

**Australian Securities and Investment Commission Consultation Paper 198:
REVIEW OF THE EFFECTIVENESS OF AN ONLINE DATABASE FOR SMALL
AMOUNT LENDERS**

**Legal Aid NSW submission
to the
Australian Securities and Investment Commission**

February 2013

About Legal Aid NSW

The Legal Aid Commission of New South Wales (Legal Aid NSW) is an independent statutory body established under the *Legal Aid Commission Act 1979* (NSW) to provide legal assistance, with a particular focus on the needs of people who are socially and economically disadvantaged.

Legal Aid NSW provides information, community legal education, advice, minor assistance and representation, through a large in-house legal practice and private practitioners. Legal Aid NSW also administers the funding for a number of services provided by non-government organisations, including 35 community legal centres and 28 Women's Domestic Violence Court Advocacy Services.

Legal Aid NSW welcomes the opportunity to contribute to the review of the effectiveness of an online database for small amount lenders by the Australian Securities and Investment Commission (ASIC). Should you require further information or clarification on any aspect of this submission, please contact David Coorey at david.coorey@legalaid.nsw.gov.au or telephone (02) 9219 5824.

1. Introduction

One way in which Legal Aid NSW fulfils its mission to assist disadvantaged people and communities is to provide advice and assistance in relation to consumer law issues, particularly in the area of consumer credit. Legal Aid NSW provided 2,802 advice and 3,555 minor assistance services in consumer law matters in 2011 – 2012 financial year and have more recently conducted a short-term casework project in relation to legal issues arising from small amount loans.

Legal Aid NSW broadly supports the introduction of an ASIC administered database for small amount lenders. This document outlines the reasons why Legal Aid NSW supports a database in principle, as well as highlighting some issues that would need to be addressed if any such database was introduced.

2. The new legislative framework

The *Consumer Credit Legislation Amendment (Enhancements) Act 2012* introduces, among other provisions, a range of additional requirements for small amount lenders and credit assistance providers above their existing obligations under the *National Consumer Credit Protection Act 2009* (NCCPA) and the National Credit Code (Schedule 1 of the NCCPA) (the Code).

In particular, two presumptions of unsuitability have been included in s131(3A) of the NCCPA (the presumption provisions) with a view to protecting consumers from the damaging effects of the repeated use of small amount, high cost loans. A small amount credit contract will be presumed to be unsuitable if, at the time of assessment:

- (a) the debtor is in default on another small amount credit contract (the default presumption), or
- (b) in the 90 day period before the time of the assessment, the consumer has been a debtor under two or more other small amount credit contracts (the 90 day presumption).

The development of an ASIC monitored database would be a simple but effective means to assist industry compliance with responsible lending obligations and provide an important, cost-effective tool for monitoring that compliance by the regulator.

The reality for consumers of short term credit contracts is that they are more vulnerable to long term financial hardship. Repeat borrowing of high cost, small amount loans pushes consumers into a debt spiral¹, which when out of control, becomes a genuine product safety issue. As Parliament explained when these special legislative requirements were designed:

These provisions provide targeted reform to address concerns in relation to both debt spirals and recurrent use of small amount credit contracts. The more credit contracts that the borrower takes out within a short period of time (whether concurrently or successively), the more likely it is that income is being continually diverted to meet the repayments, and the greater the risk that they may experience consequent financial hardship.²

¹ Office of Best Practice Regulation, *Regulation Impact Statement: Regulation of Short Term, Small Amount Lending*, September 2011 at 20

² *The Consumer Credit Legislation Amendment (Enhancements) Bill 2012*, Revised Explanatory Memorandum at 4.30

Legal Aid NSW agrees with the legislative intention and believes a database is a critical tool both for industry to comply with the presumptions provisions and for ASIC to regulate the small amount credit space for the reasons outlined below in response to each question.

3. Response to specific questions in the consultation paper

B1 *Should it be mandatory for credit licensees:*

(a) to register all small amount loans in a database; and

(b) to make an inquiry from the database to determine whether a consumer has two or more small amount loans in the preceding 90 days or whether a consumer has a current small amount loan that is in default before entering into a new small amount loan?

Legal Aid NSW supports the proposal that small amount credit licensees should be required to enter all small amount loans in a database. Legal Aid NSW supports a database on the basis that:

- (a) the purpose of the database is to assist:
 - (i) lenders to comply with the presumption provisions, and
 - (ii) ASIC to regulate responsible lending in the small amount credit market, and the information held in the database is only used for this purpose
- (b) the database is established and regulated by ASIC, rather than industry
- (c) due diligence is conducted to ensure the collection, storage and use consumer information is consistent with best practice and obligations imposed by the *Privacy Act 1988*, and
- (d) there are accessible avenues for consumers to redress any problems arising from inaccurate or improper use of their information.

Given the legislative requirements are clear that a licensee who enters into a third small amount credit contract within a 90 day period will be presumed to have breached the responsible lending requirements, Legal Aid NSW recommends that it be made clear that best practice involves checking the database before approving each loan.

B1Q1 *Would such a requirement be an effective means of enabling small amount lenders to determine whether consumers trigger the presumption of unsuitability?*

Yes. A database is a simple but effective tool of ensuring compliance with responsible lending obligations.

A database would be effective given the significant challenges faced by small amount credit providers in complying with the presumption provisions under the status quo. The primary challenge is that they must look across *all* the consumer's small amount loans in determining whether the proposed loan is unsuitable. In the experience of Legal Aid NSW it is rare that consumers will have small amount loans with only one credit provider – the average number of lenders per client, of current client files is three. In one case, a client presented with current loans with seven different small amount credit providers.

Without a database small amount credit providers are left to the following inadequate options in an attempt to discharge their obligations in relation to the presumption provisions:

(a) Self reporting

This would involve the credit provider relying on the consumer disclosing whether they had any other small amount loans in the preceding 90 days, or whether they are in default on existing small amount loans. In the experience of Legal Aid NSW, a number of small amount lenders do not ask about the consumer's debts and expenses in their loan application forms. Even if lenders did make these enquires, Legal Aid NSW is of the view that self reporting would not result in accurate assessments, and in isolation, would not discharge the lenders onus to make reasonable enquires about and verify the consumer's financial situation.

(b) Assessment of bank account statements

Under the new s117(1)(1A) and s130(1)(1A) of the NCCPA small amount credit providers and credit assistance providers will be required to obtain the consumer's preceding three months ADI account statements as part of their assessment of whether the proposed loan is unsuitable. This will provide some insight into whether a consumer has had two or more small amount loans in the past 90 days however it will not be conclusive.

A consumer may be a debtor under a current small amount credit contract and repayments are not shown on the account statements obtained for a number of reasons as follows:

- (i) repayments are made by way of the employer authority prescribed by Schedule 10 of the *National Consumer Credit protection Amendment Regulation 2012* (No.4)
- (ii) repayments are made from a different bank account, such as the consumer's partner's bank account or a second account held with another ADI
- (iii) direct debits have been cancelled pursuant to Reg 79C *National Consumer Credit Protection Amendment Regulation 2012* (No. 4) but the consumer is remains a debtor under the credit contract
- (iv) the borrower may apply for multiple loans within a very short period of time, or
- (v) in less common cases, repayments may be made by cash or cheque.

These factors suggest that while the requirement to obtain 90 days bank account statements is certainly useful it will not be sufficient for a lender in addressing the presumptions in their determination of whether a loan is unsuitable. Legal Aid NSW also notes through casework experience, small amount lenders, while obtaining bank account statements, will often not consider their contents when determining whether a loan is unsuitable.

(c) Checking the consumer's credit report

The limitations of relying on a consumer's credit report when assessing the presumptions have been outlined at paragraphs [44] – [50] of the ASIC consultation paper. The experience of Legal Aid NSW is that although some small amount lenders will make enquiries with and list defaults on a consumer's credit report this is not a standard practice across the industry. Again, the incomplete nature of a consumer's credit report means that it would be an inadequate tool for lenders when assessing whether the proposed loan triggers either of the presumption provisions in the Act.

B1Q2 *What would be the likely cost to credit licensees or to consumers of such a requirement? We are interested in the likely cost of entering data into the database as well as the cost of making a database inquiry.*

Legal Aid NSW is unable to comment in any detail about whether a database would create a notable cost to small amount credit licensees if introduced in Australia. Legal Aid NSW notes that in Florida the lender is charged \$1 per enquiry, a nominal fee given the high cost of credit and significant consumer benefits flowing presumption provisions that operate effectively.

If any additional costs were incurred as a result of the database it should be borne by the lender rather than being passed to the consumer as an additional charge under the credit contract. The new legislative framework sets out a number of measures to cap the cost of small amount credit; and in New South Wales this will result in a significant increase in the cost to consumers. Legal Aid NSW suggests that any costs incurred by the lender in complying with their responsible lending obligations should not be passed to the consumer, particularly in circumstances where a very high cost cap already exists.

Further, the likely costs of developing and maintaining a database needs to be assessed in the context of the overall basis for developing it. If product safety and avoidance of debt spirals are key objectives of the legislation, then relatively minor costs associated with compliance with those laws need to be assessed against that policy intent.

B1Q3 Are there potential flow-on effects or consequences from making such a requirement? For example, would credit licensees be less likely to subscribe to credit reporting agencies because this is not mandatory and would incur an additional cost?

Legal Aid NSW does not see that licensees would be less likely to subscribe to credit reporting agencies given that they serve very different purposes. Checking a consumer's credit file allows the lender to manage risk and obtain much more detailed information than would be available in the database.

B1Q4 Does the fact that the Australian responsible lending obligations involve a principles-based approach, plus specific rebuttable presumptions for short-term loans, mean that a database would be less useful than in overseas jurisdictions where the legal requirements are more definitive?

No. On the contrary, quantitative data to support a principled-based approach is an emerging but important tool that is being used in a wide number of areas to map and monitor effective enforcement of policy intent. For example, in the area of flood insurance, quantitative data collected after the Queensland floods assisted Treasury to identify and redress fundamental issues in the insurance market that had previously only been understood on an anecdotal basis. This approach provides reliable, real-time data that benefits a more holistic understanding of how markets operate under particular legislative regimes.

Although a database is particularly useful in jurisdictions which impose a 'hard cap' on the number of loans that can be granted in a particular period of time, Legal Aid NSW does not see that a database would be any less useful in the Australian context.

B1Q5 *Would such a requirement lead to avoidance, such as structuring loans that fall outside the definition of a small amount credit contract?*

Given certain lenders already structure their products in an attempt to avoid consumer protections under the NCCPA and the NSW interest rate cap³, it is likely that some lenders will choose to engage in avoidance practices under the new legislative framework. Legal Aid NSW does not see that a mandatory database would influence this behaviour: a database would provide a valuable tool for lenders and the regulator in ensuring compliance with the law. Avoidance practices can be better dealt with by proactive regulation by ASIC and the proposed anti-avoidance powers in the *National Consumer Credit Protection Amendment (Credit Reform Phase 2) Bill 2012*.

B2 *If a database of small amount loans is in place in Australia, what information should be recorded in it and made available to a small amount lender on inquiry?*

Possible options for information to be included on the database are:

- (a) the identity of the borrower;*
- (b) the loan amount;*
- (c) the loan start date;*
- (d) the loan contracted completion date;*
- (e) the actual loan completion date; and*
- (f) whether an existing small amount loan is in default.*

Given concerns about consumer's privacy (see B2Q8) no more information should be included in the database that is necessary for a lender to be able to identify whether a presumption provision is triggered in relation to a proposed loan. At minimum, the database would need to include the identity of the borrower, loan start date and term to be able to assess the 90 day presumption. The actual completion date would also be useful for the purpose. If the database is also to be used as a tool to assess the default presumption, lenders would also need to update the database with default information as it arises.

ASIC may determine that it is too great an impost to require lenders to update the database during the course of the loan. If this is the case Legal Aid NSW would still strongly support the introduction of a database with sufficient information available to assess the 90 day presumption. This is the most difficult presumption to comply with under the status quo and if a lender is aware that a loan is foot they are able to make further inquiries, if necessary, about whether the loan repayments are up to date.

B2Q1 *Are there any practical difficulties in obtaining the relevant information to be included in the database?*

The information to be included in the database would be within the lender's knowledge when the consumer applies for the loan. The consumer's consent would necessarily be required before the information could be passed to ASIC for inclusion in the database. This consent could be obtained in the same fashion as consent to pass information to a credit reporting agency – consumers would sign a form consenting to an ASIC database search as a standard part of the loan process.

B2Q2 *Does entering the actual completion date of a small amount loan raise practical difficulties?*

See response to B2

³ *The Consumer Credit Legislation Amendment (Enhancements) Bill 2012*, Revised Explanatory Memorandum at 11.102

B2Q3 *Would it be problematic for lenders to include information on the default of small amount loans in the database, noting that this would require a credit licensee to provide information to the database during the course of the loan (rather than only at the commencement and completion of the loan).*

See response to B2

B2Q4 *What information should be provided to the lender who makes an inquiry of the database? For example, should the database provide the inquiring lender with a response as to whether the consumer triggers the presumption of unsuitability and a brief reason, or should more details of the relevant small amount loans held in the database be released?*

Consistent with ensuring the database is only used for the purpose of assessing the presumption provisions only minimal information would need to be disclosed. It would be sufficient for the database to report on:

- (a) whether the 90 day presumption is triggered, and/or
- (b) whether the default presumption is triggered (assuming this information is available).

B2Q5 *Should a consumer have access to the database and, if so, what information should a consumer be able to obtain?*

A consumer should always be able to access information held about them quickly and free of charge. This is consistent with consumer's access to information held in the credit reporting space and the obligations to release personal information under the *Privacy Act 1988*.

B2Q6 *How can the accuracy of the database be assured?*

The development of an ASIC-approved and monitored database will be key to the success of this initiative. Given the role of the regulator, there would be a direct public interest in ensuring all aspects of the database meet best practice standards.

To maximise the accuracy of the first point of contact consumers could be required to complete an application form to have their details entered on the database when obtaining their first loan. The client could then be allocated a unique identifier based on the application form provided. Licensees would then need to be responsible for ensuring ongoing information is up to date and accurate. Audits, complaints processes and penalties for lack of compliance would all provide incentives to ensure the information included by licensees is accurate.

B2Q7 *How should consumer concerns about the accuracy of the database be addressed? For example, should there be internal and external dispute resolution requirements?*

Whenever information held by an agency will affect their access to services appropriate dispute resolution processes need to be established to ensure that incorrect or misused information does not adversely affect the consumer. Significant steps have been taken in the credit reporting space to address consumer concerns in this respect and provide a useful example of how an effective internal and external dispute resolution system could work.

B2Q8 *Are there any concerns relating to the Privacy Act 1988 because of information held in the database and the details given to a lender in response to an inquiry?*

Yes. Although Legal Aid NSW does not have particular expertise in this area Legal Aid NSW understands that the Australian Privacy Foundation has expressed concerns about how information in the database would be collected, stored and used consistently with privacy obligations. These would certainly need to be addressed, however given the database will be administered by ASIC, Legal Aid NSW is confident that these privacy concerns could be overcome.

B3 *Are there regulatory requirements beyond those addressed in Question B1 that the database could be usefully and practically used to test proposed loan contracts against?*

In relation to B3 Q1 – Q3, there are additional regulatory requirements that the database could be usefully used to test the loan against, however this would require more information being entered into the database. For example, the lender could be required to enter much more detailed information about the loan fees and charges if it were able to regulate the cost cap provisions. In the view of Legal Aid NSW, it would be more useful having a database that lenders can easily utilise without significant burden than attempting to use the database for additional purposes at this stage.

4. Challenges for ASIC in regulating the presumption provisions

As the regulator of corporations, markets and financial services, ASIC is been charged with the responsibility of enforcing and giving effect to the law in relation to consumer credit, primarily set out in the NCCPA and the Code. A core aspect of this work is to administer the licensing regime established under the NCCPA to ensure licensees act efficiently, honestly and fairly and comply with credit legislation⁴.

A small amount credit provider's compliance with the responsible lending provisions of the NCCPA is not only relevant to the individual consumer but to the broader question of whether the lender is complying with the licensing obligations. The presumption provisions are central to both of these questions in the small amount credit space.

Given the challenges faced by lenders complying with the presumption provisions as outlined above, it appears that ASIC would face significant regulatory challenges if left to rely on consumer complaints for their regulatory activity. In the view of Legal Aid NSW, a database established by ASIC for regulatory purposes would greatly assist in overcoming these challenges.

The new legislative framework acknowledges that to protect the most vulnerable, additional regulation is required in the small amount lending space. This vulnerability is well summarised in the Office of Best Practice Regulatory Impact Statement⁵ and does not need to be restated; however Legal Aid NSW notes that this means consumers are unlikely to complain about small amount credit products given that:

- (i) the consumer's level of disadvantage may limit their knowledge of complaint mechanisms and ability to articulate a complaint to the correct body – for example 30% of current Legal Aid NSW payday lending clients report experiencing an addiction and/or mental illness at the time of obtaining the loan

⁴ *National Consumer Credit Protection Bill 2009 Revised Explanatory Memorandum at 2.50 – 2.51*

⁵ *Office of Best Practice Regulation, Regulation Impact Statement: Regulation of Short Term, Small Amount Lending*, September 2011 at 13 to 19

- (ii) even if the consumer is able to engage complaint mechanisms, consumers who feel dependant on obtaining a short term loans are unlikely to complain about the lender – to use the common phrase, they will not 'cut off the hand that feeds them'
- (iii) making a complaint is often a low priority when struggling to meet immediate needs such as food and housing, and
- (iv) shame, guilt and embarrassment can deter consumers from making complaints even if points (i) – (iii) can be overcome.

It also difficult for a consumer to take any action about a small amount loan in a Court, given that filing fees may be larger than the debt in question and jurisdictional limits leave the consumer with no options but to have their matter heard in a small claim jurisdiction. This means that not only are consumers unlikely to complain, they are unable to use the Courts to access individual remedies or have systemic issues dealt with by higher Courts.

In these circumstances ASIC requires some means of monitoring compliance without relying on consumer complaints. A database could overcome these challenges by providing a tool for pro-active regulation. ASIC could, for example, monitor whether a particular lender rebuts the 90 day presumptions in a high proportion of their loans and prompt questions of the lender in these circumstances. It would also allow ASIC to regulate with confidence, knowing the tool is available to lenders in their attempt to comply with the laws

It is worth pointing out that the use of a database by Government agencies to administer and enforce the law is not new. For example, the NSW Police Force use the Firearms Registry to administer the *Firearms Act 1996* and *Firearms Regulation 2006* which set out a range of obligations on licensees, including safe storage and appropriate use of registered weapons.⁶ At a Commonwealth level, the Insolvency and Trustee Service Australia (ITSA) is responsible for the administration and regulation of the National Personal Insolvency Index. The information to be held in the index and responsibility for maintaining it is clearly set out in the *Bankruptcy Regulation 1996*.

While neither of these examples is directly analogous to a database of consumers who have used small amount loans, they do demonstrate that systemic data collection is often essential for a regulator to be able to carry out its role in ensuring compliance with the law or in the case of ITSA, carrying out its functions more broadly.

⁶ NSW Police Force, *Firearms Licence Standard Authority & Conditions*, March 2012