Sampford, *Regulating Pay Day Lending : The Consumer Credit (Queensland) Amendment Bill 2001*(QPL June 2001) 1; Government of South Australia: Office of Consumer and Business Affairs, *Payday lending in South Australia - options to increase consumer protection*, *Discussion Paper* (2006) 1.

the UK and United States,[11] and very rarely involve payday lenders requiring property as security for loans.[12]

Research by Queensland Office of Fair Trading, and Wilson in "Payday Lending in Victoria – a research report" (Wilson's report) for the Consumer Law Centre of Victoria, indicates that payday lending tends to involve payday lenders lending for a fixed fee rather than charging an interest rate and the average amount of a payday loan ranges between $200-500 for two to four weeks.[13] According to research by Sampford,[14] the pay day lender's fee is typically set at $20 or $25 for each $100 advanced, and as loans are typically for a short period of time (until the borrower's next payday), payday lenders can charge fees that translate into very high annualised interest rates. As well as loan establishment and management fees, payday lenders also typically charge a range of default and dishonour fees and fees for deferring or 'rolling over' loans not paid by the due date.[15]

There are number of different terms used to describe the practice of payday lending in the literature. These include 'payday advances' and 'cash advances', as well as more general terms including 'micro-lending', 'small-amount lending', 'high-cost low value loans', 'high-cost short-term lending', 'high-cost credit', 'micro-finance' and micro-credit.' While the term 'fringe lending' is sometimes used, it also applies to a range of small lending products outside the payday lending market, including pawnbroking, home credit and rent–to-buy credit markets.[16] This study will use the terms 'payday lending' and 'payday loans' throughout in order to avoid confusion.

2.2 Industry Overview

2.2.1 Industry Size

Although it is generally acknowledged that the payday lending market is growing rapidly in Australia,[17] it is difficult to find current statistics on the size of the payday lending market here, and estimates in the literature vary.

Wilson's 2002 research report into payday lending in Victoria reported that industry estimated the size of the payday lending market in Australia at that time at $200 million per annum.[18]

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[11] Queensland Office of Fair Trading, *Payday Lending – A Report to the Minister of Fair Trading* (2000) 5; Dean Wilson, *Payday Lending in Victoria- A research report* (2002) (Consumer Law Centre of Victoria) 33.

[12] Government of South Australia: Office of Consumer and Business Affairs, *Payday lending in South Australia - options to increase consumer protection*, *Discussion Paper* (2006) 1.

[13] Zac Gillam and the Consumer Action Law Centre, *Payday Loans: Helping hand or quicksand? An examination of high-cost short term lending in Australia*, 2002-2010 (September 2010) 1; Queensland Office of Fair Trading, *Payday Lending – A Report to the Minister of Fair Trading* (2000) 5; Dean Wilson, *Payday Lending in Victoria- A research report* (2002) (Consumer Law Centre of Victoria) 33.

[14] Karen Sampford*, Regulating Pay Day Lending : The Consumer Credit (Queensland) Amendment Bill 2001*(QPL June 2001) 1; Government of South Australia: Office of Consumer and Business Affairs, *Payday lending in South Australia - options to increase consumer protection*, *Discussion Paper* (2006) 1.

[15] Government of South Australia: Office of Consumer and Business Affairs, *Payday lending in South Australia - options to increase consumer protection*, *Discussion Paper* (2006) 3.

[16] Zac Gillam and the Consumer Action Law Centre, *Payday Loans: Helping hand or quicksand? An examination of high-cost short term lending in Australia*, *2002-2010* (September 2010) 10, 31; Office of Fair Trading (UK), *High-cost consumer credit – emerging evidence from the review* (December 2009) 5-8; Office of Fair Trading (UK), *News Release: OFT Publishes Review of High-Cost Credit* (15 June 2010) 1.

[17] Robin Scott MP, *Small Amount Lending Inquiry 2008: Report to Tony Robinson MP Minister for Consumer Affairs* (2009) (Department of Justice Consumer Affairs Victoria) 6; Zac Gillam and the Consumer Action Law Centre, *Payday Loans: Helping hand or quicksand? An examination of high-cost short term lending in Australia*, *2002-2010* (September 2010) 9.

Around that time it was predicted by the Queensland Office of Fair Trading that the number of outlets in Australia would increase 10 times within 5 years,[19] suggesting that the payday lending market in Australia could currently be worth around two billion per annum. However, no contemporary evidence has emerged to back up such an estimate, and a 2007 estimate by Searle placed annual turnover for the industry at a range closer to between $500 million and $800 million,[20] while an estimate by Consumer Action Law Centre in 2010 (based on an extrapolation from Cash Convertors figures) estimated approximately $204 million per annum is lent, to around 379,000 customers, across approximately 674,000 loans.[21]

Industry members estimate that there are approximately 500,000 active clients in the sector, and that there are around 400 lenders nationwide. This latter figure is supported by data from ASIC's new licensing regime which currently records approximately 400 registered or licensed credit providers who describe their businesses as 'micro finance', although this category includes larger ($500-$1000) short term loans as well as payday loans. This figure may rise once the licensing process is completed.

Cash Converters, Cash Stop and Cash Storehave the largest market shares, with Cash Converters estimating in 2008 that it writes $230 million in small amount loans per year in Australia.[22] There is some evidence of new entry, and according to Searle this increase in the number of lenders in the market should result in a reduction in interest rates for small loans.[23]

While much of the focus on Payday Lending has been on the emergence of store-front payday lenders, it should be noted that the online payday lending industry has also grown significantly in Australia in the last decade, comprising both Australian and off-shore lenders. According to the research report *Payday Loans: Helping hand or quicksand? An examination of high-cost short term lending in Australia*, *2002-2010* although the online environment currently represents only a small proportion of the payday loan industry (4% of survey respondents sourced their loan online), it exhibits potential for significant growth. This is due to online lending businesses being easy to establish with very few overheads, [24] and having strong consumer appeal by providing private, fast, convenient and easily-accessible 24 hour access to credit.[25] With this in mind, it is important that any consideration of payday lending regulation is designed to incorporate and be responsive to this online industry presence.

Ultimately, due to the expanding nature of the payday lending industry, as well as the lack of any recent research into market size, there is no concrete evidence of this. This gap means that estimates only are available.

2.2.2. Why are payday loans more expensive?

The Discussion Paper "Payday lending in South Australia – options to increase consumer protection" indicated that the typical payday loan was in the range $100 to $500 for a period of

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[18] Dean Wilson, *Payday Lending in Victoria- A research report* (2002) (Consumer Law Centre of Victoria) 34.
[19] Queensland Office of Fair Trading (Qld OFT), *Payday Lending – A Report to the Minister of Fair Trading* (2000) i
[20] Jane Searle, 'Cash in Demand' (August 2007) 23-29 *BRW* 36-33.
[21] Zac Gillam and the Consumer Action Law Centre, *Payday Loans: Helping hand or quicksand? An examination of high-cost short term lending in Australia*, *2002-2010* (September 2010) 9.
[22] Cash Converters, *Submission to the Small Amount Cash Lending Inquiry* (2008) 3.
[23] Jane Searle, 'Cash in Demand' (August 2007) 23-29 *BRW* 36-33.
[24] Zac Gillam and the Consumer Action Law Centre, *Payday Loans: Helping hand or quicksand? An examination of high-cost short term lending in Australia*, *2002-2010* (September 2010) 11-12.
[25] Zac Gillam and the Consumer Action Law Centre, *Payday Loans: Helping hand or quicksand? An examination of high-cost short term lending in Australia*, *2002-2010* (September 2010) 11-1.

two to four weeks, involving a flat fee of $20 to $35 per $100 lent, rather than an interest rate.[26] As a result, the situation can arise where the annual percentage rate (APR) for a two week loan can range from 390% to more than 1000% for money borrowed for only a few days. Not surprisingly these rates have fuelled much of the controversy in the literature over the payday lending industry.[27]

A number of industry supporters and academics have argued that the concept of using an annualised interest rate (APR) for a short-term loan is not appropriate as it does not fairly represent the cost of the loan.[28] Sampford refers to comments made by the American National Check Cashers Association that using an APR analysis to determine the annual percentage rate for a loan which is taken out typically for a period of 2-4 weeks is comparable to:

> *... a pedestrian in New York City hailing a cab and asking about the fare to San Francisco. There is a theoretical fare, just as there is a theoretical APR for a [payday loan], but nobody enters into a transaction with the intent to pay or receive anything like that amount*.[29]

APRs are currently the norm for comparing the cost of lending in the finance industry. According to Queensland Minister for Fair Trading:

> *… an annual percentage rate is the norm for comparing the cost of lending... [given]a vast majority of people compare interest rates between lenders in deciding which lender to borrow from and a majority of consumers find it relatively easy to compare interest rates. As a generality, more people found it easy to compare interest rates than fees and charges.*[30]

However, consumer studies by Wilson in Australia in 2002 and the Office of Fair Trading in the UK in 2010 have demonstrated that many consumers find APR's a confusing measure of cost and consider the expression of the total repayment amount in dollar terms a simpler and more understandable measure.[31]

It appears that the high charges associated with payday loans may be justified by the particular problems faced by this industry. These include higher risks associated with lending to borrowers

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[26] Government of South Australia: Office of Consumer and Business Affairs, *Payday lending in South Australia - options to increase consumer protection*, *Discussion Paper* (2006) 3.

[27] Government of South Australia: Office of Consumer and Business Affairs, *Payday lending in South Australia - options to increase consumer protection*, *Discussion Paper* (2006) 3.

[28] Karen Sampford*, Regulating Pay Day Lending : The Consumer Credit (Queensland) Amendment Bill 2001*(QPL June 2001) 5; Government of South Australia: Office of Consumer and Business Affairs, *Payday lending in South Australia - options to increase consumer protection*, *Discussion Paper* (2006) 3-4**;** Office of Fair Trading (UK), *Review of High-Cost Credit: Final Report* (June 2010) 31; Dean Wilson, *Payday Lending in Victoria- A research report* (2002) (Consumer Law Centre of Victoria); Queensland Office of Fair Trading (Qld OFT), *Payday Lending – A Report to the Minister of Fair Trading* (2000) 12-13.

[29] Queensland Office of Fair Trading (Qld OFT), *Payday Lending – A Report to the Minister of Fair Trading* (2000) 12-13; Karen Sampford*, Regulating Pay Day Lending : The Consumer Credit (Queensland) Amendment Bill 2001*(QPL June 2001) 5.

[30] Quoted in: Queensland Office of Fair Trading (Qld OFT), *Payday Lending – A Report to the Minister of Fair Trading* (2000) 12-13; Karen Sampford*, Regulating Pay Day Lending : The Consumer Credit (Queensland) Amendment Bill 2001*(QPL June 2001) 5.

[31] Office of Fair Trading (UK), *Review of High-Cost Credit: Final Report* (June 2010) 31; Dean Wilson, *Payday Lending in Victoria- A research report* (2002) (Consumer Law Centre of Victoria) 77.

with low income or impaired credit ratings. [32] They also include high administrative overheads involved in providing short-term low value loans.[33] The low value of the loan means that administration costs are higher per loan for short-term credit.[34] This is supported by Lawrence and Elliehausen's economic evaluation of payday lending.[35] Their analysis demonstrated that companies providing larger loans have lower costs per dollar of credit extended than those providing smaller loans, so that, for a given interest rate, larger loans are more profitable than smaller loans.[36]

According to research by Burton, online lenders face even higher costs, because they reject a higher proportion of loan applications, and they face higher rates of fraud and default.[37] These appear to be among the reasons why mainstream lenders do not provide such loans but offer credit cards as an alternative.[38]

It should further be noted that anecdotal evidence from Industry, as well as research done by Burton for Consumer Focus in the UK indicates that payday lenders finance the main share of their businesses from internal resources, meaning that they carry a far greater risk than mainstream credit providers.[39]

Very little empirical data on the costing structure of the payday industry in Australia is available. Ernst & Young in their report *The Cost of Providing Payday Loans in Canada: A Report Prepared for the Canadian Association of Community Financial Service Providers* considered the cost of a payday loan included fixed and variable operating costs, the cost of the loan capital and bad debt costs.[40] They concluded that costing largely depended on the size of the lender, with larger companies having lower average costs because of economies of scale.[41]

The lack of any current reliable information on the costs of payday loans to the lenders provides a significant impediment to regulating fees and/or interest charged. Ernst & Young in their report advised that any attempt at regulation would need to take into account the underlying costs (i.e. fixed and variable costs as well as bad debt costs) of the loan.[42] Fees and interest must

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[32] Government of South Australia: Office of Consumer and Business Affairs, *Payday lending in South Australia - options to increase consumer protection*, *Discussion Paper* (2006) 4; Marie Burton, *Keeping the Plates Spinning: Perceptions of Payday Loan in Great Britain* (2010) (for Consumer Focus) 13.

[33] Government of South Australia: Office of Consumer and Business Affairs, *Payday lending in South Australia - options to increase consumer protection*, *Discussion Paper* (2006) 4; Marie Burton, *Keeping the Plates Spinning: Perceptions of Payday Loan in Great Britain* (2010) (for Consumer Focus) 13; Karen Sampford*, Regulating Pay Day Lending : The Consumer Credit (Queensland) Amendment Bill 2001*(QPL June 2001) p 4.

[34] Office of Fair Trading (UK), *Review of High-Cost Credit: Final Report* (June 2010) 5; Dean Wilson, *Payday Lending in Victoria- A research report* (2002) (Consumer Law Centre of Victoria) 33.

[35] Edward C. Lawrence and Gregory Elliehausen, 'A Comparative Analysis of Payday Loan Customers' (2008) 26:2 *Contemporary Economic Policy* 300-302.

[36] Edward C. Lawrence and Gregory Elliehausen, 'A Comparative Analysis of Payday Loan Customers' (2008) 26:2 *Contemporary Economic Policy* 301.

[37] Marie Burton, *Keeping the Plates Spinning: Perceptions of Payday Loan in Great Britain* (2010) (for Consumer Focus) 14.

[38] Government of South Australia: Office of Consumer and Business Affairs, *Payday lending in South Australia - options to increase consumer protection*, *Discussion Paper* (2006) 4.

[39] Marie Burton, *Keeping the Plates Spinning: Perceptions of Payday Loan in Great Britain* (2010) (for Consumer Focus) 13

[40] Ernst & Young Tax Policy Services Group, *The Cost of Providing Payday Loans in Canada: A Report Prepared for the Canadian Association of Community Financial Service Providers* (October 2004) pp 8 -10.

[41] Ernst & Young Tax Policy Services Group, *The Cost of Providing Payday Loans in Canada: A Report Prepared for the Canadian Association of Community Financial Service Providers* (October 2004) pp 8, 46.

[42] Ernst & Young Tax Policy Services Group, *The Cost of Providing Payday Loans in Canada: A Report Prepared for the Canadian Association of Community Financial Service Providers* (October 2004) pp 7, 45-46.

be sufficient to cover the average total costs of providing payday loans in order to maintain a viable long-term payday loan industry, and preserve current competition in the market.[43]

As summarised by Lawrence and Elliehausen:

> *Unfortunately, despite the strong opinions held by both sides, there has been very little academic research conducted on the industry to allow policymakers to understand what ... the true benefits and costs are.* [44]

3. Benefits and Perceived Problems Associated with Payday Lending

3.1 Benefits Associated with Payday Lending

There is broad agreement in the literature concerning the benefits associated with payday lending services.

The benefit most commonly identified is that these services can help meet the needs of people who do not have ready access to mainstream financial services because they are financially excluded, or have only limited access to a small number of financial services.[45] Research into what type of consumers borrow from payday lenders and why, reports that for these consumers, payday lending services can represent the only form of borrowing available,[46] and are essential to help buffer shocks to income created by large bills and sudden emergencies.[47]

This benefit was also identified by Malbon, in the *Do the Poor Pay More?,* a Report by consumer lawyers that considered the outcomes for low-income consumers of more than a decade of microeconomic reform. This Report defined financial exclusion as:

> *the lack of access to financial services by individuals or communities due to their geographic location, economic situation or any other 'anomalous' social condition which prevents them from fully participating in the economic and social structures of mainstream communities.*

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[43] Ernst & Young Tax Policy Services Group, *The Cost of Providing Payday Loans in Canada: A Report Prepared for the Canadian Association of Community Financial Service Providers* (October 2004) p7.

[44] Edward C. Lawrence and Gregory Elliehausen, 'A Comparative Analysis of Payday Loan Customers' (2008) 26:2 *Contemporary Economic Policy* 299.

[45] Office of Fair Trading (UK), *Review of High-Cost Credit: Final Report* (June 2010) 14; Australia and New Zealand Banking Group Limited, *Community Development Finance in Australia - A Discussion Paper* (May 2004) 2; C. Connolly, and K. Hajaj, *Financial Services and Social Exclusion* (2001) (Report prepared for the Chifley Research Centre, University of NSW) 1.

[46] Office of Fair Trading (UK), *Review of High-Cost Credit: Final Report* (June 2010) 14; Australia and New Zealand Banking Group Limited, *Community Development Finance in Australia - A Discussion Paper* (May 2004) 2.

[47] Office of Fair Trading (UK), *Review of High-Cost Credit: Final Report* (June 2010) 14; Australia and New Zealand Banking Group Limited, *Community Development Finance in Australia - A Discussion Paper* (May 2004) 2; Dean Wilson, *Payday Lending in Victoria- A research report* (2002) (Consumer Law Centre of Victoria) 66, 67; Thinkwell Research, *Payday Loan Customer Study: Final Report* (September 2010) (for the Canadian Payday Loan Association) 4, 9.

> *Accordingly, financial exclusion is a key policy concern since the options for operating a household budget without mainstream financial services are more expensive, often unregulated and very limiting.*[48]

In addition, research by Wilson,[49] Burton,[50] OFT (UK),[51]Thinkwell Research (Canada),[52] Stobaus,[53] and Sampford,[54] all indicate that payday lenders attract consumers (both low income and otherwise) with their accessibility, convenience and speed of access (i.e. in terms of its use as an emergency borrowing facility). According to Burton:

> *Some consumers are positively choosing this form of lending as a result of deficiencies in what is available to them in the mainstream: They see payday loan fees as clearer than the charging structures for other forms of finance; they feel more able to 'control' their debt by taking out a short-term payday loan than by using other finance options; [and] other forms of finance are often not considered or seen as an option because they were not available to these consumers (e.g. due to poor credit ratings) or negative associations, such as the potential for longer-term debt.* [55]

Further consumer benefits which Burton's study identified were that consumers found payday lending easier to understand than credit card charges in terms of how much they had to pay back and when, and that this lending avoided problems consumers encountered when using traditional products such as overdrafts and credit cards as a short-term borrowing option. Burton's research indicated that payday loans were seen as a 'luxury' in that the borrowers were aware that the cost of the loan was high, but they believed they were getting value for money in other ways (i.e. speed, customer service and convenience).[56]

This concept of consumer convenience and customer service is a particularly strong feature within the literature, with Malbon stating:

> *The front counter experience is a powerful one for many consumers, not just vulnerable consumers... A consumer who feels looked down upon or not treated with respect is likely to take their business elsewhere. Payday lenders are very effective in taking advantage of the humiliating or bureaucratic experiences their customers receive from mainstream lenders. They provide a quick and easy service and make vulnerable consumers feel welcome...It is the banks' failure to cater for these consumers that, in part, has facilitated the emergence of payday lending.*[57]

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[48] Dr Justin Malbon, 'Do the Poor Pay More for Credit' in Anna Stewart (ed), *Do the Poor Pay More?* (2005) (Consumer Law Centre Victoria) 17, 17, 6.
[49] Dean Wilson, *Payday Lending in Victoria- A research report* (2002) (Consumer Law Centre of Victoria).
[50] Marie Burton, *Keeping the Plates Spinning: Perceptions of Payday Loan in Great Britain* (2010) (for Consumer Focus) 9.
[51] Office of Fair Trading (UK), *Review of High-Cost Credit: Final Report* (June 2010) 1.
[52] Thinkwell Research, *Payday Loan Customer Study: Final Report* (September 2010) (for the Canadian Payday Loan Association) 4, 9.
[53] Pat Stobaus, *Background Paper on Payday Lending* (2009) (West Heidelberg Legal Community Legal Service) 1.
[54] Karen Sampford*, Regulating Pay Day Lending : The Consumer Credit (Queensland) Amendment Bill 2001*(QPL June 2001) 3, 8-9.
[55] Marie Burton, *Keeping the Plates Spinning: Perceptions of Payday Loan in Great Britain* (2010) (for Consumer Focus) 35.
[56] Marie Burton, *Keeping the Plates Spinning: Perceptions of Payday Loan in Great Britain* (2010) (for Consumer Focus) 9.
[57] Dr Justin Malbon, 'Do the Poor Pay More for Credit' in Anna Stewart (ed), *Do the Poor Pay More?* (2005) (Consumer Law Centre Victoria) 17, 17, 6.

Furthermore, Wilson's study into payday loans, which included material gathered from 12 in-depth interviews with payday loan consumers found that:

> *A repeated theme that emerged from the responses of all consumers interviewed was the high standard of customer service provided by payday lenders. Payday lenders have been quite explicit about this in their own literature. The commitment to customer service is taken quite seriously, and in this area it is clear that payday lenders have some lessons for mainstream financial services providers.*
>
> *The importance of this to consumers cannot be overstated. Visually payday lenders mimic mainstream financial providers, and this heightens feelings amongst consumers that they are active participants in a commercial economy.*
>
> *Further visits to payday lenders also involved a 'personalised' level of service. Consumers spoke favourably of their interactions with payday lending staff, and generally had pleasant recollections of their visits. For most consumers there was no stigma attached to visiting a payday lender. They are viewed as a legitimate means of accessing credit...*[58]

The overall response which Wilson received from the interviews was that while consumers considered the cost of payday loans to be high, they found the customer service and design of the financial product pleasing, and appreciated having a source of credit, viewing the high cost as a 'trade-off'.[59] The OFT report further states that while the rates charged by payday lenders are high, they can be lower than some mainstream alternatives such as unarranged overdrafts.[60]

However Sampford notes that this strong consumer brand loyalty does result in consumers' failing to fuel competition since they do not usually shop around for the best price. [61]

As such payday loans have been identified as meeting consumer needs, providing a popular financial product and ensuring a very personalised and friendly service, in which clients speak of being treated with dignity and respect regardless of their financial situation. Payday loans can also appear to provide a legitimate, easily inspected and regulated source of credit, as opposed to informal lending or an underground black market lending regime.

3.2 Perceived Problems Associated with Payday Lending

Despite these benefits, a number of concerns have been expressed with regard to payday lending and the market failures associated with it that may require regulation.

Wilson's report identified the major criticisms of payday lending as follows:

- Payday lenders charge unconscionably high interest rates with effective interest charges as high as 1300% per annum;

[58] Dean Wilson, *Payday Lending in Victoria- A research report* (2002) (Consumer Law Centre of Victoria) 76.
[59] Dean Wilson, *Payday Lending in Victoria- A research report* (2002) (Consumer Law Centre of Victoria) 77, 79.
[60] Office of Fair Trading (UK), *Review of High-Cost Credit: Final Report* (June 2010) 1.
[61] Karen Sampford, *Regulating Pay Day Lending : The Consumer Credit (Queensland) Amendment Bill 2001*(QPL June 2001) 8-9.

- Payday lenders target vulnerable consumers;
- Payday loans lead such consumers into debt spirals through "rollover" and "back-to-back" loans;
- Lenders use direct debit as a form of payment guarantee, thus giving them first take at the income of those who may be in financial difficulty and exposing them to high dishonour fees from banks. [62]

Wilson's report argued that the use of rollovers has the potential to create 'debt traps' where 'vulnerable consumers' experience an inability to repay due to:

> *...financial difficulties, worsened by the high cost of credit, mean*[ing] *that debtors are forced to rollover their loans or borrow back-to-back, and incur further fees and charges.*[63]

These concerns have more recently been echoed by Burton, who makes two main criticisms of the payday industry: that payday loans are expensive in terms of APR, while conceding that these may be justified by the high cost of lending small sums of money, and that most borrowers are repeat borrowers who can fall into a 'debt spiral'.[64]

Similarly, consumer forums conducted as part of the Victorian Small Amount Lending Inquiry in 2008 found that:

> *The most prominent areas of concern were the price and availability of small amount credit and their impact on vulnerable borrowers.*[65]

In particular the Inquiry noted concerns of consumer advocates that lenders failed to adequately or properly assess the capacity of consumers to repay loans. This was an issue due to the financial difficulty of some consumers in making ends meet and the excessive cost of small amount loans. The Inquiry also noted that consumer advocates considered that proper assessment of capacity to repay would result in fewer consumers being eligible for such loans.[66] Concerns were also raised that complaint handling processes were not transparent, and that some payday loans involved the use of security taken over household goods. Sampford also identified major problems associated with pay day lending as including the high cost to borrowers, the practice of rolling-over of loans and taking security over property, which may be disproportionate to the amount loaned.[67] However, within the literature there is no evidence of the existence or extent of such a practice occurring in Australia. The *National Credit Code* (and formerly the *Uniform Consumer Credit Code* (UCCC)) includes provisions making void mortgages of all property (s 44NCC; s40 UCC) and prohibiting mortgages of essential household goods (s 50 NCC; s 46 UCC), with the latter provision having being introduced into the UCCC to stop predatory practices then prevailing.

A 2006 Discussion Paper by the Government of South Australia's Office of Consumer and Business Affairs, which endorsed the issues raised by Wilson's report, added that:

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[62] Dean Wilson, *Payday Lending in Victoria- A research report* (2002) (Consumer Law Centre of Victoria) 33.
[63] Dean Wilson, *Payday Lending in Victoria- A research report* (2002) (Consumer Law Centre of Victoria) 33.
[64] Marie Burton, *Keeping the Plates Spinning: Perceptions of Payday Loan in Great Britain* (2010) (for Consumer Focus) 5.
[65] Robin Scott MP, *Small Amount Lending Inquiry 2008: Report to Tony Robinson MP Minister for Consumer Affairs* (2009) (Department of Justice Consumer Affairs Victoria) 19.
[66] Robin Scott MP, *Small Amount Lending Inquiry 2008: Report to Tony Robinson MP Minister for Consumer Affairs* (2009) (Department of Justice Consumer Affairs Victoria) 22.
[67] Karen Sampford, *Regulating Pay Day Lending : The Consumer Credit (Queensland) Amendment Bill 2001*(QPL June 2001) 1, 7.

It would appear that the problems resulting from payday lending are in the nature of social justice or inequity problems - of the poor paying more for credit than higher income consumers and becoming over-committed financially by entering into high cost loans that they have little prospect of repaying.

The problems posed by payday lenders could not be characterised as resulting from market failure due to an inability of consumers to ascertain which payday lenders are competent or honest. It has not been demonstrated that consumers suffer detriment as a result of payday lenders acting incompetently, eg failing to properly prepare loan documentation. Similarly, it appears that payday lenders generally comply with the disclosure requirements contained in the Credit Code. Rather, the main problems of payday lending in SA are the high costs and credit over-commitment.

Without detailed information about payday lenders' costs, it is difficult to be certain whether payday lenders' charges can be justified, that is, whether payday loan fees fairly reflect the costs (to the lender) of high-risk, short term small amount lending.[68]

This Discussion Paper also observed:

It does appear though in OCBA's view that payday lending problems stem from the absence of rigorous standards for assessing a borrower's capacity to repay.[69]

Malbon's report regarded the problem with payday lending as follows:

The problem we are seeking to address: predatory lending- practices, which promote or exacerbate poverty. Unchecked, predatory lending has the capacity to undermine social cohesion and wreak havoc upon families.[70]

But noted that:

Consumer debt is not solely attributable to predatory lending, indeed it only accounts for a relatively small proportion of that debt. [71]

However the Office of Fair Trading (UK) in their 2010 review of the high-cost credit identified the problems of payday lending as simply being systemic to a lack of competition in the market:

While we consider that these markets are operating reasonably well in some respects, we do have some concerns with the effectiveness of competition in these markets that have arisen from this review...on the demand side, there is relatively low ability and effectiveness of consumers in driving competition between suppliers, given their low levels of financial capability... on the supply side, sources of additional supply such as mainstream financial suppliers seem to be limited, and ...in such circumstances,

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[68] Government of South Australia: Office of Consumer and Business Affairs, *Payday lending in South Australia - options to increase consumer protection*, *Discussion Paper* (2006) 6.
[69] Government of South Australia: Office of Consumer and Business Affairs, *Payday lending in South Australia - options to increase consumer protection*, *Discussion Paper* (2006) 7.
[70] Dr Justin Malbon, Do the Poor Pay More for Credit' in Anna Stewart (Deputy Director Consumer Law Centre Victoria) Do the Poor Pay More? (2005) 17- 34, 17.
[71] Dr Justin Malbon, Do the Poor Pay More for Credit' in Anna Stewart (Deputy Director Consumer Law Centre Victoria) Do the Poor Pay More? (2005) 17- 34, 17.

competition on price is limited and there appear to be some suppliers charging higher prices than would be expected [in a competitive market].[72]

3.3 The CALC 2010 Report

The research report *Payday Loans: Helping hand or quicksand? An examination of high-cost short term lending in Australia*, *2002-2010* [73] (the CALC 2010 Report) updated Wilson's 2002 report into the impact of high-cost short term lending in Victoria.[74] CALC is one of Australia's largest consumer advocacy and public interest organizations, focusing on advancing the interests of low-income and vulnerable consumers.

The CALC Report makes recommendations for regulation of the payday loan market, focusing principally on the policy issues surrounding the implementation of comprehensive interest rate caps.

The quantitative research undertaken for the Report included commissioning research company "Pure Profile" to undertake an online survey of high-cost short-term loan borrowers. Short-term loan borrowers were those who took a cash loan of under $2,000 from a registered institution that was to be repaid within an 8 week period.[75]The amount and repayment period used for the survey exceeds the average payday loan, but CALC argued that this was necessary to fully capture the desired respondent base. Although the survey generated 448 responses during May 2008, this broad definition of 'short term loan' may limit the usefulness of the results so far as payday lending is concerned. It can also be criticised as self-selecting only those consumers with computer access/skills. There is also no indication as to how the online survey was conducted or initiated and if it was targeted.

CALC also contracted the "Open Mind Research Group" to undertake a small scale qualitative study which involved a combination of group discussion, in-depth interviews and extended in-home interviews of high-cost short term loan borrowers in Melbourne, notably from Footscray and Geelong. This involved 12 in-depth interviews with payday loan consumers, whose ages ranged from 23 to 55, with ten participants classified as low-income earners, 1 participant lower middle-income earner and 1 participant as a higher middle-income.[76] The aim of the Open Mind report was to identify the sociological and psychological drivers of payday lending and the impact on borrowers. The limited number of participants,[77] in a small geographic area, means that the results may not be representative.

Finally, in September 2009, Consumer Action distributed a case study template to financial counsellors, seeking anonymous case studies of clients with a history of high-cost short term loans. The response rate was low -eleven responses- and such case studies may be 'worse case scenarios', so these factors may limit reliance on the results.

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[72] Office of Fair Trading (UK), *Review of High-Cost Credit: Final Report* (June 2010) 27.

[73] Zac Gillam and the Consumer Action Law Centre, *Payday Loans: Helping hand or quicksand? An examination of high-cost short term lending in Australia*, 2002-2010 (September 2010) 35, 36.

[74] Dean Wilson, *Payday Lending in Victoria- A research report* (2002) (Consumer Law Centre of Victoria).

[75] Zac Gillam and the Consumer Action Law Centre, *Payday Loans: Helping hand or quicksand? An examination of high-cost short term lending in Australia*, 2002-2010 (September 2010) 35, 36.

[76] Dean Wilson, *Payday Lending in Victoria- A research report* (2002) (Consumer Law Centre of Victoria) 71.

[77] Zac Gillam and the Consumer Action Law Centre, *Payday Loans: Helping hand or quicksand? An examination of high-cost short term lending in Australia*, 2002-2010 (September 2010) 37.

The Report concluded by advocating a comprehensive 48 % interest rate cap (such as those which currently exist in Queensland and New South Wales) as the only genuinely effective legislative measure to be taken against high-cost short-term lending. The conclusion was based predominately on American literature and the US experience, as well as anecdotal evidence and publicly available financial reports on Cash Converters, rather than the survey data. In doing so the Report did not acknowledge the findings of the UK OFT report (launched in July 2009 in the middle of the CALC project and published prior to the CACL report) and its recommendations that price controls for pawnbroking, payday loans, home credit and rent-to-buy credit would not be an appropriate solution to the particular concerns which have been identified in these high-cost credit markets.

The CALC report also criticised payday lending as being harmful to consumers and their financial position where used other than as a 'one-off', on the basis that it creates a system of repeat borrowing which in turn causes an ongoing debt spiral:

- *Ongoing repeat borrowing sequesters a proportion of the borrower's already limited income and assigns it to the service of ongoing, high interest debt. This prevents the borrower from stabilising their fragile financial position.*[78]

- *In this circumstance, the consumer finds they are not 'choosing' to purchase the product but are instead locked into a forced cycle of repeat borrowing. This has a strongly negative impact on their quality of life, prevents them from stabilising their financial position and detracts from their capacity to participate in the mainstream economy.*[79]

According to the Report, payday loans are also harmful because they take a “first stake” in the consumer’s income - impinging on their capacity to meet basic needs without further borrowing.[80]

However, despite the Report’s claims that repeat borrowing represents a major problem associated with payday lending, exploiting the financial distress of borrowers and perpetuating hardship,[81] their 2008 Consumer Action survey did not identify a high degree of repeat borrowing among respondents.[82] The survey found that 46.4% (208 of 448) of borrowers had taken out only one loan in the past 18 months, and a further 27.5% (123 of 448) reported having taken out only two (collectively this represented 73.9%of respondents).[83] Overall, the survey found that 86.4% of respondents had taken out four or less high-cost short term loans over an eighteen month period, with over half of those reporting only one loan. This indicated that repeat borrowing was not a high occurrence among short-term loan consumers.[84]

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[78] Zac Gillam and the Consumer Action Law Centre, *Payday Loans: Helping hand or quicksand? An examination of high-cost short term lending in Australia*, *2002-2010* (September 2010) 26.
[79] Zac Gillam and the Consumer Action Law Centre, *Payday Loans: Helping hand or quicksand? An examination of high-cost short term lending in Australia*, *2002-2010* (September 2010) 204.
[80] Zac Gillam and the Consumer Action Law Centre, *Payday Loans: Helping hand or quicksand? An examination of high-cost short term lending in Australia*, *2002-2010* (September 2010) 26-27, 205.
[81] Zac Gillam and the Consumer Action Law Centre, *Payday Loans: Helping hand or quicksand? An examination of high-cost short term lending in Australia*, *2002-2010* (September 2010) 33.
[82] Zac Gillam and the Consumer Action Law Centre, *Payday Loans: Helping hand or quicksand? An examination of high-cost short term lending in Australia*, *2002-2010* (September 2010) 7, 8, 69.
[83] Zac Gillam and the Consumer Action Law Centre, *Payday Loans: Helping hand or quicksand? An examination of high-cost short term lending in Australia*, *2002-2010* (September 2010) 7, 8, 69.
[84] Zac Gillam and the Consumer Action Law Centre, *Payday Loans: Helping hand or quicksand? An examination of high-cost short term lending in Australia*, *2002-2010* (September 2010) 7, 8, 69.

While the issue of repeat borrowing appears to be a significant issue within the literature, and is frequently cited as a major risk of high-cost short term lending, the extent to which it is a problem in the Australian payday market is questionable. As pointed out by the CALC Report, there is a lack of comprehensive Australian data regarding repeat borrowing behaviour by high-cost short term loan borrowers, and much of the allegations which exist derive from anecdotal evidence which suggests the practice may be common.[85] Clearly, the issue of repeat borrowing requires further research to identify whether it is indeed a problem within the payday lending industry.

Ultimately while the Report does present some useful data from its survey and interview studies, questions remain as to whether the sample used was representative for payday lending and why the Report's findings on interest rate cap regulation were based on anecdotal evidence rather than actual data.

A comparative table outlining the perceived problems associated with the payday loan industry, and how they may now be addressed under the new National Consumer Credit Regime is contained in Appendix A of this Study.

4. Regulatory models in other jurisdictions

During the past two decades the USA, Canada and the United Kingdom have experienced a rapid emergence and expansion of payday lending in their alternative finance sectors, with current indications suggesting that these expansions will continue into the foreseeable future.[86] In response to this phenomenon, each of these countries has attempted to develop their own models for industry regulation of payday lending.

4.1. United States of America

Regulation of payday lending in the USA is predominantly state-based.[87] The practice is legal and regulated in 37 states.[88] Some writers[89] report that in 13 states payday lending is either illegal or unviable due to the imposition of interest rate caps (which set the maximum interest rate well below what is charged for payday loans) combined with usury laws.[90]

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[85] Zac Gillam and the Consumer Action Law Centre, *Payday Loans: Helping hand or quicksand? An examination of high-cost short term lending in Australia*, *2002-2010* (September 2010) 68.

[86] Robin Scott MP, *Small Amount Lending Inquiry 2008: Report to Tony Robinson MP Minister for Consumer Affairs* (2009) (Department of Justice Consumer Affairs Victoria) 29.

[87] Dean Wilson, *Payday Lending in Victoria- A research report* (2002) (Consumer Law Centre of Victoria) 25; Robin Scott MP, *Small Amount Lending Inquiry 2008: Report to Tony Robinson MP Minister for Consumer Affairs* (2009) (Department of Justice Consumer Affairs Victoria) 26.

[88] Anna Ellison and Robert Forster, *The Impact of Interest Rate Ceilings: the Evidence from International experience and the implications or regulation and consumer protection in the credit market in Australia* (2008) 2; Consumer Federation of America, *Payday Loan Consumer Information* (2010) http://www.paydayloaninfo.org/legal.asp, at 8 September 2010.

[89] Robin Scott MP, *Small Amount Lending Inquiry 2008: Report to Tony Robinson MP Minister for Consumer Affairs* (2009) (Department of Justice Consumer Affairs Victoria) 26; Dean Wilson, *Payday Lending in Victoria- A research report* (2002) (Consumer Law Centre of Victoria) 26.

[90] Zac Gillam and the Consumer Action Law Centre, *Payday Loans: Helping hand or quicksand? An examination of high-cost short term lending in Australia* (2010); Marie Burton, *Keeping the Plates Spinning: Perceptions of Payday Loan in Great Britain* (2010) (for Consumer Focus) 16.

Where payday lending is legal, some states regulate through lender licensing regimes and statutory limitations on the amount or number of renewals of loans.[91] There are often prohibitions on the use of threats of criminal prosecution, and fees are often capped at 20% for the first $300 loaned, and 7.5% for any funds over $300.[92]

In 2006 Federal legislation was passed to cap fees at 36% nationwide on payday loans to military personnel and their dependants,[93] addressing a growing concern by consumer advocates about payday lenders' apparently targeting military bases.[94] As a form of consumer loans, payday loans are also subject to the federal Truth in Lending Act (15 U.S.C. § 1601) implemented by the Federal Reserve Board's Regulations Z, which requires the disclosure of the price and other terms of consumer credit transactions.

In terms of the American literature, the observation by Wilson in 2002[95] that the majority of studies and research on payday lending has emerged from the USA, remains true today, perhaps because the USA has the largest payday lending industry worldwide. Estimates of its value were provided by Morse and Ernst, reporting in 2006 that over $28 billion in payday loans were written annually,[96] and by the Europe Economics report for the UK Office of Fair Trading in 2009, providing the figure of $40 billion.[97]

Although much of the Australian literature refers to the American payday lending experience, there are key differences between the two systems, and for this reason American literature will not be examined in any detail. Although both environments use the term "payday" lending, the loans differ in form and the socio-economic conditions of the borrowers. In form, American payday loans usually take the form of a 'deferred presentment transaction' by which the lender accepts a post-dated cheque from the borrower and in return advances a cash loan. The borrower can then pay the lender in cash and have the cheque returned, or the lender may deposit the cheque to retrieve the amount lent.[98] This cash and cheque nature of payday lending reflects the American financial environment, in which twenty eight million Americans do not have a bank account and therefore cannot access the majority of financial loan products, and millions more are ineligible through unemployment or because they are paid through the "black economy" (i.e. cash in hand).[99] This means that payday lending in America is closely connected with unemployment and financial exclusion. This can be contrasted with the Australian model which uses a direct debit authority, in a financial environment in which

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[91] Robin Scott MP, *Small Amount Lending Inquiry 2008: Report to Tony Robinson MP Minister for Consumer Affairs* (2009) (Department of Justice Consumer Affairs Victoria) 26; R.J. Mann and J. Hawkins J, 'Just Until Payday' (2007) 54:4 *UCLA Law Review 855* 857-912; Marie Burton, *Keeping the Plates Spinning: Perceptions of Payday Loan in Great Britain* (2010) (for Consumer Focus) 15-16.

[92] Robin Scott MP, *Small Amount Lending Inquiry 2008: Report to Tony Robinson MP Minister for Consumer Affairs* (2009) (Department of Justice Consumer Affairs Victoria) 26; R.J. Mann and J. Hawkins J, 'Just Until Payday' (2007) 54:4 *UCLA Law Review 855* 857-912; Marie Burton, *Keeping the Plates Spinning: Perceptions of Payday Loan in Great Britain* (2010) (for Consumer Focus) 15-16.

[93] Robin Scott MP, *Small Amount Lending Inquiry 2008: Report to Tony Robinson MP Minister for Consumer Affairs* (2009) (Department of Justice Consumer Affairs Victoria) 26.

[94] Zac Gillam and the Consumer Action Law Centre, *Payday Loans: Helping hand or quicksand? An examination of high-cost short term lending in Australia* (2010) 134-136.

[95] Dean Wilson, *Payday Lending in Victoria- A research report* (2002) (Consumer Law Centre of Victoria) 19.

[96] A. Morse, *Payday Lenders: Heroes or Villains? (*2006) (in association with the Ross School of Business); Keith Ernst, John Farris, Uriah King, *Quantifying the Economic Cost of Predatory Payday Lending* (2003) (Centre for Responsible Lending) 2.

[97] Office of Fair Trading (UK), *A report by Europe Economics for the OFT International research: Case studies on Ireland, Germany and the United States* (December 2009) 66.

[98] Dean Wilson, *Payday Lending in Victoria- A research report* (2002) (Consumer Law Centre of Victoria) 25; Marie Burton, *Keeping the Plates Spinning: Perceptions of Payday Loan in Great Britain* (2010) (for Consumer Focus) 15-16.

[99] The Social Research Centre, *ANZ Survey of Financial Literacy in Australia* (October 2008) (ANZ Bank) 37.

approximately 97% of the population hold a bank account.[100] The different nature of the payday lending products means that that the American system of payday lending results in the provision of different financial services, administrative tasks, different costing structures, payment systems, default systems and charges. It has also resulted in a different and more fragmented regulatory response in the USA.

4.2 Canada

Canada has experienced a strong rise in payday lending, and in the size of the alternative financial sector generally.[101] Although transactions there can be by use of a post-dated cheque, more commonly the form resembles an Australian payday loan by using a direct debit from the borrower's bank account.[102] All provinces have some consumer protection legislation regulating disclosure in credit contracts,[103] while several also provide remedies for excessive credit charges by allowing reopening of unconscionable credit contracts under the *Unconscionable Transaction Relief Acts.*[104]

Federal regulation was originally limited to s347 of the Canadian *Criminal Code*, which made charging more than 60% interest per year a criminal offence, but in 2007 amendments exempted payday loans under $1500 and for less than 62 days from this.[105] The 2007 amendments provided guidelines on how the provinces might regulate payday lending, including limiting the total cost of borrowing and licensing of lenders. Since then, some provinces have introduced regulation consistent with the national guidelines, including the 'implication of cancellation' protections, disclosure requirements, rollover prohibition and licensing.[106]

In 2009 British Columbia introduced new payday loan regulation under which the maximum charges for short term loans are capped at 23% (including interest and fees), the borrower can cancel the loan by the end of the day following the signing the agreement without paying any charge, only one loan per borrower at a time is permitted, a lender must not extend a loan with additional charges or issue a new loan to pay out an existing loan, and the lender's ability to access the borrower's bank or employer in order to have first claim over their salary has been restricted.[107] Lenders are also prohibited from lending more than 50 percent of a borrower's take-home pay or requiring repayment before the borrower's next payday. All lenders are required to register with the Business Practices and Consumer Protection Authority.[108]

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[100] The Social Research Centre, *ANZ Survey of Financial Literacy in Australia* (October 2008) (ANZ Bank) 37.
[101] Iain Ramsay, *Access to Credit in the Alternative Consumer Credit Market* (2000) (for the Office of Consumer Affairs, Industry Canada/ Ministery of Attorney General, British Columbia) 1-3; Scott MP, *Small Amount Lending Inquiry 2008: Report to Tony Robinson MP Minister for Consumer Affairs* (2009) (Department of Justice Consumer Affairs Victoria) 26, 27.
[102] Dean Wilson, *Payday Lending in Victoria- A research report* (2002) (Consumer Law Centre of Victoria) 27.
[103] Dean Wilson, *Payday Lending in Victoria- A research report* (2002) (Consumer Law Centre of Victoria) 27, 28; Scott MP, *Small Amount Lending Inquiry 2008: Report to Tony Robinson MP Minister for Consumer Affairs* (2009) (Department of Justice Consumer Affairs Victoria) 27.
[104] [RSPEI 1988] *Unconscionable Transactions Act*. Cap. U-2; [RSNB 1987] *Unconscionable Transactions Relief Act*. C. U; [RSNL 1990] *Unconscionable Transaction Relief Act*. U-1.
[105] Office of Fair Trading (UK), *High-cost consumer credit – emerging evidence from the review* (December 2009) 15; Scott MP, *Small Amount Lending Inquiry 2008: Report to Tony Robinson MP Minister for Consumer Affairs* (2009) (Department of Justice Consumer Affairs Victoria) 27.
[106] Ibid.
[107] Consumers Association of Canada, *Payday Loans Regulation in British Columbia* (2010) http://www.consumer.ca/1757 at 3 January 2011.
[108] Consumers Association of Canada, *Payday Loans Regulation in British Columbia* (2010) http://www.consumer.ca/1757 at 3 January 2011.

Disclosure obligations require payday lenders to have posters near the entrance of their business displaying information including the lender's charges for a payday loan and the total cost of borrowing for a sample loan; internet lenders must have similar notices on their website.[109] The effectiveness and impact of these measures have yet to be researched.

Other provinces which have set an interest rate cap are Quebec and Manitoba (setting caps of 35% and 17% respectively). Ontario has made provision for a payday lending education fund to which licensed payday lenders contribute and which promotes financial literacy to increase consumer protection.[110]

In an attempt to achieve national uniformity of regulation, the Canadian Payday Loan Association (CPLA) developed a *Code of Best Business Practice* which commits members to a set of standards designed to protect consumers, including the prohibition of rollovers, multiple loans and the taking of collateral. The benefits of this self-regulation are limited as not all Canadian Payday lenders are members of the CPLA and a substantial number have not committed to adopting these standards.[111]

One of the most recent and expansive studies undertaken in Canada is the *Payday Loan Customer Study: Final Report* (September 2010) (for the Canadian Payday Loan Association) conducted by Thinkwell Research. This involved a large scale telephone survey of current payday loan customers in Prince Edward Island, New Brunswick and Nova Scotia, asking consumers about their practices, behaviours and opinions in relation to various financial products. The survey resulted in 350 completed interviews.

Over half of the respondents indicated that they chose payday loans rather than other financial products because they believed the process was "quick and easy" and that they were able to receive a loan whenever they needed it.[112] The most common reasons for needing a payday loan were emergency cash for necessities or unexpected expenses.[113] The survey results indicated customers were extremely satisfied with their understanding of the terms of their loan and when payment was due and with the level of customer service they received (receiving a mean score above 9 on a 10-point scale).[114] A strong majority of the respondents (89%) reported that they were able to pay back all of their loans on time.[115] The survey indicated that customers largely disagreed that Governments should have the ability to set limits on the amount of loans an individual could receive.[116]

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[109] Consumers Association of Canada, *Payday Loans Regulation in British Columbia* (2010) http://www.consumer.ca/1757 at 3 January 2011.
[110] Office of Fair Trading (UK), *High-cost consumer credit – emerging evidence from the review*(December 2009)16-17.
[111] Office of Fair Trading (UK), *High-cost consumer credit – emerging evidence from the review*(December 2009)16-17.
[112] Thinkwell Research, *Payday Loan Customer Study: Final Report* (September 2010) (for the Canadian Payday Loan Association) 4, 9.
[113] Thinkwell Research, *Payday Loan Customer Study: Final Report* (September 2010) (for the Canadian Payday Loan Association) 4, 9.
[114] Thinkwell Research, *Payday Loan Customer Study: Final Report* (September 2010) (for the Canadian Payday Loan Association) 4, 11.
[115] Thinkwell Research, *Payday Loan Customer Study: Final Report* (September 2010) (for the Canadian Payday Loan Association) 4, 10.
[116] Thinkwell Research, *Payday Loan Customer Study: Final Report* (September 2010) (for the Canadian Payday Loan Association) 4, 11-12.

Although the survey appears to have been well conducted and had a strong response rate, the results may favour the industry, given that the survey instrument was developed by CPLA in consultation with its partners, and then refined by Thinkwell Research.[117]

4.3. United Kingdom

Payday lending emerged in the United Kingdom ('UK') a decade ago, and a 130% expansion rate was recorded by the Office of Fair Trading (UK) between August 2007 and June 2008.[118] The report by Marie Burton, *Keeping the Plates Spinning: Perceptions of Payday Loan in Great Britain* (2010) for Consumer Focus, found that the UK payday lending market generated a gross income of £242 million in 2009, estimating that there were 4.1 million loans resulting in a total lending of £1.2 billion across the UK.[119] The Office of Fair Trading (UK) *Review of High-Cost Credit: Final Report* (June 2010)
found that the size high-cost lending sector was approximately £7.5 billion in 2008, making it a highly valuable part of the UK economy.[120]

In the UK, payday loans can involve the provision of a cash advance in exchange for a post-dated cheque,[121] but more commonly, use direct-debit facilities for security, similar to the Australian practice.[122]

Payday lending, as extended credit, is subject to the provisions of the *Consumer Credit Act 1974*, which require lenders to be licensed by the Office of Fair Trading (OFT) before being permitted to offer payday loans.[123] Trading without a licensing arrangement is a criminal offence. Relatively few regulations apply explicitly to payday loan lenders, but all lenders are required to comply with the rules under the *Consumer Credit Act 1974* and the Consumer Credit Directive (CCD). These require advertisements offering loans to display the Annual Percentage Rate of interest (APR), to do so more prominently and in larger type than information about comparisons or incentives, and to include a representative example.

Some significant recent UK studies into payday lending make important contributions to the literature. First, the Office of Fair Trading (UK) published its *Review of High-Cost Credit: Final Report* in June 2010. The high-cost sector identified comprised pawnbroking, payday loans, home credit and rent-to-buy credit markets. The review was conducted in response to mounting public debate over payday loans and their growth and aimed to assist the Government in considering its approach towards the regulation of this sector. The review focused on the level of competition in this market, the business models of lenders, the behaviour and decision making of consumers, and whether consumers obtained the information they needed to make good decisions.

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[117] Thinkwell Research, *Payday Loan Customer Study: Final Report* (September 2010) (for the Canadian Payday Loan Association) 3, 13.
[118] Marie Burton, *Keeping the Plates Spinning: Perceptions of Payday Loan in Great Britain* (2010) (for Consumer Focus) 5, 12-13; Office of Fair Trading (UK), *Irresponsible Lending – A Scoping Paper* (August 2008).
[119] Marie Burton, *Keeping the Plates Spinning: Perceptions of Payday Loan in Great Britain* (2010) (for Consumer Focus) 12.
[120] Office of Fair Trading (UK), *Review of High-Cost Credit: Final Report* (June 2010) 4.
[121] Dean Wilson, *Payday Lending in Victoria- A research report* (2002) (Consumer Law Centre of Victoria) 28.
[122] Marie Burton, *Keeping the Plates Spinning: Perceptions of Payday Loan in Great Britain* (2010) (for Consumer Focus) 5.
[123] Office of Fair Trading (UK), *Consumer Credit Licences* (2010) http://www.oft.gov.uk/OFTwork/credit-licensing/credit-licence/ at 16 December 2010.

The Report found that these markets worked reasonably well by serving borrowers not catered for by mainstream suppliers. Complaint levels were low. Problems associated with the sector stemmed from the low financial capability and choice of consumers when seeking credit, and limited competition in the market.[124]

The OFT concluded that capping the interest rates and other charges levied by high-cost credit providers[125] would not address the problems identified. The OFT was concerned that such controls might further reduce supply in the market and identified practical problems associated with their implementation and effectiveness. There were a number of high-cost products available at different prices based on product characteristics and target consumers. Imposing price controls would require detailed investigations into the pricing and profits of suppliers at a product- by-product level.[126] Price controls might also lead suppliers to impose a more stringent regime for late payments and default, which would have more impact on low-income consumers.[127] Another foreseeable consequence was the risk that suppliers would receive lower profits, and so might seek to regain such lost profits by restricting the type of consumers to whom they would lend and their risks, or might withdraw from the market altogether, adding to their customers' financial exclusion.[128]

The Report instead recommended helping consumers make informed decisions on high-cost credit, by making information available on price comparison sites and ensuring that financial literacy programs cover high-cost credit products. Other recommendations included increasing consumers' ability to develop a documented credit history, collecting essential information about pricing of credit, about levels of repeat business and default to inform future policies, and promoting best practice among suppliers with an industry-wide code of practice. [129] It is therefore unlikely that interest rate caps will form part of the UK regulatory environment.

Launched on 2 July 2010,[130] the benefits of this Report lie in its contemporaneous nature and objective authorship, and in the extensiveness of the research undertaken. This drew upon consumer survey studies, industry analysis and assessment and a behavioural economics experiment which examined consumers' understanding of credit products and the information they used in making decisions.

The second Report, by Marie Burton, *Keeping the Plates Spinning: Perceptions of Payday Loan in Great Britain* (2010) was commissioned for Consumer Focus, a consumer advocacy group. This Report produced a balanced analysis. In particular it highlighted that, although high APR's associated with payday loans are undesirable, they might be justified by the high cost of lending small sums of money.[131] It also noted that the socio-economic and demographic nature of payday lending in the US differs significantly from the UK market, and so did not consider them to be comparable. Further, although it recognised that some consumers suffered long term negative experiences through the use of payday loans, especially from rollovers, it confirmed through qualitative research that others found using payday loans a positive experience.[132]

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[124] Office of Fair Trading (UK), *Review of High-Cost Credit: Final Report* (June 2010) 4-5, 6, 26.
[125] Office of Fair Trading (UK), *High-cost consumer credit – emerging evidence from the review* (December 2009).
[126] Office of Fair Trading (UK), *Review of High-Cost Credit: Final Report* (June 2010) pp 9-10.
[127] Office of Fair Trading (UK), *Review of High-Cost Credit: Final Report* (June 2010) 9-10.
[128] Office of Fair Trading (UK), *Review of High-Cost Credit: Final Report* (June 2010) 9, 55-56.
[129] Office of Fair Trading (UK), *Review of High-Cost Credit: Final Report* (June 2010) 6-7.
[130] Office of Fair Trading (UK), *High-Cost Consumer Credit: Evidence from the Review* (December 2009) 2.
[131] Marie Burton, *Keeping the Plates Spinning: Perceptions of Payday Loan in Great Britain* (2010) (for Consumer Focus) 5.
[132] Marie Burton, *Keeping the Plates Spinning: Perceptions of Payday Loan in Great Britain* (2010) (for Consumer Focus) 6.

The Report found that payday loans provide consumers with a number of advantages over other forms of lending.[133] It concluded there was no clear evidence that banning payday loans would help consumers avoid financial difficulties, warning that prohibiting this market could lead to illegal lending prospering.[134] Nor did it advocate the imposition of an interest rate cap. Rather the Report called for limits on the number of loans an individual could take out at any one time, or on a repeat, or rollover basis, and the use of responsible lending measures.[135]

5. Previous Regulatory Approach in Australia

The use of consumer credit has grown rapidly in Australia over the past 20 years,[136] and the regulation of the consumer credit sector in Australia has been undergoing fundamental change. On 3 July 2008 the Council of Australian Governments (COAG) agreed that the Commonwealth Government would assume responsibility from the States and Territories for regulating all consumer credit products.[137] The Australian Government has subsequently implemented a two phase National Consumer Credit Regime which will result in the first genuinely uniform national laws for consumer credit in Australia.[138]

5.1 Uniform Consumer Credit Code

The *Uniform Consumer Credit Code* (UCCC), was the primary piece of legislation in the regulatory framework for consumer credit in Australia,[139] and was established following the 1993 agreement between the States and Territories that consumer credit laws should be consistent across all jurisdictions in Australia.[140] Template legislation was introduced in Queensland, and then each of the other states passed legislation implementing the UCCC in their jurisdictions, with the exception of Western Australia which enacted "consistent" legislation. The Code commenced operation on 1 November 1996. The Code allowed borrowers to make informed choices through disclosure requirements,[141] and provided for changes to be made to contract terms on the grounds of hardship[142] and for changes and the re-opening of unjust transactions by courts and tribunals [143] The Code also ensured mandatory comparison rates for fixed term loans.[144]

The only provisions of the UCCC which dealt directly with constraining the cost of consumer credit were section 70, which granted the Court the power to reopen unjust transactions, and section 72, which allowed the Courts to annul or reduce a change in interest rate, or fee or charge payable under a credit contract where it was deemed to be unconscionable.

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[133] Ibid 7.
[134] Ibid 7.
[135] Ibid 7.
[136] Office of Fair Trading (UK), *Review of High-Cost Credit: Interim research report* (2009), 63.
[137] Australian Government: The Treasury, *COAG Agreement* (2009); http://treasury.gov.au/consumercredit/content/coag_agreement/default.asp at 28 March 2010.
[138] Zac Gillam and the Consumer Action Law Centre, *Payday Loans: Helping hand or quicksand? An examination of high-cost short term lending in Australia* (2010) 17.
[139] Productivity Commission, *Review of Australia's Consumer Policy Framework* (2008) 2:45, 447, 446.
[140] *Australian Uniform Credit Laws Agreement 1993* (the Uniformity Agreement).
[141] *Consumer Credit Code 1994 (Qld)*, ss14 and 15.
[142] *Consumer Credit Code 1994 (Qld)*, ss66-74.
[143] *Consumer Credit Code 1994 (Qld)*, s70.
[144] *Consumer Credit Code 1994 (Qld)*, s146A.

The UCCC did not deal with all matters relating to consumer credit regulation. Clause 12 of the *Uniformity Agreement*[145] provided that some matters, including fixing of maximum interest rates payable under consumer credit contracts, and decisions for licensing and/or registration of credit providers, might be dealt with by States and Territories on a separate (non-uniform) basis. As a result while some jurisdictions chose to regulate on this matter by imposing interest rate caps (i.e. New South Wales, Queensland, Victoria and the Australian Capital Territories), others did not. Since the introduction of the new National Consumer Credit Regime, notwithstanding the transfer of most credit powers to the Commonwealth, those States have retained their interest rate cap provisions from the UCCC and, in the case of New South Wales, strengthened them. This has posed some ongoing compliance issues for lenders operating across state and territory borders,[146] and has resulted in what the CALC Report describes as "patchwork quilt" of regulation for the industry.[147]

A table containing a brief outline of these different regulatory responses is contained in Appendix B.

5.1.1 New South Wales and the Australian Capital Territory

New South Wales and the Australian Capital Territory prescribed a maximum annual interest rate of 48 % for all consumer credit contracts,[148] applying to both secured and unsecured credit. The cap was also 'all inclusive' or 'comprehensive', meaning that all fees and charges for interest and credit under the credit contract were included when calculating the annual percentage rate ('**APR**').[149] A credit provider committed an offence by entering into a credit contract that imposes an APR in excess of the prescribed amount,[150] and the contract would be void to the extent that it did so, with any amount paid under the contract being recoverable.[151]

When the cap on the APR was first introduced, it applied only to short-term credit contracts (not exceeding 62 days).[152] This was amended in March 2006 to apply to all consumer credit contracts covered by the *Consumer Credit Code*, regardless of their term,[153] to prevent

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[145] Clause 12 *Australian Uniform Credit Laws Agreement 1993* ("Uniform Agreement").

[146] Robin Scott MP, *Small Amount Lending Inquiry 2008: Report to Tony Robinson MP Minister for Consumer Affairs* (2009) (Department of Justice Consumer Affairs Victoria) 29.

[147] Zac Gillam and the Consumer Action Law Centre, *Payday Loans: Helping hand or quicksand? An examination of high-cost short term lending in Australia* (2010) 17.

[148] Originally under the *Consumer Credit (New South Wales) Special Provisions Regulation 2002*, regulation 7(1) and *Consumer Credit (New South Wales) Act 1994,*s11, and now under the *Credit (Commonwealth powers) Bill 2010* (NSW), Schedule 3, Part 2, Division 2, ss 4, 5(5); Section 8B(1) of the *Consumer Credit Act 1995 (ACT)* provides that that the regulations may prescribe a maximum APR, and they are set at 48% under the *Consumer Credit Regulation 1996 (ACT)*, regulation 5(1).

[149] *Consumer Credit (New South Wales) Act 1995* s 11(2); *Consumer Credit (New South Wales) Special Provisions Regulation 2002*, regulation 7(2); *Consumer Credit Act 1995 (ACT),* s8B1; *Consumer Credit Regulation 1996 (ACT),* Regulation 5(2).

[150] *Consumer Credit Code* s 22; *Consumer Credit (New South Wales) Act 1994*, s 11(2); *Consumer Credit Act 1995 (ACT),* s 8B(3).

[151] *Consumer Credit Code* s 21(2); *Consumer Credit Act 1995 (ACT),* s 8B(3).

[152] *Consumer Credit (New South Wales) Amendment (Pay-day Lenders) Act 2001, schedule 1, amendment to s 11*; Nicola Howell, Therese Wilson and James Davidson, *Interest Rate Caps: protection or paternalism?* (2008) (Griffith CCCL Program) 11.

[153] *Consumer Credit (New South Wales) Amendment (Maximum Annual Percentage Rate) Act 2005, schedule 2, amendment to regulation 7; Justice and Community Safety Legislation Amendment Act 2005 (No 4) (ACT*), Schedule 1, Part 1.8; Nicola Howell, Therese Wilson and James Davidson, *Interest Rate Caps: protection or paternalism?* (2008) (Griffith CCCL Program) 12.

loopholes being exploited by credit providers to evade the section (by providing credit just beyond 62 days, outside of the short-term time lines).[154]

Further, New South Wales has since amended the method of calculating the maximum interest rate.[155] This new method requires the inclusion of all fees and charges payable by the debtor to any person for an introduction to the credit provider, and any subsequent service following an introduction, and any fees or charges payable by the debtor to the credit provider for any service relating to the provision of credit.[156] This means that fees or charges payable to third parties such as upfront broker fees for the introduction of credit will now need to be included when calculating the maximum APR. It also provides consumers with the right to challenge excessive broking fees or inappropriate conduct in the Consumer Trader and Tenancy Tribunal.[157]

The New South Wales *Credit (Commonwealth Powers) Bill 2010* provides for the retention of the State's 48% interest rate cap on all consumer credit contracts for a period of 12 months after commencement date of the Commonwealth legislation,[158] in order to ensure that NSW consumer protections remain in place while new national credit laws are phased in.[159] The legislation will cease to apply after 1 July 2011.[160]

As a Territory, the ACT is already bound by the *National Consumer Credit Protection Act 2009 (Cth)* and did not need to introduce a *Credit (Commonwealth Powers) Bill* to refer its powers. The interest rate cap in the ACT has ceased to apply.

The effectiveness of this 48 % all inclusive cap is discussed further at [7.4] of this Study.

5.1.2 Queensland

Queensland similarly introduced a 48% 'all-inclusive' interest rate cap under the *Consumer Credit (Queensland) and Other Acts Amendment Act 2008,*[161] and the *Consumer Credit (Queensland) Special Provisions Regulation 2008.*[162] As a result, a provision of a credit contract which seeks to impose a monetary liability in excess of the 48% APR will be void and any excess amount paid under the contract may be recovered.[163] In addition the credit provider will have committed an offence by entering into such a contract.[164]

On 1 April 2010 Queensland passed the *Credit (Commonwealth Powers) Act 2010* (Qld) which referred constitutional power for credit to the Commonwealth and repealed Queensland's credit legislation. This Act retained the 48% maximum annual percentage rate by providing that the provisions of the former consumer credit legislation in relation to the maximum annual

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[154] The Hon John Stanhope and the Legislative Assembly for the ACT, *Hansard* (20 October 2005) 3912, http://www.hansard.act.gov.au/hansard/2005/week12/3912.htm, at 12 March 2010.
[155] *Credit (Commonwealth Powers) Bill 2010* (NSW)
[156] *Credit (Commonwealth powers) Bill 2010 (NSW),* Schedule 3, Part 2, Division 2, ss 4, 5(5).
[157] New South Wales Office of Fair Trading, *NSW Consumers Protected as Credit Laws Go National*, (2010) http://www.fairtrading.nsw.gov.au/About_us/News_and_events/Media_releases/2010_media_releases/20100407_credit_laws_go_national.html at 8 May 2010.
[158] 1st April 2010, *Credit* (*Commonwealth Powers*) *Act* 2010 No 6 - *Commencement Proclamation*.
[159] *Credit (Commonwealth powers) Bill 2010 (NSW),* Schedule 3, Part 2, Division 2, Section 6, 8.
[160] *Credit* (*Commonwealth Powers*) *Act* 2010 No 6 - *Commencement Proclamation*; *Credit (Commonwealth powers) Bill 2010 (NSW),* Schedule 3, Part 2, Division 2, Section 6, 8.
[161] *Consumer Credit (Queensland) and Other Acts Amendment Act 2008, s*4 .
[162] *Consumer Credit (Queensland) Special Provisions Regulation 2008, s*3.
[163] *Consumer Credit (Queensland) and Other Acts Amendment Act 2008, s*4.
[164] Ibid.

percentage rate under an existing credit contract continue to apply as if those provisions had not been repealed and were still in force.[165]

Queensland has not adopted the New South Wales new method of calculating the cap and does not have a 'sunset' clause with respect to the continuing 'cap' provisions.

5.1.3 Victoria

Victoria also implemented an interest rate cap under its *Consumer Credit (Victoria) Act 1995.* However it took a slightly different approach by setting its interest rate cap at 30% for mortgages (i.e. secured credit)[166] and 48 % for all other unsecured credit contracts regulated under the UCCC.[167] Any applicable credit contract which sought to impose an APR over the prescribed amount was unenforceable, [168]and must not be entered into by a credit provider,[169] while a mortgage relating to a credit contract which exceeds an APR of 30% was void in so far as it related to that contract.[170]

The Victorian legislation did not have an 'all-inclusive' requirement for fees and charges to be included when determining the interest rate (it is a 'traditional' interest rate cap), and as a result no limit on any fees or charges in relation to credit contracts was imposed.

Under the *Victorian Credit (Commonwealth Powers) Bill 2010*, the provisions of the Victorian Consumer Credit Act continued to apply to credit contracts until the commencement of the Commonwealth National Credit Code.[171] As such the interest rate cap ceased to operate from 1 April 2010.

5.1.4 Northern Territory, South Australia, Tasmania and Western Australia

The Northern Territory, South Australia, Tasmania and Western Australia did not have interest rate caps, but left it to the market to determine the cost of consumer credit.[172] Tasmania,[173] Western Australia,[174] and South Australia[175] have passed their referral legislation.

At one time Tasmania did impose a cap for a brief period under the *Payday Lenders Moratorium Act 2000* ('Moratorium Act') from 26 April 2001 until 1 December 2002. The Act implemented an interest rate cap of 60% in addition to a prohibition on fees exceeding 10% of the total credit provided.[176]

While Western Australia had not imposed interest rate cap regulation, it did adopt a unique licensing regime for non-bank credit providers, including small amount lenders. These credit

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[165] *Credit (Commonwealth Powers) Act 2010 (Qld)* Part 4 Division 4 s 21
[166] *Consumer Credit (Victoria) Act 1995* s 40.
[167] *Consumer Credit (Victoria) Act 1995* s 39(1).
[168] *Consumer Credit (Victoria) Act 1995* s 39(1).
[169] *Consumer Credit (Victoria) Act 1995* s 39(3).
[170] *Consumer Credit (Victoria) Act 1995* s 40.
[171] *Credit (Commonwealth Powers) Bill 2010(Vic)* s16.
[172] Nicola Howell, Therese Wilson and James Davidson, *Interest Rate Caps: protection or paternalism?* (2008) (Griffith CCCL Program) 10, 13, 14; Office of Fair Trading (UK), *OFT International case studies: Australia and Canada* (2009) 10-11.
[173] *Credit (Commonwealth Powers) Act 2009 (Tas)* received assent on 12 November 2009..
[174] *Credit (Commonwealth Powers) Act 2010 (WA).*
[175] *Credit (Commonwealth Powers) Act 2010 (SA).*
[176] Camilla Hughes, *Pay day lending in Tasmania* (January 2009)(Social Action and Research Centre, Anglicare Tasmania) 18.

providers were required to obtain a Credit Provider's Licence under the Credit *(Administration) Act 1984*, and under which the Department of Consumer and Employment Protection (DoCEP) could audit lenders' compliance.[177] This may have provided effective means of preventing exploitative practices and predatory lending by requiring traders to demonstrate competence and probity before being allowed to enter the market, and by allowing the government to exclude 'rogue traders' from participating in the market through a process of regular review.[178] It may also have provided consumer protection without the need for an interest rate cap which could drive credit providers from the industry and further reduce competition in the market.[179]

6. Existing protections for pay day borrowers in Australia

6.1 Introduction

Before considering whether additional specific protection is required for pay day lending, it is necessary to consider the existing general consumer protections and whether they provide adequate protection for borrowers. In Australia consumer protection in relation to financial services is provided by the following legislation:

- the *National Consumer Credit Protection Act 2009 (Cth*) and the National Credit Code; and
- the *Australian Securities and Investments Commission Act 2001* (Cth) (ASIC Act).

6.2 Development of the National Consumer Credit Regime

Under the new National Consumer Credit Regime, the Commonwealth has assumed responsibility for consumer credit regulation, introducing as part of the National Consumer Credit Protection Reform Package ('Reform Package')[180] the *National Consumer Credit Protection Act 2009 (Cth)* (NCCP). This largely replicates, and enacts as Commonwealth legislation, the State-based Uniform Consumer Credit Code as the National Credit Code (Schedule 1 of the NCCP).[181]

Phase One of the Reform Package included establishing a comprehensive licensing regime for all providers of consumer credit and brokering services, imposing mandatory responsible lending conduct requirements and expanding consumer protection through external dispute resolution

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[177] Robin Scott MP, *Small Amount Lending Inquiry 2008: Report to Tony Robinson MP Minister for Consumer Affairs* (2009) (Department of Justice Consumer Affairs Victoria) 30; Zac Gillam and the Consumer Action Law Centre, *Payday Loans: Helping hand or quicksand? An examination of high-cost short term lending in Australia*, *2002-2010* (September 2010) 177.

[178] Zac Gillam and the Consumer Action Law Centre, *Payday Loans: Helping hand or quicksand? An examination of high-cost short term lending in Australia*, *2002-2010* (September 2010) 177; Cash Converters, *Position Paper - Response to the Federal Government's Green Paper on Financial Services and Credit Reform* (July 2008) 9; Government of South Australia: Office of Consumer and Business Affairs, *Payday lending in South Australia - options to increase consumer protection*, *Discussion Paper* (2006) 23.

[179] Zac Gillam and the Consumer Action Law Centre, *Payday Loans: Helping hand or quicksand? An examination of high-cost short term lending in Australia*, *2002-2010* (September 2010) 177; Cash Converters, *Position Paper - Response to the Federal Government's Green Paper on Financial Services and Credit Reform* (July 2008) 9; Government of South Australia: Office of Consumer and Business Affairs, *Payday lending in South Australia - options to increase consumer protection*, *Discussion Paper* (2006) 23.

[180] Passed by Parliament on 23 November 2009.

[181] New South Wales Office of Fair Trading, *The National Consumer Credit Protection Reform Package* (2009); http://treasury.gov.au/consumercredit/content/legislation.asp at 18 May 2010.

requirements.[182] The Australian Securities and Investments Commission (ASIC) became the sole national administrator and regulator for consumer credit and finance broking legislation, except in relation to interest rate caps where retained by the states, receiving improved sanctions and enhanced enforcement powers.[183] The *National Consumer Credit Regime* commenced on 1 July 2010 with the registration process beginning on 1 April 2010.

6.2.1 Further Regulatory Reform

Phase Two of the Reform Package concerns the review of other matters which may require Commonwealth regulation to stem unfavourable lending practices.[184] This includes examining State and Territory approaches to interest rate caps,[185] and other reform projects.[186] It was initially agreed that Phase two of the National Credit Regime would be in place by mid-2010, but it now appears that any release of draft legislation will not occur till 2011-2012.[187] According to the former Minister for Financial Services, Superannuation and Corporate Law, Chris Bowen MP, the timetable was changed to allow the credit industry more time to make the necessary changes to move to the new regime.[188]

6.2.2 Licensing Regime

As detailed in Part 5 (Regulatory Approach in Australia), consumer credit legislation provides the primary source of consumer protection in relation to this financial service. That legislation is now the NCCP and its National Credit Code. Its introduction of strict licensing, disclosure and conduct provisions align consumer credit with the regulation of financial services generally. The provisions of the NCCP mirror those that were introduced by the amendments to Chapter 7 of the *Corporations Act 2001* (Cth) which brought in a single national regulatory regime governing the provision of financial services such as superannuation, managed investments, deposit products, securities and insurance.

Under the new licensing regime in Chapter 2 of the NCCP, lenders who intended to continue lending after 1 July 2010 must apply for an Australian Credit Licence from ASIC. [189] A person is prohibited from engaging in a "credit activity" without a licence after that date.[190] A person engages in a credit activity (s 6) if they provide a credit service (s 7) which includes providing

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[182] Australian Government: The Treasury, *National Consumer Credit Government Action Plan* (2008); http://www.treasury.gov.au/documents/1381/PDF/NCC_Brochure_02102008.pdf at 8 April 2010; Australian Government: The Treasury, *Consumer Credit Legislation* (2010) http://www.treasury.gov.au/consumercredit/content/legislation.asp at 28 March 2010.

[183] Australian Government: The Treasury, *National Consumer Credit Government Action Plan (*2008); http://www.treasury.gov.au/documents/1381/PDF/NCC_Brochure_02102008.pdf at 8 April 2010.
[184] Australian Government: The Treasury, *National Consumer Credit Government Action Plan* (2008) http://www.treasury.gov.au/documents/1381/PDF/NCC_Brochure_02102008.pdf at 8 April 2010.
[185] Ibid.
[186] Ibid.
[187] COAG, *National Partnership Agreement to Deliver a Seamless National Economy* (n.d) at http://www.coag.gov.au/coag_meeting_outcomes/2009-07-02/docs/implementation_plan_seamless_national_economy.pdf viewed at 25 March 2010.
[188]Chris Bowen MP, *National Consumer Credit Registration & Licensing Requirements - Lenders with Pre-Existing Credit Contracts* (Press Release, 30 March 2010); http://ministers.treasury.gov.au/DisplayDocs.aspx?doc=pressreleases/2010/030.htm&pageID=003&min=ceba&Year=&DocType=0 at 4 June 2010.
[189] *National Consumer Credit Protection Act 2009* (Cth) Chapter 2, Part 1-2, Division 2.
[190] *National Consumer Credit Protection Act 2009* (Cth) Chapter 2, Part 1-2, Division 1.

credit assistance or acting as an intermediary: s7. Providing credit assistance includes suggesting to a consumer that they apply for a particular credit product with a particular credit provider or apply for the increase of a credit limit with a particular credit provider: s 8.

The licence, and the associated general conduct obligations and responsible lending obligations, cover both the licensees' old and new loans.[191] It was planned that these new arrangements would strengthen and clarify the regulatory framework governing pre-existing consumer credit contracts and consumer leases and in doing so, safeguard consumers by mandating appropriate regulatory standards in respect of those contracts.[192] Lenders who did not offer new loans or consumer leases after 1 July 2010 but would still continue to collect payments due under pre-existing contracts had the option to apply for a licence, but if they did not, were required to notify ASIC so that ASIC could monitor their compliance with the new conduct obligations.[193]

Licensees are required to comply with a number of general conduct obligations. These include doing all things necessary to ensure that the credit activities authorised by the licence are engaged in efficiently, honestly and fairly; comply with the conditions on the licence; comply with the credit legislation and take reasonable steps to ensure that its representatives also comply; have an internal dispute resolution procedure that complies with the standards and requirements of ASIC; be a member of an ASIC-approved external dispute resolution body; and have compensation arrangements in accordance with s 48. [194]

6.2.3 Responsible Lending Conduct Requirements

The new responsible lending requirements are found in Chapter 3 of the NCCP. Licensees are prohibited from entering into a credit contract and from increasing the credit limit of a credit contract, if the contract is unsuitable for the consumer: s 133. Before entry or raising the credit limit, the licensee must make an assessment of whether the proposed credit contract will be unsuitable for the consumer and, if requested, provide a written assessment that the credit contract is unsuitable.[195] To determine whether a credit contract is or will be unsuitable the licensee must make reasonable inquiries and verifications about the consumer's requirements, objectives and financial situation.[196] A credit contract will be unsuitable where the contract would not meet a consumer's needs or requirements, or where the consumer does not have the capacity to repay, or can only do so with substantial hardship.[197] 'Substantial hardship' is not defined in the NCCP or by ASIC, but rather is expected to develop as case law comes before the courts.[198] However, there is a presumption under ss 123(3), 131 (3) and 133(3) of the NCCP that,

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[191] The Hon Chris Bowen MP, *National Consumer Credit Registration & Licensing Requirements - Lenders with Pre-Existing Credit Contracts* (Press Release, 30 March 2010); http://ministers.treasury.gov.au/DisplayDocs.aspx?doc=pressreleases/2010/030.htm&pageID=003&min=ceba&Year=&DocType=0 at 4 June 2010.
[192] Ibid.
[193] The Hon Chris Bowen MP, *National Consumer Credit Registration & Licensing Requirements - Lenders with Pre-Existing Credit Contracts* (Press Release, 30 March 2010); http://ministers.treasury.gov.au/DisplayDocs.aspx?doc=pressreleases/2010/030.htm&pageID=003&min=ceba&Year=&DocType=0 at 4 June 2010.
[194] s 47 NCCP; see also s 912A *Corporations Act* 2001 (Cth).
[195] *National Consumer Credit Protection Act 2009* (Cth) Chapter 3, Part 3-2, Division 3.
[196] *National Consumer Credit Protection Act 2009* (Cth) Chapter 3, Part 3-2, Division 3 and 4.
[197] *National Consumer Credit Protection Act 2009* (Cth) Chapter 3, Part 3-2, Division 3 and 4.

[198] CPA Australia, *Responsible Lending Conduct Obligations* (2010) http://www.cpaaustralia.com.au/cps/rde/xchg/cpa-site/hs.xsl/knowledge-financial-policy-credit-reform-responsible-lending.html at 16 December 2010.

if the consumer could only comply with the consumer's financial obligations under the credit contract by selling their principal place of residence, then they can only comply with substantial hardship, unless the contrary is proven. The responsible lending requirements impose corresponding obligations on credit assistance providers so that they must not suggest that consumers enter into an unsuitable credit contract or assist them to enter into an unsuitable credit contract, nor suggest to a consumer, or assist a consumer, to increase the limit on an unsuitable credit contract without making the preliminary assessment.[199] These requirements effectively prohibit lending where there is no reasonable capacity to repay.

The responsible lending conduct requirements have also imposed additional disclosure requirements on licensees. Licensees who provide credit assistance to a consumer (i.e. by suggesting to, or assisting in, a consumer applying for a credit contract or increasing its credit limit, or suggesting a consumer remains in a particular credit contract) must first provide the consumer with a quote for providing credit assistance: s 114. They must then give the consumer a credit guide containing information about the licensee, including details of their internal and external dispute resolution processes, and information about fees and charges for the credit assistance and commissions the licensee is likely to receive from credit providers for the assistance: s113. When providing the credit assistance they must give a credit proposal disclosure document: s121. This is to contain:

- the total amount of any fees or charges that the consumer is liable to pay to all relevant parties in relation to the credit contract and the method used for working out that amount;[200]
- a reasonable estimate of the total amount of any commissions that the licensee, employee, director or credit representative of the licensee is likely to receive in relation to the credit contract and the method used for working out that amount;[201]and
- if the credit is to be applied to pay any of the above fees or charges, a reasonable estimate of the likely amount of credit that will be made available to the consumer after payments are made.[202]

Licensees who are credit providers need give only the credit guide containing information about the licensee, including details of their internal and external dispute resolution processes: s 126.

6.2.4 Consumer Redress

An important consumer protection mechanism is the ability to seek redress from a financial service provider if the financial service is either not provided as represented or the service was provided in an inappropriate manner. Licensees must provide an Internal Dispute Resolution (IDR) service as well as be a member of an ASIC- approved External Dispute Resolution[203] (EDR) service. EDR Schemes will hear complaints against a financial service provider, can deal with financial hardship even to the extent of enforcing a stay of proceedings against the provider, provide free access for the consumer and the EDR scheme's decisions are binding on the credit provider but not on the consumer.

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[199] *National Consumer Credit Protection Act 2009* (Cth) Chapter 3, Part 3-1, Division 4 and Division 6.
[200] *National Consumer Credit Protection Act 2009* (Cth) s121(2)(a), (c), (d).
[201] *National Consumer Credit Protection Act 2009* (Cth) s121(2)(b).
[202] *National Consumer Credit Protection Act 2009* (Cth) s121(2)(e).
[203] The Credit Ombudsman Service Limited (COSL) and the Financial Ombudsman Service limited (FOS) are the two ASIC approved EDR Schemes which satisfy the requirements of an Australian Credit Licence (ACL) obligations under S47 NCCP

In order to ensure compensation and reparation is available to the consumer, if the EDR scheme or a court finds in favour of the consumer, the credit provider is required to have appropriate compensation arrangements in place. These arrangements are typically facilitated through professional indemnity insurance. Compensation arrangements are a licence obligation and failure to maintain them can result in licence revocation as would the licensee's ceasing to be a member of an approved EDR scheme.

A court may order a credit provider to compensate a debtor for loss or damage suffered from a contravention of the NCCP: s 178. Other curial remedies include orders varying a contract, refusing to enforce any or all of the terms, directing refunds, or declaring the whole or part of a contract void: s 179. Orders may also be made to prevent an unlicensed credit provider from profiting from a debtor or to compensate a debtor for any loss or damage suffered from the credit provider's unlawful activity: s 180.

The public policy intent is to provide free and easy access to dispute resolution and to facilitate this ASIC supervises EDR schemes to ensure they can make orders based on the NCCP without the formality of a court. While EDR schemes have regard to the law they can also make determinations having regard to other factors such as industry standards as set out in various codes.

6.3 ASIC Act

The *Australian Securities and Investments Commission Act 2001* (Cth) (ASIC Act) contains a number of consumer protection provisions designed to prevent wrongful conduct by credit and other financial services providers. These are parallel to those in the Australian Consumer Law (ACL) in the *Competition and Consumer Act 2010* (Cth) (CCA), which applies to the provision of goods and services. The CCA replaced the *Trade Practices Act 1974 (*Cth). Section 131A (1) of the CCA provides that with the exception of linked credit contracts, the ACL[204] does not apply to the supply of 'financial services'. A 'financial service' is defined in s 2 of the ACL to have the same meaning given by the ASIC Act.

Part 2 Division 2 of the ASIC Act deals with consumer protection in relation to financial services. Broadly, a person provides a financial service if they provide financial product advice or deal in financial products: s 12BAB ASIC Act. Section 12BAA (7) (k) provides that a credit facility (within the meaning of the regulations) is a financial product. Regulation 2B(3) of the Australian Securities and Investments Commission Regulations 2001defines 'credit' broadly to mean a contract, arrangement or understanding under which payment of a debt owed by one person (a debtor) to another person (a credit provider) is deferred. This would include pay day loans.

Four general protections contained within the Part 2 Div 2 ASIC Act benefit payday borrowers:

- the prohibition of misleading conduct;
- the prohibition of unconscionable conduct;
- the prohibition of unfair contract terms; and
- implied warranties of due care and skill and fitness for purpose.

[204] The Australian Consumer Law is contained in Schedule 2 of the *Competition and Consumer Act 2010* (Cth).

6.3.1 Misleading conduct: Subdivision D

This subdivision commences with a broad general prohibition against misleading or deceptive conduct in relation to financial services or financial products. Section 12DA provides:

> (1) A person must not, in trade or commerce, engage in conduct in relation to financial services that is misleading or deceptive or is likely to mislead or deceive.

This provision is parallel to s 18 of the ACL which replaces the former s 52 of the *Trade Practices Act 1974 (*Cth). The Subdivision goes on to deal with false representations in relation to financial services or financial products involving interests in land (s12DB-s 12DC) and unlawful sales techniques (s12DD- s 12DN).

Where conduct alleged to have been misleading is directed not at an individual but at a class of persons or the public generally, the class must first be identified. Having identified the class, the effect of the conduct must be assessed having regard to the reactions of an ordinary, reasonable member of the class, not those of persons whose reactions were extreme or fanciful. [205] An example relevant in the payday loan context is *ACCC v Original Mama's Pizza & Ribs*.[206] There the misleading conduct consisted of representations that the 'purchasers' of the pizza ovens, who financed their acquisition by leases from third party financiers, could try them for six months, and if they were not satisfied, could return them to the financiers, and the 'purchasers' would have no further financial obligations in relation to the lease. In fact there was no six month trial period, and no entitlement to be released from the obligations after six months. Madgwick J held that the representations contravened s 12DA (1) ASIC Act and s 12DB (1) (g) ASIC Act – making a false or misleading representation concerning the existence or effect of a right.

Applying this, it seems that s 12DA ASIC Act would apply, for example, if a pay day loan provider made false representations concerning the interest payable or other terms and conditions of the loan, such as that the fees and charges of the loan were considerably less than those of another lender.

Where a person is found to have breached s 12DA, a court may order the person to pay damages, and/or make 'other orders', including an order declaring the contract void, varying the contract, or refusing to enforce one or more of its provisions: s 12GF.

6.3.2. Unconscionable conduct: Subdivision C

Subdivision C contains a number of prohibitions against unconscionable conduct. The general one, s12CB (1), prohibits a person, in trade or commerce, in connection with the supply or possible supply of financial services, from engaging in conduct that is, in all the circumstances, unconscionable.

Section 12CB (2) sets out some of the matters to which a court may have regard in determining whether there has been a contravention of s 12CB(1). These include:

> (a) the relative strengths of the bargaining positions of the supplier and the consumer; and

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[205] *Campomar Sociedad Limitada v Nike International Ltd* (2000) 202 CLR 45 at 85 [103] (Gleeson CJ, Gaudron, McHugh, Gummow, Kirby, Hayne and Callinan JJ); *Astrazeneca Pty Ltd v GlaxoSmithKline Australia Pty Ltd* [2006] ATPR ¶42-106 at [37] (Wilcox, Bennett and Graham JJ); *ACCC v Telstra Corporation Ltd* (2007) ATPR ¶42-203 at [14]-[15] (Gordon J); *Energizer Australia Pty Ltd v Remington Products Australia Pty Ltd* (2008) ATPR ¶42-219 at [16] (Moore J); and *ACCC v Prouds Jewellers Pty Ltd* (2008) ATPR ¶42-217 at [16]-[19](Moore J).

[206] *ACCC v Original Mama's Pizza & Ribs* (2008) ATPR ¶42-236.

(b) whether, as a result of conduct engaged in by the person, the consumer was required to comply with conditions that were not reasonably necessary for the protection of the legitimate interests of the supplier; and

(c) whether the consumer was able to understand any documents relating to the supply or possible supply of the services; and

(d) whether any undue influence or pressure was exerted on, or any unfair tactics were used against, the consumer or a person acting on behalf of the consumer by the supplier or a person acting on behalf of the supplier in relation to the supply or possible supply of the services; and

(e) the amount for which, and the circumstances under which, the consumer could have acquired identical or equivalent services from a person other than the supplier.

Section 12CB (5) requires that the financial services or products to be 'of a kind ordinarily acquired for personal, domestic or household use'. A payday loan would be of this kind.

As a distinct ground of equitable relief unconscionability is most often associated with the unconscientious exploitation of a special disadvantage as in *Commercial Bank of Australia v Amadio*.[207] Under the *Amadio* species of unconscionability it is first necessary to indentify a particular person at whom the conduct is directed. Having identified that person it is then necessary to satisfy three elements.

- First, the person identified must be suffering from a special disadvantage vis-à-vis the stronger party.
- Secondly, the stronger party must have knowledge of that special disadvantage or it must be sufficiently evident.
- Thirdly, there must be a taking advantage by the stronger party of the weaker party's disadvantage.[208]

The class of circumstances which might amount to 'special disadvantage' has tended to focus on a constitutional disadvantage arising from some inherent weakness, such as illiteracy, drunkenness, sickness, advanced age, infirmity of mind, or even emotional dependence such as that which arose in *Louth v Diprose* (1992) 175 CLR 621 where the appellant manufactured an atmosphere of crisis about her accommodation in order to influence the respondent to provide her with money to purchase a house.

The focus of the specific equitable concept is on the effect of the conduct on a particular individual and whether, because of their special disadvantage, they are able to assess what is in their own best interests. As Gleeson CJ noted in the *Berbatis* case:

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207 Commercial Bank of Australia v Amadio (1983) 151 CLR 447.

208 *Commercial Bank of Australia Ltd v Amadio* (1983) 151 CLR 447 at 462 (Mason J) and 474-480 (Deane J). See also *Blomley v Ryan* (1956) 99 CLR 362 at 405 (Fullagar J); *Louth v Diprose* (1992) 175 CLR 621 at 626 (Brennan J).

> It was the inability of a party to judge his or her own best interests that was said by McTiernan J in *Blomley v Ryan*, and again by Deane J in *Amadio*, to be the essence of the relevant weakness. [209]

The focus of the specific equitable concept is also on procedural, rather than substantive, unconscionable conduct. Procedural unconscionable conduct refers to the bargaining process leading to the formation of transaction and the particular conduct of the parties. Relevant factors include the conduct of the negotiations in adverse circumstances, absence of meaningful choice, and the use of an influential third party or lack of information.

The concept of unconscionability in Part 2, Division 2 *ASIC Act* is not limited by reference to the meaning of unconscionable under the unwritten law or to the *Amadio* species of unconscionability. The statutory factors in s12CB(2) to which a court may have regard when determining whether conduct is unconscionable, go beyond those that have traditionally been considered in equity.

In *Australian Securities Investment Commission v National Exchange Pty Ltd* (2005) 148 FCR 132 the Full Federal Court noted that the legislative purpose of s12CC of the ASIC Act, which adopts the same approach as s 12CB of the ASIC Act, was '… to build on and not be constrained by the unwritten law'.[210] According to the Court, unconscionable conduct required a 'high level of moral obloquy'.[211] Something more than unfairness needed to be established; instead the conduct must offend "good conscience and fair play". [212]

The importance of the respondent's conduct being unfair, as distinct from the respondent merely occupying a significantly superior bargaining position, is illustrated by *National Australia Bank Ltd v Meeke.*[213] Here, the bank sought to enforce a mortgage given to it by the Meekes to secure advances the bank had made to a company with which they were associated. The Meekes sought to resist this claim by relying on s 51AC, arguing that the bank was in a much stronger bargaining position than they were when the transaction was entered into. This was accepted, but was insufficient on its own to render the bank's conduct unconscionable. To be so characterised, the bank would have had to 'unlawfully, unfairly or unreasonably taken advantage of its stronger bargaining position' and this had not been established.[214]

In *CIT Credit Pty Ltd v Keable*,[215] the New South Wales Court of Appeal overturned the trial judge's decision that the actions of CIT Credit were unconscionable under s 51AC of the TPA (another form of statutory unconscionability). The respondent had signed a guarantee, without reading it, based on a false representation that it would be operative only while the respondent was a director of the company.

The Court held that '...to say that a misrepresentation has been made and, therefore, that there was false or misleading conduct in trade or commerce, is a long way from a conclusion of unconscionability, or of unjustness'.[216] The appellant was not responsible for the respondent's

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[209] *ACCC v CG Berbatis Holdings Pty Ltd* (2003) 214 CLR 51 at 64 [12].
[210] *Australian Securities Investment Commission v National Exchange Pty Ltd* (2005) 148 FCR 132 at 140 [30]-[31].
211 *Australian Securities Investment Commission v National Exchange Pty Ltd* (2005) 148 FCR 132 at 140 [43], referring to Spigelman CJ's judgment in *Attorney-General of NSW v World Best Holdings Ltd* (2005) 63 NSWLR 557.
[212] *Australian Securities Investment Commission v National Exchange Pty Ltd* (2005) 148 FCR 132 at 140 [43].
[213] *National Australia Bank Ltd v Meeke* (2007) ATPR (Digest) ¶46-272; [2007] WASC 11.
[214] *National Australia Bank Ltd v Meeke* (2007) ATPR (Digest) ¶46-272 at 54,549; [2007] WASC 11 at [508].
[215] *CIT Credit Pty Ltd v Keable* [2006] NSWCA 130 (Spigelman CJ, with whom Giles JA and Gzell J agreed).
[216] *CIT Credit Pty Ltd v Keable* [2006] NSWCA 130 at [70], citing *ACCC v 4WD Systems Pty Ltd* (2003) 200 ALR 491 at [184]-[185].

failure to read the guarantee before executing it. The decision not to read it was that of the appellant alone. He had access to legal and accounting advice if he had thought it appropriate to seek it. None of the terms of the guarantee were unreasonable or unjust.

Spigelman CJ cited with approval[217] the following statement by Gleeson CJ in *Baltic Shipping Co v Dillon*, a *Contract Review Act* case:

> '...the general policy of the law is that people should honour their contracts. That policy forms part of our idea of what is just.'[218]

According to Spigelman CJ, this principle was equally applicable to statutory unconscionability.

Precisely what will be regarded as amounting to exploitation of a consumer's vulnerability appears to depend very much on the impression created by the specific facts and circumstances of the particular case. There appears to be a reluctance on the part of some judges to allow statutory unconscionability to undermine the sanctity of contract.[219]

In summary, the concept of unconscionability in this Subdivision has a broader meaning than unconscionable under the equitable concept. This is because the factors listed in s12CB(2) that may be taken into account in deciding whether conduct is unconscionable, go beyond those that have been considered under the *Amadio* species of unconscionability.

Statutory unconscionability for the purposes of s 12CB of the ASIC Act focuses on the conduct of the dominant party and whether that conduct, looked at as a whole, can be said to offend good conscience. It is necessary to prove not only that the conduct was clearly unfair, but that it was also a taking advantage, or exploitation of the vulnerable position of the weaker party, in a way that is morally reprehensible. Did the stronger party know of the vulnerability of the weaker party? Did they take advantage of it in a way that was 'predatory and against good conscience'?[220]

In the *National Exchange* case, the Full Court stated:

> National Exchange set out to systematically implement a strategy to take advantage of the fact that amongst the official members there would be a group of inexperienced persons who would act irrationally from a purely commercial viewpoint and would accept the offer. They were perceived to be vulnerable targets and ripe for exploitation, as they would be likely to act inadvertently and sell their shares without obtaining proper advice…This is not a case of shrewd commercial negotiation between businesses within acceptable boundaries. The conduct can properly be described as predatory and against good conscience. This is not a case of obtaining a low price by shrewd negotiation. It is predatory conduct designed to take advantage of inexperienced offerees.[221]

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[217] *CIT Credit Pty Ltd v Keable* [2006] NSWCA 130 at 74.
[218] *Baltic Shipping Co v Dillon* (1991) 22 NSWLR 1 at 98.
[219] See Bryson J in *Burt v Australian and New Zealand Banking Group Ltd*(1994) ATPR (Digest) ¶46-123 at 53,597-53,598; *CIT Credit Pty Ltd v Keable*[2006] NSWCA 130.
[220] *ASIC v National Exchange Pty Ltd* (2005) 148 FCR 132 at 142 [43].
[221] *ASIC v National Exchange Pty Ltd* (2005) 148 FCR 132 at 142 [43].

Thus, it may not be unconscionable for the purposes of s 12CB of the ASIC Act merely to insert unfair terms into a payday loan agreement; it may be necessary to seek to enforce or give effect to them in a way that was exploitative or morally reprehensible.[222]

Payday lenders will need to take great care and exercise responsible lending practices lest they be accused of "exploiting vulnerable targets, ripe for exploitation" contrary to s 12CB. In the context of a pay day loan, matters that may be relevant in determining whether there has been a contravention of s 12CB (1) include:

- was the payday lender aware that the borrowers were financially distressed and were unable to obtain finance from alternative sources;
- was the payday lender aware that the borrowers were unemployed and in receipt of Centrelink payments;
- was the borrower required to comply with conditions that were not reasonably necessary to protect the legitimate interests of the payday lender;
- was the payday lender aware that the borrowers were not sophisticated in financial affairs and were not able to understand any documents relating to the loan;
- did the payday lender charge an excessive amount for the loan having regard to the charges of other payday lenders for equivalent loans;
- was the payday lender's conduct towards the borrower consistent with its conduct in similar transactions with other borrowers; and
- did the payday lender exert undue influence or pressure or have recourse to unfair tactics against the borrower?

6.3.3 Unfair contract terms: Subdivision BA

This Subdivision applies to unfair terms in consumer contracts. The principal operative provisions are s 12BF (1) and (2) ASIC Act which provide:

> *(1) A term of a consumer contract is void if:*
>
> *(a) the term is unfair; and*
>
> *(b) the contract is a standard form contract; and*
>
> *(c) the contract is:*
>
> *(i) a financial product; or*
>
> *(ii) a contract for the supply, or possible supply, of services that are financial services.*
>
> *(2) The contract continues to bind the parties if it is capable of operating without the unfair term.*

Section 12BF(3) of the ASIC Act provides that a 'consumer contract' is a contract where at least one of the parties is an individual whose acquisition of what is supplied is wholly or predominantly an acquisition for personal, domestic or household use or consumption. A payday loan would meet this description.

The provisions do not apply to all of the terms of the contracts covered. Section 12BI provides that s 12BF does not apply to:

- terms that define the main subject matter of the contract; or
- set the upfront price payable under the contract; or
- are required or expressly permitted by a law of the Commonwealth, State or Territory.

[222] See also *Attorney General (NSW) v World Best Holdings Ltd* (2005) 63 NSWLR 557 at [121] (Spigelman CJ).

Section 12BI(2) provides that the upfront price is the consideration that is provided for the supply under the contract, and is disclosed at or before the time the contract was entered into, and does not include any other consideration that is contingent on the occurrence or non-occurrence of a particular event, such as default on a loan.

ASIC provides the following example:

> *... the up-front price of a mortgage includes the amount borrowed and the interest payable and any fees disclosed at the time the contract is entered into, but does not include contingent fees, such as default fees. As a result, principal and interest cannot be challenged under the unfair contract terms provisions*.[223]

The high APR's charged for pay day loans cannot be challenged as unfair terms; however, the contingent fees payable in the event of a default may be able to be challenged.

Section 12BG (1) of the ASIC Act provides that a term will be unfair if:

> *(a) it would cause a significant imbalance in the parties' rights and obligations arising under the contract; and*
> *(b) it is not reasonably necessary in order to protect the legitimate interests of the party who would be advantaged by the term; and*
> *(c) it would cause detriment (whether financial or other wise) to a party if it were to be applied or relied on.*

In determining whether a consumer contract is unfair under subs (1) a court may consider any relevant matter, but a court must consider:

> *(a) the extent to which the term is transparent;*
> *(b) the contract as a whole*: s 12BG (2)

Section 12BG (3) provides:

> *A term is transparent if the term is:*
> *(a) expressed in reasonably plain language; and*
> *(b) legible; and*
> *(c) presented clearly; and*
> *(d) readily available to any party affected by the term.*

As regards this requirement the Australian Competition and Consumer Commission (ACCC), in its *Guide to the Unfair Contract Terms Law*, states:

> *An apparently unfair term may be regarded in a better light when seen in the context of other counterbalancing terms. For example, a potentially unfair term may be included in a consumer contract but may be counterbalanced by additional benefits – such as a lower price – being offered to the other party*.[224]

In other words, some contractual terms that appear to be unfair when viewed in isolation, might be considered to be fair in the context of the agreement as a whole; a harsh term may be

[223] See ASIC, *Australian Consumer Law – Unfair terms*, available at: www.asic.gov.au/asic/asic.nsf/byheadline/Unfair-contract-terms-law?openDocument.
[224] ACCC, *A Guide to the Unfair Contract Terms Law* (Canberra, 2010), p 13.

necessary to ensure that the consumer obtains the goods or services at a lower price. The lower price is the trade-off for the harsh term.

It is submitted that the following matters will be relevant in applying s 12BG (3) (c):

- the purpose of the term which is alleged to be unfair;
- the consequences of failing to enforce it; and
- whether the term is necessarily related to the consumer's achieving some other benefit under the contract.

6.3.4 Unconscionability and unfair terms: scope for overlap

The mere reliance on the terms of a contract cannot, without something more, constitute unconscionable conduct.[225] For example, where a pay day loan contains a provision allowing for termination on the slightest default, the inclusion of such a provision may not be unconscionable, but relying on it where there is reasonable doubt about whether the borrower has, in fact, breached a term of the loan,[226] or where the breach is of a minor or technical nature, may be unconscionable.

The terminology or length of the contract may be such that the other party is unable to comprehend the contract and may sign without understanding the full import of the agreement. While that alone would not be enough to constitute statutory misconduct, it would be a matter that the court could consider in deciding whether the statutory unconscionability provisions have been breached.[227] For this reason, it is common to include a provision in a contract requiring one party to obtain independent legal advice about the meaning of the terms and provide a certificate to this effect.

The implications of such a term were considered in *CIT Credit Pty Ltd v Keable* [2006] NSWCA 130. There a guarantee contained an acknowledgement that, before executing the agreement, the guarantor had received advice as to the purport, effect and obligations created by the transaction and documents from an independent legal advisor and had provided a certificate signed by the independent legal advisor to that effect. The guarantor executed the guarantee without reading or comprehending it and did not provide a certificate that independent legal advice had been obtained. A representative of the creditor had misrepresented the effect of the guarantee, as operating only while the respondent was a director of the company so that if he resigned all liability would end. The New South Wales Court of Appeal held that this misrepresentation did not amount to unconscionable conduct.

The trial judge characterised Clause 12 as a 'scheme designed to ensure that prospective guarantors obtained independent legal advice and fully understood the guarantee'. The creditor had failed to adhere to the scheme by accepting the guarantee without the certificate.[228] However, this failure to implement the scheme did not amount to unconscionable conduct. The creditor bore no responsibility for the guarantor's failure to read the guarantee,[229] and the decision not to read it was his decision alone.[230] There was no evidence of fraud or special

[225] *Hurley v McDonald's Australia Ltd* (2000) ATPR ¶41-741 at 40,586, [1999] FCA 1728 at [29].
[226] See, eg *Automasters Australia Pty Ltd v Bruness Pty Ltd* [2002] WASC 286.
[227] See ACL, ss 21(2)(c) and 22(2)(c).
[228] *CIT Credit Pty Ltd v Keable* [2006] NSWCA 130 at [60].
[229] *CIT Credit Pty Ltd v Keable* [2006] NSWCA 130 at [71].
[230] *CIT Credit Pty Ltd v Keable* [2006] NSWCA 130 at [76].

circumstances such as evidence to suggest to the creditor that the guarantor was not able to read and understand the document himself.

Spigelman CJ held that the failure by CIT Credit to pursue the failure to obtain legal advice and the certification mechanism was not unconscionable:

> *Given the terms and clarity of the Guarantee, the understanding on the part of Mr Keable of its essential quality, and the absence of any form of relevant disability in either himself understanding, or obtaining advice with respect to, the Guarantee, in my opinion the failure to follow the scheme in cl 12 is not entitled to determinative weight, whether for the determination of unjustness or unconscionability*.[231]

Spigelman CJ cited with approval the following passage from the judgment of Bryson J in *Burt v Australian and New Zealand Banking Group Ltd*:

> *The ordinary means of establishing in honesty and fair dealing that a person with whom one is dealing knows the nature and terms of a document which one proposes should be signed is to put the document before that person for signature. The opportunity to find out what is in the document is therefore, available to that person, who can use the opportunity in whatever manner is thought right. Unless the person with whom one is dealing is known to be at some special disadvantage, this is as much as conscience requires. There is no reason why it is unconscionable* per se *for a bank to deal with and take a guarantee from a person who is closely related to or otherwise well disposed towards a customer; indeed that is the ordinary case in which a guarantee is available. Unconscionability is not a slight matter, and behaviour is only unconscionable where there is some real and substantial ground based on conscience for preventing a person from relying on what are, in terms of the general law, that person's legal rights.*[232]

If Keable had been under some form of disability that had been obvious to the creditor, the failure to follow up on the failure to obtain independent legal advice may have carried more weight.

In summary, although the interest payable under a pay day loan is excluded from consideration under the unfair terms provisions, it is possible that it may be found to be unconscionable if it is excessive and the pay day lender is seen to be exploiting the vulnerability of the borrower. There has been a tendency to construe the unconscionability provisions in a restrictive way.

6.3.5 Implied terms: Subdivision E ASIC Act

This Subdivision implies certain terms into contracts for the supply of financial services, and so are relevant to contracts for payday loans.

Section 12 ED(1) of the ASIC Act provides that in every contract for the supply of financial services by a person to a consumer in the course of a business, there is an implied warranty that the services will be rendered with due care and skill. In such a contract, if the consumer expressly or by implication, makes known to the lender any particular purpose for which the

[231] *CIT Credit Pty Ltd v Keable* [2006] NSWCA 130 at [82].
[232] [2006] NSWCA 130 at [75]; *Burt v Australian and New Zealand Banking Group Ltd* (1994) ATPR (Digest) ¶46-123 at 53,597-53,598.

services are required or the result he or she desires the services to achieve, there is an implied warranty that the services will be reasonably fit for that purpose or are of such a nature or quality that they might reasonably be expected to achieve that result: s 12 ED (2).

This may arise where, based on the information provided by a borrower, a payday loan is unsuitable for the borrower's purposes, and a more traditional source of finance such as a residential mortgage would have been appropriate. A payday lender, who failed to take into account the borrower's purpose in this way, may be liable in contract for damages for breach of the implied warranties.

7. Additional Protection for payday borrowers

A number of specific protections in the form of positive obligations to be imposed on pay day lenders have been advanced in the literature. These include: imposing statutory limits on the number of loans and rollovers that a consumer may access; banning rollovers; and imposing interest rate caps. Each of these will be examined in turn before considering whether any additional regulation is necessary to protect payday borrowers.

7.1 Responsible Lending

The responsible lending obligations, discussed above in 6.2.3, have been the main focus of the recent regulatory reform in Australia. They seem to deal with the main problems perceived to be associated with payday lending - lending to vulnerable consumers who lack the capacity to repay, or triggering debt spirals.

In the near future lenders may also be in a better position to assess the appropriateness of loans for their customers due to the proposal to introduce *Privacy Act 1988* (Cth) reforms for the provision of comprehensive credit reporting.[233]These amendments are designed to give lenders access to more reliable information relating to a consumer's payment history, thus enhancing lenders' ability to assess the suitability of a loan.

The Discussion Paper, *Payday lending in South Australia - options to increase consumer protection*,[234] provides a thorough consideration of the different regulatory options to increase consumer protection for payday loan consumers. The Discussion Paper views responsible lending regulation as one of the key measures to address the problems associated with payday lending, especially in regards to vulnerable consumers and those who are over-optimistic about their prospects of repaying a loan.[235]

Accordingly, it found that such measures:

> *...represent a more targeted approach to the identified problem of borrower over-commitment. They would theoretically operate so as to allow payday loans to be made only to those with an ability to repay the loan without genuine hardship.*[236]

[233] http://www.aph.gov.au/Senate/committee/fapa_ctte/priv_exp_drafts/guide/credit_guide.pdf.
[234] Government of South Australia: Office of Consumer and Business Affairs, *Payday lending in South Australia - options to increase consumer protection*, *Discussion Paper* (2006).
[235] Government of South Australia: Office of Consumer and Business Affairs, *Payday lending in South Australia - options to increase consumer protection*, *Discussion Paper* (2006) 19.
[236] Government of South Australia: Office of Consumer and Business Affairs, *Payday lending in South Australia - options to increase consumer protection*, *Discussion Paper* (2006) 21.

It also found that such measures:

> *... would force payday lenders to adhere to reasonable lending standards that have lapsed since the mainstream lenders moved out of this market sector.*[237]

The Report, Keeping *the Plates Spinning: Perceptions of Payday Loan in Great Britain* (2010) by Marie Burton for Consumer Action, similarly found that responsible lending in the form of affordability checks when the loan was taken out, and repeating affordability checks when additional loans were taken out in changed circumstances, would be a solution to safeguarding vulnerable consumers and preventing problems of payday loans being extended to consumers who do not have the capacity to repay.[238] The Report further noted that, while the effect of such regulation would make payday loans slower or harder to access,[239] that may be an additional benefit by giving consumers additional time to consider whether they really need the loan or if an alternative more suitable source of credit exists.[240]

Under the cost /benefit analysis conducted by the Discussion Paper, *Payday lending in South Australia - options to increase consumer protection*, the cost to industry of implementing responsible lending requirements to assess capacity to repay would involve the cost of:

> *...establishing new loan assessment systems and procedures (including possibly replacing or modifying computer systems, application forms, etc) as well as additional time to assess each loan application and additional record keeping requirements to enable lenders to justify loans when seeking to enforce them. It is also likely that payday lenders will forgo a significant proportion of their revenue as a result of being unable to loan to persons without capacity to repay.*[241]

In terms of the cost to consumers, it found that:

> *Those consumers who could afford to repay a payday loan would probably pay even higher prices for those loans as a result of payday lenders offsetting their increased costs of assessing loans.*[242]

However, the Discussion Paper considered that these costs would be offset by the benefits to consumers who would otherwise have suffered over-commitment and the associated costs, including the wider social costs such as health costs and increased reliance on Government and

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[237] Government of South Australia: Office of Consumer and Business Affairs, *Payday lending in South Australia - options to increase consumer protection*, *Discussion Paper* (2006) 19.
[238] Marie Burton, *Keeping the Plates Spinning: Perceptions of Payday Loan in Great Britain* (2010) (for Consumer Focus.
[239] Marie Burton, *Keeping the Plates Spinning: Perceptions of Payday Loan in Great Britain* (2010) (for Consumer Focus) 37.
[240] Marie Burton, *Keeping the Plates Spinning: Perceptions of Payday Loan in Great Britain* (2010) (for Consumer Focus) 37.
[241] Government of South Australia: Office of Consumer and Business Affairs, *Payday lending in South Australia - options to increase consumer protection*, *Discussion Paper* (2006) 20.
[242] Government of South Australia: Office of Consumer and Business Affairs, *Payday lending in South Australia - options to increase consumer protection*, *Discussion Paper* (2006)21.

welfare agencies.[243] It also found that the cost to Government would be limited to legal enforcement costs.[244]

A disadvantage of responsible lending, highlighted by the Discussion Paper, is the difficulty of monitoring compliance compared to compliance with an interest rate cap, because the lender's assessment of capacity to repay is unlikely to be transparent on the face of a transaction.[245] The *Small Amount Lending Inquiry 2008: Report* also reported industry concerns that problems may arise with responsible lending regulation if lenders are not able to fully assess an applicant's capacity to repay as a result of consumers' not disclosing or misrepresenting their financial circumstances.[246] However, it suggested that the introduction of a positive credit-reporting scheme could alleviate many of these problems.[247]

With the new responsible lending measures in Australia now requiring lenders to verify capacity to repay, and prohibiting lenders from proceeding where the consumer does not have the capacity to repay or can only do so with substantial hardship,[248] the effectiveness of a responsible lending regime will soon be tested. On the basis of the literature, while monitoring compliance (a role which will now fall to ASIC) may prove more expensive than in the case of interest rate caps, it appears to be one of the few regulatory options which provide strong consumer protection without causing significantly detrimental industry impact.

So far there has been little or no commentary in the literature relating to consumers' access to redress where they find themselves in situations where they believe the loan may have been inappropriate for their circumstances or of financial hardship in servicing the loan. It is arguably too early as yet for the consumer experience emanating from the introduction of the responsible lending obligations to be tested. Payday loan customers are now protected by the same dispute and compensation arrangements afforded to other consumers of financial products.[249] There will inevitably be complaints about the provision of credit relating to responsible lending and for the first time these consumers will have a statutory right to have their complaint dealt with at no cost, first by the lender's internal dispute resolution process and then if not satisfied, by an ASIC approved external dispute resolution (EDR) service.[250]These EDR services also have powers to deal swiftly in relation to cases of financial hardship, thus providing redress if lenders fail to comply with responsible lending obligations.

7.2 Limiting the number of loans

Another regulatory approach to payday loans which has been raised in the literature is the implementation of a cap on the number of loans or rollovers in which consumer may take out.

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[243] Government of South Australia: Office of Consumer and Business Affairs, *Payday lending in South Australia - options to increase consumer protection*, *Discussion Paper* (2006) 21.
[244]Government of South Australia: Office of Consumer and Business Affairs, *Payday lending in South Australia - options to increase consumer protection*, *Discussion Paper* (2006) 21.
[245] Government of South Australia: Office of Consumer and Business Affairs, *Payday lending in South Australia - options to increase consumer protection*, *Discussion Paper* (2006) 22.
[246] Robin Scott MP, *Small Amount Lending Inquiry 2008: Report to Tony Robinson MP Minister for Consumer Affairs* (2009) (Department of Justice Consumer Affairs Victoria) 19-20.
[247] Robin Scott MP, *Small Amount Lending Inquiry 2008: Report to Tony Robinson MP Minister for Consumer Affairs* (2009) (Department of Justice Consumer Affairs Victoria) 19-20.
[248] *National Consumer Credit Protection Act 2009* (Cth) Chapter 3, Part 3-2, Division 3 and 4.
[249] S912A *Corporations Act 2001* (Cth).
[250] Financial Ombudsman Service Limited or Credit Ombudsman Service Limited.

The Report, Keeping *the Plates Spinning: Perceptions of Payday Loan in Great Britain* (2010) by Marie Burton for Consumer Action, highlighted this as one of the key regulatory measures to prevent a debt trap scenario being established.[251]

According to this Report, the rationale for such as a policy measure is based on findings that:

> *...the availability of payday loans increases consumer ability to make ends meet but the gains diminish as use becomes more frequent.*[252]

This Report concluded that UK borrowers should not take out more than five loans in a year.[253] As such, Burton argues that limiting the number of loans or rollovers to a maximum of five per household[254] should prevent a potential debt trap scenario being established,[255] without significantly reducing supply of credit to consumers,[256] and thus increasing the risk of financial exclusion:

> *Thus, by limiting the number of loans or rollovers to a maximum of five, payday lending should still be available for consumers to use them, but not to the point where they become an unsustainable debt. The aim of limiting the number of loans or rollovers would be to prevent consumers getting into a debt spiral where they are borrowing in order to service the loan and it is increasing rather than relieving their burden of indebtedness.*[257]

This Report argued that implementation of this cap in the UK could be achieved by clarifying the Office of Fair Trading (OFT) *Irresponsible Lending Guidance for Creditors* so that the definition of 'unsustainable' lending includes borrowers' taking out more than five payday loans or rollovers in one year,[258] and where consumers have borrowed or 'rolled over' up to the maximum of five times in one year, this should be treated as an indicator of financial difficulty and lenders should be obliged to refer consumers to independent advice and support to deal with any financial problems.[259]

Under the new regulation for responsible lending in Australia, a similar approach could be adopted by expanding the definition of an 'unsuitable' credit contract under Chapter 3 of the *National Consumer Credit Protection Act 2009 (Cth)* ('the Act') to include where the borrower has already taken out a certain number of loans or rollovers in a year.

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[251] Marie Burton, *Keeping the Plates Spinning: Perceptions of Payday Loan in Great Britain* (2010) (for Consumer Focus) 35.
[252] Marie Burton, *Keeping the Plates Spinning: Perceptions of Payday Loan in Great Britain* (2010) (for Consumer Focus) 18.
[253] Marie Burton, *Keeping the Plates Spinning: Perceptions of Payday Loan in Great Britain* (2010) (for Consumer Focus) 18.
[254] Marie Burton, *Keeping the Plates Spinning: Perceptions of Payday Loan in Great Britain* (2010) (for Consumer Focus) 18.
[255] Marie Burton, *Keeping the Plates Spinning: Perceptions of Payday Loan in Great Britain* (2010) (for Consumer Focus) 19.
[256] Marie Burton, *Keeping the Plates Spinning: Perceptions of Payday Loan in Great Britain* (2010) (for Consumer Focus) 20.
[257] Marie Burton, *Keeping the Plates Spinning: Perceptions of Payday Loan in Great Britain* (2010) (for Consumer Focus) 21.
[258] Marie Burton, *Keeping the Plates Spinning: Perceptions of Payday Loan in Great Britain* (2010) (for Consumer Focus) 19.
[259] Marie Burton, *Keeping the Plates Spinning: Perceptions of Payday Loan in Great Britain* (2010) (for Consumer Focus) 29.

Given that a principal problem claimed to be associated with payday loans is the issue of repeat borrowing, by rolling-over or back-to-back loans, leading consumers into debt spirals - a rapidly growing debt that consumers may find it difficult to repay without hardship – the capping of the number of loans and rollovers may be a practical regulatory approach.

7.3 Banning Rollovers

The literature shows a diverse understanding on what actually constitutes a 'rollover'. Under a rollover service, if the borrower is unable to make arrangements for re-payment, or does not wish to settle the debt when it is due, some payday lenders allow the term of the loan to be extended for an additional finance charge.[260] In some cases, lenders allow customers a maximum of four rollovers, after which if not paid, the customer will be in default. The definition of a rollover does not include the creation of a new loan to settle the previous loan (a're-write'), or the provision of a back-to-back loan.

Rollovers have recently become the subject of much focus in regulatory debate, being criticised as extending payday loans beyond the original term, increasing the fees and charges of the original loan, and subsequently contributing towards a debt spiral from which the borrower has little chance of escaping. The Victorian Small Amount Lending Inquiry found that rollovers are:

> *.. problematic in the small amount credit market, where some borrowers may be on very low fixed incomes and loan repayment cycles are short. Should the consumer not be able to repay the loan, fees and charges can rapidly accumulate to the point where repayments cannot cover payment of additional charges on top of the initial fees, charges and interest payments.*
>
> *The detriment this practice can cause consumers is substantial where they become locked into an ever-increasing loan spiral, thereby placing additional financial and emotional pressure on an already struggling household. Such practices can also increase the risk of over-indebtedness because the size of the loan grows without the consumer choosing to borrow more money.*[261]

On 8 and 9 August 2007, the Productivity Commission convened a roundtable on the topic "Behavioural Economics and Public Policy" in Melbourne. Behavioural economics is a relatively new field that applies insights from psychology to economic issues and analysis. Participants at the Roundtable discussed the contribution that behavioural economics could make to a broader understanding of people's motivation and behaviour in markets and the implications for policy and regulatory approaches.

The Productivity Commission acknowledged that behavioural economics has particular relevance to consumer policy, and that the insights gained through the Roundtable made a useful contribution to the Commission's inquiry on Australia's consumer policy framework.[262] Several important insights for consumer protection emerge from behavioural economics. One is

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[260] Ernst & Young Tax Policy Services Group, *The Cost of Providing Payday Loans in Canada: A Report Prepared for the Canadian Association of Community Financial Service Providers* (October 2004) 4.

[261] Robin Scott MP, *Small Amount Lending Inquiry 2008: Report to Tony Robinson MP Minister for Consumer Affairs* (2009) (Department of Justice Consumer Affairs Victoria) 24.

[262] See especially the papers by Mulholland, "Behavioural economics and the Federal Trade Commission" and Field, "Having one's cake and eating it too — an analysis of behavioural economics from a consumer policy perspective." The conference proceedings are available at: http://www.pc.gov.au/research/confproc/behaviouraleconomics.

that consumers do not always behave rationally and are in need of assistance in making purchasing decisions. Some consumers behave emotionally and are vulnerable to exploitation.

Within the literature, reliance has been placed on the findings of behavioural economics to support arguments for a regulatory ban on the use of rollovers by payday lenders. According to the Discussion Paper, *Payday lending in South Australia - options to increase consumer protection,* a rollover prohibition, under which a lender would be prohibited from extending the term of a loan if it was not repaid within the contracted timeframe, would be desirable:

> *Behavioural economics tells us that consumers, whilst understanding the cost of the original loan..., will often be over-optimistic about their prospects of repaying the loan and therefore not factor in the longer-term costs that quickly mount once the loan is rolled over.*[263]

Further, it is argued that where consumers require a rollover, it can reasonably be assumed that they do not have capacity to repay, as they were unable to repay the original loan within the contracted timeframe. The argument is that allowing rollovers permits the industry to engage in predatory lending.

Under the cost/benefit analysis undertaken for the Discussion Paper, *Payday lending in South Australia - options to increase consumer protection*, the cost to business of a rollover prohibition would mostly comprise lost profits, but these are expected to be largely offset by the benefits accruing from reductions in borrowers' over commitment. The cost to Government would be minimal as the prohibition could be made self-enforcing.[264] However, the cost to consumers would probably be paying even higher prices for payday loans, as a result of lenders' offsetting lost revenue from rollovers.[265] The Discussion Paper argued however, that the benefits to consumers would outweigh this detriment, by providing a reduction in over-commitment and the associated costs, including the wider social costs for health costs and increased reliance on Government and welfare agencies, and could possibly break the cycle of debt and dependence on payday loans.[266]

Given that the *Small Amount Lending Inquiry 2008: Report* found that it was difficult to determine the incidence and impact of rollovers, apart from anecdotal evidence from consumer advocates, it is doubtful how many lenders actually provide rollover loans.[267] Thus it is not possible to quantify the extent or nature of problems associated with rollovers based on the current literature, and as such assess the appropriateness of any regulatory prohibition. Further the Discussion Paper, *Payday lending in South Australia - options to increase consumer protection,* identified practical problems of likely avoidance:

> *In practice it may be very difficult to enforce a prohibition on roll-overs. A prohibition on roll-overs could not easily prevent a borrower from obtaining a loan from another*

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[263] Government of South Australia: Office of Consumer and Business Affairs, *Payday lending in South Australia - options to increase consumer protection*, *Discussion Paper* (2006) 19.

[264] Government of South Australia: Office of Consumer and Business Affairs, *Payday lending in South Australia - options to increase consumer protection*, *Discussion Paper* (2006) 21.

[265] Government of South Australia: Office of Consumer and Business Affairs, *Payday lending in South Australia - options to increase consumer protection*, *Discussion Paper* (2006) 21.

[266] Government of South Australia: Office of Consumer and Business Affairs, *Payday lending in South Australia - options to increase consumer protection*, *Discussion Paper* (2006) 20 .

[267] Robin Scott MP, *Small Amount Lending Inquiry 2008: Report to Tony Robinson MP Minister for Consumer Affairs* (2009) (Department of Justice Consumer Affairs Victoria) 24.

payday lender to repay an outstanding loan from a first payday lender. Indeed, this might be circumvented by splitting into separate entities and referring lenders between entities for further loans.[268]

The practical outcome of such a regulatory response is therefore questionable on a number of grounds.

Despite this, industry appears to be receptive to the idea of a self regulatory limitation on the number of rollovers allowed. The industry peak body, the NFSF, has indicated a willingness to impose a limit with the apparent support of its membership. As will be seen below this willingness appears to be borne out in one lender's practices as they limit the number of rollovers. The Canadian Payday Loan Association (CPLA), in its *Code of Best Business Practice*, has committed members to prohibiting rollovers[269] (as discussed in [4.2] above of this Study).

As part of our Study examining responsible lending practices and the prevalence of rollovers in the current payday loan industry, we have conducted interviews with lenders. As an example, a lender with operations in the three states where our customer survey is being conducted, provided a breakdown of the numbers of clients who rollover (refinance), based on their entire Australian operation for a period of the last two and a half years. The following table indicates that the use of rollovers in Australia might not be as prevalent as some have suggested:

Table 1 - **Prevalence of Rollovers in Australia for one large payday lender – 2008 - 2010**

Two-thirds of customers pay off the initial loan while one-third refinance as follows:

Base loan, no refinancing	67%
One refinancing	18%
Two refinancings	7%
Three refinancings	3%
Four refinancings	5%
Total	100%

The following is the commentary provided by the lender on the above statistics:

Lender Customer refinancing experience:

- This table demonstrates customers' refinancing behaviour since the start of operations mid-2008 (i.e. 2 ½ years approx);
- Only one-third of all customers take a refinance after the base loan is made;
- Of those customers who choose to refinance for the first time (1st refinance), a little less than half take another refinance (2nd refinance);
- Of customers who take a 2nd refinancing, 62% take another refinancing (3rd refinancing);
- Of customers who take a 3rd refinancing, few take another refinancing (4th refinancing);
- Customers who default are not eligible for refinancing; and

[268] Government of South Australia: Office of Consumer and Business Affairs, *Payday lending in South Australia - options to increase consumer protection*, *Discussion Paper* (2006) 19.
[269] Ernst & Young Tax Policy Services Group, *The Cost of Providing Payday Loans in Canada: A Report Prepared for the Canadian Association of Community Financial Service Providers* (October 2004) 4.

- The Lender's internal policy is not to offer more than 4 refinances in sequence, although hardship extensions are available for valid claims for no additional fees, interest or charges.

7.4 Interest Rate Caps

Regulating payday loans by imposing an interest rate cap on the price of credit has been widely adopted at both a state level within Australia and in Canada.

Interest rate caps control the cost of credit by imposing a limit on the legally allowable rate of interest that can be charged.[270] Two different types of caps currently exist in Australia: a traditional cap on the interest rate of the loan (such as was used in Victoria) and an all-inclusive/ comprehensive cap, which include fees and charges (as used in New South Wales and Queensland).

As we have seen, the interest payable under a pay day loan is excluded from consideration under the unfair terms provisions of the *ASIC Act*: s 12BF [6.2.8] above.

In recent years, the effectiveness of interest rate caps as a means of preventing usurious rates, debt spirals or exorbitant fees, has been the subject of a number of research studies:

(1) "Payday Loans: Helping hand or quicksand? An examination of high-cost short term lending in Australia, 2002-2010" CALC Report
The 2010 CALC Report[271] favoured a national all-inclusive 48 % interest rate cap as a positive and necessary consumer protection measure to shield consumers from harmful high-cost short term lending.[272] This conclusion was reached largely on the basis of anecdotal evidence and evidence from the USA, as discussed in 3.3 above.

The CALC Report argued that such caps would have a targeted, measurable impact on high-cost short term lending, which would carry little risk to the broader consumer credit market.[273] The Report acknowledged that such a cap would effectively result in prohibition of high-cost short term lending, but asserted this is necessary because of the 'inherently harmful' nature of the product. [274] As regards the economic impact on the industry, the CALC report concludes:

> *The principal 'negative' impact of an interest rate cap will be that felt by the Australian high-cost lending industry itself - which is still in an early stage of development, does not employ a significant workforce and does not generate significant or widespread economic benefit.*[275]

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[270] Zac Gillam and the Consumer Action Law Centre, *Payday Loans: Helping hand or quicksand? An examination of high-cost short term lending in Australia*, *2002-2010* (September 2010) 39.
[271] Zac Gillam and the Consumer Action Law Centre, *Payday Loans: Helping hand or quicksand? An examination of high-cost short term lending in Australia*, *2002-2010* (September 2010).
[272] Zac Gillam and the Consumer Action Law Centre, *Payday Loans: Helping hand or quicksand? An examination of high-cost short term lending in Australia*, *2002-2010* (September 2010) 29.
[273] Zac Gillam and the Consumer Action Law Centre, *Payday Loans: Helping hand or quicksand? An examination of high-cost short term lending in Australia*, *2002-2010* (September 2010) 27.
[274] Zac Gillam and the Consumer Action Law Centre, *Payday Loans: Helping hand or quicksand? An examination of high-cost short term lending in Australia*, *2002-2010* (September 2010) 39.
[275] Zac Gillam and the Consumer Action Law Centre, *Payday Loans: Helping hand or quicksand? An examination of high-cost short term lending in Australia*, *2002-2010* (September 2010) 206.

As regards the impact on consumers, the Report merely stated that:

> *..it is likely that at least the majority of consumers will resort to a wide range of alternative coping mechanisms to meet temporary shortfalls in income. Such mechanisms include informal lending through friends and family, the negotiation of hardship variation payments, utility concessions and relief grants, the purchase of credit from alternative credit providers and some recourse to charity and welfare services.*[276]

This study does not consider these as long-term or sustainable credit options for those facing financial exclusion.

The CALC Report notes that there is no 'magic' or contemporary basis behind the 48% figure - it is simply an historical carry over from English legislation, devised in 1927, which determined that when lending above 48% APR, the onus lay on the lender to show that the loan was not unconscionable.[277]

(2) Victorian "Small Amount Lending Inquiry" Report

The 2008 *Victorian Small Amount Lending Inquiry Report* focused on the use of the all-inclusive cap in NSW. The Report found that since its introduction in 2006, lenders have generally sought to avoid the cap by taking advantage of legislative loopholes, or have stopped operating in NSW.[278] It noted that there was some evidence suggesting that lenders circumvented the cap by increasing the minimum loan size and duration so the loan fell outside the cap's operation,[279] or by using a broker/credit provider arrangement to split fees and charges, in order to bring the cost of the loan within the cap.[280]

Further, the Report found:

> *A major issue with interest rate caps, whether inclusive or not, is determining the level at which the cap should be set. Balancing the needs of consumers and providers is a difficult process. If pitched too low, the cap can damage the market. If pitched too high, its effectiveness is compromised. The 48 per cent figure implemented in NSW is based on historical precedent rather than an assessment of the cost base for lenders.*[281]

The Report therefore suggested that further research needed to be undertaken in order to determine the appropriate level at which to set an inclusive interest rate cap, and that any introduction of a cap should be based on a systematic understanding of the costs of lending and the impact of such a cap on disadvantaged consumers.

It concluded:

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[276] Zac Gillam and the Consumer Action Law Centre, *Payday Loans: Helping hand or quicksand? An examination of high-cost short term lending in Australia*, *2002-2010* (September 2010) 207-208.

[277] Zac Gillam and the Consumer Action Law Centre, *Payday Loans: Helping hand or quicksand? An examination of high-cost short term lending in Australia*, *2002-2010* (September 2010) 205.

[278] Robin Scott MP, *Small Amount Lending Inquiry 2008: Report to Tony Robinson MP Minister for Consumer Affairs* (2009) (Department of Justice Consumer Affairs Victoria) 38.

[279] The amendments made in 2006 appear to have been in response to this: see [5.1.1] above.

[280] The amendments made in 2010 appear to have been in response to this: see [5.1.1] above

[281] Robin Scott MP, *Small Amount Lending Inquiry 2008: Report to Tony Robinson MP Minister for Consumer Affairs* (2009) (Department of Justice Consumer Affairs Victoria) 38.

> *Given inconsistent evidence that a ceiling significantly ameliorates the high cost of credit and the difficulty in determining the appropriate ceiling, a more nuanced policy approach combining more established regulatory tools is preferred.*[282]

(3) "The Ramifications of Regulating Payday Lending in Victoria" Report

These concerns were shared in a report *The Ramifications of Regulating Payday Lending in Victoria* by Roger Ouk, who argued that the imposition of a 48% per annum interest rate cap might be commercially unviable for payday lenders, given the lack of empirical data on the industry's cost structure, and indicated that more research was needed by the Government to make a well informed decision on this issue and its impact on the credit industry.[283]

(4) "*Review of High-Cost Credit: Final Report"*

The *Review of High-Cost Credit: Final Report* by the Office of Fair Trading (UK) June 2010 found that where interest rate caps were implemented, market participants sought to circumvent these controls. Where the cap was based solely on interest rates, this was easily done by increasing fees and charges on loans, as had been the case in Victoria in Australia and Canada.[284] All-inclusive caps had been circumvented in other parts of Australia, Canada, USA and Germany, by locating a lender outside the jurisdiction and obtaining cross-border loans (made easier by internet-lending), or by restructuring credit transactions as different financial arrangements to avoid legislation in Australia.[285]

The Report concluded that it did not consider that price controls, such as interest rate caps, were an appropriate solution to the particular concerns identified within the payday lending market,[286] stating:

> *We are aware that price controls can represent an efficient way to address concerns around high profits among suppliers and can, initially, limit the headline prices paid by consumers in the high-cost credit sector. We are, however, also aware that the strategic responses to price controls among suppliers may lead to an outcome in these high-cost credit markets which is unlikely to be of benefit for consumers...*
>
> *The imposition of price controls in high-cost credit markets creates a risk for suppliers that they would generate lower profit levels. It would be reasonable to expect these suppliers to respond to the imposition of a price control by seeking to regain such lost profit by restricting the type and risk of consumers they are willing to supply. In an extreme case of a highly restrictive price control for high-cost credit, some suppliers could cease offering a particular product or exit the market entirely.*[287]

According to the Report, this creates the potential for reduced access to high-cost credit, exacerbating financial exclusion and having a significant impact on consumers' ability to manage their finances.[288] Other adverse likely consequences identified are discussed at [4.3] above.

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[282] Robin Scott MP, *Small Amount Lending Inquiry 2008: Report to Tony Robinson MP Minister for Consumer Affairs* (2009) (Department of Justice Consumer Affairs Victoria) 38.
[283] Roger Ouk, *The Ramifications of Regulating Payday Lending in Victoria*, (undated) 8-9.
[284] Office of Fair Trading (UK), *High-cost consumer credit – emerging evidence from the review* (December 2009) 16.
[285] Office of Fair Trading (UK), *High-cost consumer credit – emerging evidence from the review* (December 2009) 16.
[286] Office of Fair Trading (UK), *Review of High-Cost Credit: Final Report* (June 2010) 54-55.
[287] Office of Fair Trading (UK), *Review of High-Cost Credit: Final Report* (June 2010) 55.
[288] Office of Fair Trading (UK), *Review of High-Cost Credit: Final Report* (June 2010) 55.

(5) "Regulating the Cost of Credit", Consumer Affairs Victoria Research Paper No.6 (March 2006)
The research paper, *Regulating the Cost of Credit, Consumer Affairs Victoria Research Paper No.6* (March 2006) by Manning and de Jong also rejected the imposition of an interest rate cap.

This study on the use of interest rate caps involved detailed cost-based analyses of payday lending.[289] The research indicated that the correlation between credit prices and unrepayable debt was poor, [290]and the correlation between high interest rates and debt spirals are fairly loose.[291]
They concluded that the use of interest rate caps to prevent lending at interest rates likely to lead borrowers into a downwards debt spiral was both blunt and indirect. In their view, "the obvious method of tackling spiralling debt is improved loan assessment." [292]

Their product costing demonstrated that conventional interest rate caps were likely to be no more than 'cosmetic' controls over the overall price of credit as they could be easily circumvented,[293] while all-inclusive interest rate caps of 48% effectively prohibited short-term small-amount loans as it is below cost-recovery for short period loans.[294]

According to this research paper:

> *If the policy goal is specifically to prohibit short-term small-amount lending, the instrument is ideal, but policy-makers should be aware that this indeed is its effect: legal short-term small-amount loans will disappear from the market... If the policy aim is to prevent profiteering in lending, the all-encompassing single-rate cap is fairly useless.*[295]

These authors considered that better assessment of capacity to repay through the use of 'responsible lending' was a more appropriate regulatory response to the issues associated with payday lending, than the use of interest rate caps. [296]

(6) "The Effect of Interest Rate Controls in Other Countries" Report
The Policis research report, *The Effect of Interest Rate Controls in Other Countries* (July 2004) (Department of Trade and Industry[297] also strongly opposed the use of interest rate caps as a regulatory measure. Their extensive research involved the use of diverse methodology and evidence (including a survey of 2717 consumers in France, Germany and the UK).

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[289] Ian Manning, Ian and Alice de Jong, *Regulating the Cost of Credit, Consumer Affairs Victoria Research Paper No.6* (March 2006) 23.
[290] Ian Manning, Ian and Alice de Jong, *Regulating the Cost of Credit, Consumer Affairs Victoria Research Paper No.6* (March 2006) 23.
[291] Ian Manning, Ian and Alice de Jong, *Regulating the Cost of Credit, Consumer Affairs Victoria Research Paper No.6* (March 2006) 33.
[292] Ian Manning, Ian and Alice de Jong, *Regulating the Cost of Credit, Consumer Affairs Victoria Research Paper No.6* (March 2006) 23.
[293] Ian Manning, Ian and Alice de Jong, *Regulating the Cost of Credit, Consumer Affairs Victoria Research Paper No.6* (March 2006) 33-34.
[294] Ian Manning, Ian and Alice de Jong, *Regulating the Cost of Credit, Consumer Affairs Victoria Research Paper No.6* (March 2006) 34, 44.
[295]Ian Manning, Ian and Alice de Jong, *Regulating the Cost of Credit, Consumer Affairs Victoria Research Paper No.6* (March 2006) 34.
[296] Ian Manning, Ian and Alice de Jong, *Regulating the Cost of Credit, Consumer Affairs Victoria Research Paper No.6* (March 2006) 33.
[297] Policis, *The Effect of Interest Rate Controls in Other Countries* (July 2004) (Department of Trade and Industry).

This Report indicated that lenders withdrew from the market where caps were imposed,[298] or raised access hurdles to high risk borrowers,[299] or adapted pricing structures to transfer the cost of credit to the consumer from front end rates to back end penalty charges.[300]

This Research Report also argued that interest rate caps push low-income borrowers into less appropriate credit such as credit cards or pawn broking[301] by reducing the availability of credit, or creating financial exclusion from the credit market altogether.[302] Furthermore, their research indicated that preventing access to credit for vulnerable consumers exacerbates financial exclusion and creates the conditions for the expansion and growth of the illegal lending market.[303]

However this Research Report can be criticised for failing to release the questions asked in the consumer survey, leading to some uncertainty surrounding the nature of its findings. Also, it should be noted that while the report is an independent study, some commentators have doubted the independent nature of Policis' work on the basis that later reports by some members of Policis, are said to have been prepared for Australian payday lender Cash Convertors.[304] Nonetheless there is apparently nothing to suggest this earlier Research Report was affected by the alleged bias of the later Australian research.

(7) Discussion Paper "Payday lending in South Australia - options to increase consumer protection"

Finally, the *Discussion Paper*, *Payday lending in South Australia - options to increase consumer protection*, Office of Consumer and Business Affairs, (2006) conducted an independent cost-benefit analysis. This found that the costs to lenders of an all-inclusive 48% cap on interest would make payday lending unprofitable, so that many lenders now trading would go out of business, with effects on their owners and staff.[305] Although consumers would experience reduced levels of over-commitment and insolvency, they would lose access to these loan products. The cost to Government would be minimal due to the cap being self-enforceable (i.e. the credit contract would be unenforceable by the lender to the extent that it imposed charges exceeding the cap).[306]

A separate cost/benefit analysis of the use of a structured cap (a cap that reflects payday lenders' costs and allowed them a fair market level of profit) found that the cost to industry might be a reduction in the levels of profit currently enjoyed by payday lenders, and initial compliance costs of restructuring their pricing to ensure they charged under the cap.[307] The cost to consumers would be a reduction in the cost of credit. The costs to Government in setting a

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[298] Policis, *The Effect of Interest Rate Controls in Other Countries* (July 2004) (Department of Trade and Industry) 16.
[299] Policis, *The Effect of Interest Rate Controls in Other Countries* (July 2004) (Department of Trade and Industry) 15.
[300] Policis, *The Effect of Interest Rate Controls in Other Countries* (July 2004) (Department of Trade and Industry) 16, 21.
[301] Policis, *The Effect of Interest Rate Controls in Other Countries* (July 2004) (Department of Trade and Industry) 26, 28, 36.
[302] Policis, *The Effect of Interest Rate Controls in Other Countries* (July 2004) (Department of Trade and Industry) 35, 37, 38.
[303] Policis, *The Effect of Interest Rate Controls in Other Countries* (July 2004) (Department of Trade and Industry) 40.
[304] Neil Ashton and the Consumer Action Law Centre, *Payday Lending Report- Draft Literature Review* (n.d).
[305] Government of South Australia: Office of Consumer and Business Affairs, *Payday lending in South Australia - options to increase consumer protection*, *Discussion Paper,* (2006) 15.
[306] Government of South Australia: Office of Consumer and Business Affairs, *Payday lending in South Australia - options to increase consumer protection*, *Discussion Paper,* (2006) 16.
[307] Government of South Australia: Office of Consumer and Business Affairs, *Payday lending in South Australia - options to increase consumer protection*, *Discussion Paper,* (2006) 16.

structured cap would involve significant initial costs associated with analysing costs in the industry in order to derive the appropriate cap.[308]

Ultimately, the Discussion Paper concluded that the costs of short term, small amount lending are so great that a 48% cap would be considered as having the policy objective and likely effect of prohibiting payday lending, rather than protecting consumers by limiting what payday lenders can charge.[309] It warned that a 48% cap could therefore deny low-income borrowers an alternative source of cash to smooth over fluctuations in expenses or tide them over in an emergency.

Finally, the Discussion Paper concluded that a more targeted regulatory approach, directed specifically at ensuring that those without capacity to repay were not extended credit, namely the use of responsible lending measures, would be preferable.

7.5 EDR Complaints Data

There are a number of general protections already available to protect pay day borrowers under the National Credit Code and the ASIC Act. These have been discussed above at [6.2] and [6.3] of this Study.

All of the conduct obligations have applied to the providers of payday loans since 1st July 2010. Enquiries made by the research team of both EDR Schemes,[310] as well as seven payday lenders, revealed that seven months of operation of the NCCP, few cases relating to responsible lending associated with a payday loan have been decided by an EDR scheme and none by 'determination' of the Ombudsman. Of the seven lenders, one advised of having only one case decided at EDR, which was found in favour of the member.

In discussions with FOS, they expressed the view that disputes relating to responsible lending for longer term credit contracts may take twelve to eighteen months to filter through to the schemes. Because of the shorter nature of payday loans (usually a term of eight weeks), COSL representatives believe it is more likely that disputes would be registered earlier.

[308] Government of South Australia: Office of Consumer and Business Affairs, *Payday lending in South Australia - options to increase consumer protection*, *Discussion Paper,* (2006) 16, 17.
[309] Government of South Australia: Office of Consumer and Business Affairs, *Payday lending in South Australia - options to increase consumer protection*, *Discussion Paper,* (2006) 15.
[310] Financial Ombudsman Service (FOS) and Credit Ombudsman Service Limited (COSL).

Table 2 **Data provided by** Credit Ombudsman Service Limited (**COSL) relating to disputes lodged by customers of Small Amount Short Term Lenders.**

Complaints received between 1 July 2010 and 31 December 2010:

1. COSL received 30 EDR complaints relating to micro lenders who were NFSF Members.
2. COSL received 12 EDR complaints relating to micro lenders who were not NFSF Members.

The top 7 issues were:

Issues	NFSF Members %	Micro lenders (Including NFSF Members) %
Loan was unjust	28%	23%
Incorrect listing on credit report	12%	12%
Brokerage fees - excessive	12%	9%
Other fees - excessive/incorrect	10%	8%
Financial hardship	6%	9%
Failure to advise of relevant product information	6%	4%
Failure to provide notice of default	6%	5%
Other	20%	30%

COSL advised that the table includes all small- amount short term loans from what they class as 'micro lenders' which includes payday loans. COSL further advised that the issue 'Loan was unjust' is the previous terminology which equates to 'responsible lending'.

EDR Case Status

NFSF	Closed	Open	Total
EDR	17 (43.6%)	13 (33.3%)	30 (76.9%)

Micro lenders*	Closed	Open	Total
EDR	6 (27.3%)	6 (27.3%)	12 (54.5%)

* Not including NFSF Members

Micro lenders**	Closed	Open	Total
EDR	23 (37.7%)	19 (31.1%)	42 (68.9%)

** Including NFSF Members

Conclusions from the complaints data:
It can be seen that less than 12 disputes were lodged with COSL concerning 'responsible lending' for all categories of micro lenders for the half year. As this number includes all micro

loans, it seems likely that those relating to responsible lending in the payday loan context would be less than that number.

Two other conclusions may be drawn: First, the evidence indicates a lack of widespread complaint activity against micro lenders or indicates most complaints are resolved by Internal Dispute Resolution before escalation. Second, the number of matters relating to 'financial hardship' is at the lower end of the scale. FOS representatives advised this is an escalating problem in relation to more traditional lenders.

7.6 Summary and conclusions

Of the additional specific protections that have been contemplated, the imposition of a national interest rate cap is likely to be one of the more contentious. While interest rates caps have been heralded as the only regulatory measure that can adequately protect vulnerable consumers,[311] the evidence of recent studies appears to indicate the contrary.

While the imposition of a traditional cap would seem to be a 'blunt instrument' which is easily circumvented, the effect of an all inclusive cap is likely to have the effect of prohibiting payday lending as being unprofitable. If lenders can use the suggested methods [312] of avoiding the cap, such as operating outside the jurisdiction, or transferring the cost of credit to default charges, the cap will not work. If the cap works properly so that avoidance is not possible, lenders may respond by leaving the market or reducing the availability of payday loans. If lenders withdraw from the market, this form of credit will not be available to any borrowers, including those who might have been able to afford the loan. Withdrawal or severe restriction is likely to produce financial exclusion or channel the most vulnerable borrowers to illegal lenders.

An all-inclusive cap may also have the effect of further reducing the range of credit products in the credit market and thus further limiting competition. Given that the mainstream lending market does not provide credit for small loans repayable over a short period, the cap would be likely to have the effect of excluding some low-income consumers from the market or leading others to take out larger loans than they need.

If an all-inclusive cap were to be introduced, further research to determine an appropriate level would be required, given the lack of information about the costs of different products to lenders, discussed above at [1.2], [2.2.1] and[2.2.2] above. An effective cap would need to take into account payday lenders' costs and allow them a reasonable level of profit.

In addition, the use of a limit on the number of loans or the 'rollovers', discussed in [7.2] and [7.3] above, should not be considered for implementation without further evidence concerning industry costing and the effects on consumers' access to short-term small amount lending.

The more preferable regulatory response appears to lie in the adoption of the responsible lending regulations, together with the associated licensing, conduct and disclosure obligations, to prevent credit being extended to those who cannot afford to repay it. Given that responsible

[311] Zac Gillam and the Consumer Action Law Centre, *Payday Loans: Helping hand or quicksand? An examination of high-cost short term lending in Australia*, 2002-2010 (September 2010) 39.
[312] Office of Fair Trading (UK), *High-cost consumer credit – emerging evidence from the review* (December 2009) 16; Policis, *The Effect of Interest Rate Controls in Other Countries* (July 2004) (Department of Trade and Industry) 16, 21.

lending, together with other provisions, as a regulatory response is yet to be tested, it would appear premature to introduce further regulatory measures.

In conclusion there appears to be no evidence that the general protections in the NCCP and the *ASIC Act* and the remedies they make available to payday borrowers are inadequate. On the contrary, we believe they are comprehensive and sufficient. Alternative dispute resolution through independent external dispute resolution schemes is available to borrowers which is free, easy to access and provides a wide range of remedies. This is a significant practical benefit as redress from courts, while available under the legislation, can be very expensive for borrowers. In all the circumstances therefore, there is no compelling argument that additional specific protections are required.

Appendix A: Perceived Problems Associated With Payday Loans and Australia's New Regulatory Regime

New Licensing Regime, Responsible Lending Obligations, and Disclosure Obligations Under the *National Consumer Credit Protection Act 2009* (Cth)	**Relevant Problems said to be Associated with Payday Loans**	**What will be the Regulatory Impact?**
National Consumer Credit Protection Act 2009 (Cth) Chapter 2, Part 1-2: new licensing regime for credit providers	'Predatory lending' practices are undertaken by some members of the payday industry.	By introducing a national licensing regime which strengthens and clarifies the regulatory framework in respect of credit providers' conduct, and providing improved enforcement measures for ASIC, it is intended that this will exclude predatory lenders and their practices from the market, subject credit providers to more stringent competence and probity checks, and rid the industry of 'rogues'.
National Consumer Credit Protection Act 2009 (Cth) Chapter 3, Part 3-2, Division 3 and 4: prohibiting licensees from providing credit products and services that are unsuitable for the consumer, and from increasing the credit limit on any unsuitable credit contract	The high cost of credit in terms of an APR, and its impact on vulnerable consumers- causing them to take on credit they cannot afford, or causing/exacerbating poverty through 'debt spirals'. Payday lenders failure to adequately or properly assess the capacity of consumers to repay loans/ inappropriate lending practices by some providers/ absence of rigorous standards for assessing a borrower's capacity to repay/ lenders targeting vulnerable consumers Rollovers and back-to-back	Under the new responsible lending obligations, lenders are required each time a new loan is issued or credit is increased, to make reasonable inquiries and verifications about the consumer's requirements, objectives and financial situation, to ensure that the loan is not unsuitable and will not cause substantial hardship. Under these new regulations lenders will be prohibited from providing a loan/back-to-back loan where a consumer would not have the capacity to repay, or could only do so

	loans result in debt spirals through repeat borrowing	with substantial difficulty. The intention is to prevent the occurrence of debt spirals and help reduce the incidences in which rollover facilities are needed.
National Consumer Credit Protection Act 2009 (Cth) Chapter 3, Part 3-1, Division 4 and Division 6: prohibiting credit providers suggesting that consumers enter into an unsuitable credit contract, assisting them to enter into an unsuitable credit contract, or suggesting to a consumer, or assisting in a consumer, increasing the limit on a unsuitable credit contract	Payday lenders target vulnerable consumers Consumers take on credit they cannot afford Rollovers and back-to-back loans resulting in debt spirals through repeat borrowing	The new responsible lending requirements mean that payday lenders and brokers are prohibited from suggesting that consumers enter into a payday loan where it is unsuitable (i.e. in relation to their financial situation/ capacity to repay or their requirements and objectives) or assisting vulnerable consumers from entering into a payday loan where it is unsuitable. This is designed to prevent payday lenders and brokers promoting/ providing payday loans to vulnerable consumers and help prevent consumers taking on credit they could not afford. It also prohibits payday lenders or brokers suggesting that consumers remain in a particular credit contract where it is unsuitable, or increasing lines of credit under an existing credit contract where that action is also unsuitable.
National Consumer Credit Protection Act 2009 (Cth) Chapter 3 Part 3-1, Division 5: requirement for licensees to provide the consumer with a credit proposal disclosure document at the time of providing credit	The high cost of credit in terms of APR and its impact on vulnerable consumers Low ability and effectiveness of consumers in driving	By disclosing the fees, charges and commissions for a payday loan at the time of seeking assistance/advice in regards to a payday loan,

assistance to a consumer	competition between suppliers	this will help vulnerable consumers be made aware of the high cost of credit prior to taking out the loan. It may also help drive competition in the market by further facilitating price comparison and selection to be undertaken by consumers
National Consumer Credit Protection Act 2009 (Cth) s47 (1) (h), (j): Requirements for all licensees to have an internal dispute resolution procedure that complies with the standards and requirements of ASIC, and membership of an external dispute resolution body.	Complaint handling processes within the payday loans industry are not transparent The payday loan industry has inadequate or non-existent dispute handling procedures	The new requirements for internal dispute resolution under the Act aim to provide complainants with an open, responsive, effective and easy-to-use complaints-handling process (in accordance with *National Consumer Credit Protection Regulations 2010* (Cth), Regulation 10; *Australian Standard* AS ISO 10002). It also aims to ensure complainants access to free independent external dispute resolution bodies to ensure independent, fair, accountable and effective dispute handling processes where the internal dispute resolution process has not, from the customer's perspective, been successful (*National Consumer Credit Protection Regulations 2010* (Cth), Regulation 10) It will also improve consumers prospects of obtaining redress, where warranted, and enforcing their rights under the National Credit Code

Appendix B: Overview of Regulatory Responses to Payday Lending in Australia

State or Territory	Approach
Australian Capital Territory	48% all inclusive/comprehensive cap and UCCC
New South Wales	48% all inclusive/ comprehensive cap and UCCC**
Queensland	48% all inclusive/comprehensive cap and UCCC
Victoria	48% interest rate cap and UCCC
Northern Territory	No regulation beyond UCCC
South Australia	No regulation beyond UCCC
Tasmania	No regulation beyond UCCC
Western Australia	Licensing regime and UCCC

** for NSW the 'all inclusive' cap is taken to mean any interest, fees and charges payable to any party, directly or indirectly, for a service relating to the provision of the credit.

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