

# FINANCE INDUSTRY DELEGATION

## SUBMISSION

regarding the

### Development of Governance Standards Consultation Paper December 2012

**To:**

The Manager  
Philanthropy and Exemptions Unit  
Indirect, Philanthropy and Resource Tax Division  
The Treasury  
Langton Crescent  
PARKES ACT 2600

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## **Introduction**

The Finance Industry Delegation has reviewed the "Development of Governance Standards Consultation Paper", dated December 2012, and is most concerned that there is absolutely no recognition of the post-March 1, 2013 and post-July 1, 2013 decimation of commercial small amount, short term lending.

This decimation is a result of current and proposed credit legislation, which will create a socioeconomic disaster that the Not-For-Profit (NFP) sector will be forced to attempt to counteract.

## **About the Finance Industry Delegation**

The Finance Industry Delegation is a consortium of non-mainstream credit providers involved in the small amount, short term sector of the Australian finance market. Supporters of the Delegation consist of payday and microlenders, brokers and industry sector suppliers and the sector covers lenders who generally provide amounts from hundreds of dollars up to \$10,000.

The Finance Industry Delegation was formed in March/April 2011, to contribute comment and advice to government agencies and Ministers on proposed legislation and regulation that will affect its supporters' businesses and their customers.

It also provides a useful role of disseminating information and providing analyses concerning proposed and actual legislation and regulation to the 224 "bricks and mortar" and internet lending outlets and 42 brokers across Australia who support the Delegation, as well as 5 other businesses involved in lending and/or broking, but not as their core business. The Finance Industry Delegation is also supported by 3 of the biggest service suppliers to Australian small amount, short term lenders.

It is estimated that, during the calendar year 2012, supporters of the Finance Industry Delegation alone provided in excess of 250,000 loans.

Representing small amount, short term lenders, the Finance Industry Delegation is very concerned as to what NFP governance measures will be put in place to cover the disaster mentioned above.

## **Regarding the Finance Industry Delegation's Concerns**

We bring to your attention that the combined effect of:

1. the National Consumer Credit Protection Act 2009, passed to enable the Commonwealth to regulate small amount, short term credit provision from 1 July 2010;
2. the amendments to that legislation passed by way of the Consumer Credit Legislation Amendment (Enhancements) Act in July 2012;
3. the proposed National Consumer Credit Protection Amendment (Credit Reform Phase 2) Bill 2012; and
4. the associated Regulations -

will result in around 92% of all small amount, short term commercial lenders being forced to exit the market in 2013 and a substantial proportion of currently available loans - even as high as 80% - not being available, because it will be uneconomic for lenders to continue to lend the amounts for the terms involved.

A major restraint on lending to Centrelink benefit recipients, commencing 1<sup>st</sup> March 2013, will be followed by draconian financial restrictions on all non-ADI lenders commencing 1<sup>st</sup> July 2013.

We may debate the extent, but the reality is a considerable number of the near one million borrowers, who borrowed \$1.2 billion in 2011, with the issuing of approaching

1.5 million loans, will have to turn to the NFP sector for their loans as, under the forthcoming regime, current commercial lenders will not be able to afford to lend to them.

As mentioned above, that means the new governance regime for the NFP sector will have to recognise a major lending role for the sector, in order to avert a socioeconomic disaster.

The consultation draft does not appear to contain any recognition of this forthcoming role.

This in circumstances where the relevant Minister, The Hon Bill Shorten, has frequently asserted that the borrowers already have appropriate borrowing opportunities available to them with the NFP sector organisations.

A copy of our previous submission concerning governance for NFP organisations is appended to this document. It provides greater details of our concerns.

It is hoped that the final draft of the "*Development of governance standards*" will contain standards that appropriately recognise the forthcoming major credit role the NFP sector organisations will have to undertake.

We thank you for the opportunity to make this submission.

**A response to the December 2011  
Treasury Consultation Paper:**

**Review of not-for-profit  
governance arrangements**

A consideration of the impact on the development of governance arrangements for Not-For-Profit entities, should the current Consumer Credit and Corporations Legislation Amendment (Enhancements) Bill 2011 be passed without amendment.

Submitted to:

The Manager  
Philanthropy and Exemptions Unit  
Personal and Retirement Income Division  
The Treasury  
Langton Crescent  
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## **A consideration of diversity and essential governance arrangements required as a result of forthcoming legislation**

### **Introduction**

We note that the Final Report on the Scoping Study for a National Not-For-Profit Regulator “concluded that the diversity of the sector should drive consideration of suitable governance arrangements” and that the Final Report “recommended that Treasury undertake a review to determine, what, if any, should be the core organisational governance principles applying to registered NFPs” (Paragraphs 11 and 14, Treasury Discussion Paper).

This submission addresses an additional diversity that is highly likely to be imposed on the NFP (Not-for-Profit) sector within months, if the current Consumer Credit and Corporations Legislation Amendment (Enhancements) Bill 2011, that is before the Parliament, is passed without amendment.

For many NFP entities, this will require significant new and large amounts of government funding and a major expansion of responsibility in a specialised area, lending large numbers of small amount, short term loans, that will demand inclusions in the core organisational principles.

The Delegation expects that there will be considerable resistance from the NFP sector in response to this imposition. While it may look attractive to some NFPs seeking to expand their activities, many are likely to assess that this opportunity is NOT an attractive one to be enthusiastically welcomed. This assessment will be absolutely valid and the essential multiple governance arrangements will be daunting because:

1. it will represent a major expansion of responsibility, into a highly specialised area, with few NFPs having any previous experience;
2. those NFPs with some experience will have gained that with involvement at a very tiny and specific level, compared to the new level of activity that will be both expected by government and demanded by hundreds of thousands of consumers seeking financial help; and
3. the weekly volume of transactions involved will overwhelm most NFPs and peak volumes, during three times of the year, can be triple the average weekly volume.

The impost on the necessarily numerous NFP entities participating in lending will be profound in regard to the need to develop new management systems and essential governance arrangements. We note:

- (a) these multiple governance arrangements have to be finalised, in place, and in use starting April this year (2012) and ready to be even more relevant beginning October this year;
- (b) the internal management system necessary to observe these governance arrangements will be substantial and it will be essential that the system for each participating NFP embraces detailed and very comprehensive management and staff manuals. These will take months to draft, assess and then finalise;
- (c) due to the diversity of potential consumer/client demand and the variety of cultures to be found in participating NFPs, it cannot be assumed that these essential management systems can simply be duplicated, with a common application to all relevant NFPs;

- (d) the new management system required to be designed, tested and applied will be addressing an entirely different culture and set of tasks to the current system;
- (e) the new culture to be adopted and promoted will be dramatically different from most current NFP cultures and will not be readily accepted by existing management, employees and volunteers;
- (f) the new management systems will introduce major new dynamics to their internal auditing functions;
- (g) the new management systems will require a major expansion of their annual briefing to the external financial auditors;
- (h) the costs associated with internal and external auditing functions will dramatically increase;
- (i) the community will expect very lean and flat management structures, which will require recruitment of very experienced, educated and expensive management personnel to manage the raft of demanding responsibilities associated with the new imposition. This recruitment will occur in a highly competitive recruitment market. The banks may be shedding staff, but the people who will go are not the staff members/management with the relevant required skills;
- (j) participating NFPs will be expected to be entrepreneurial with the imposed business activity, in a way in which they have never had to be before; and
- (k) extensive time management skills, organisational skills and other existing resources of the participating NFPs will be needed, in order to manage the many months of conferencing and stakeholder participation in the development of the new management systems and to build a foundation on which the new duties and responsibilities can be successfully launched and embraced, including essential training on an ongoing basis.

Smiles Turner, Management, Strategic and Compliance Consultants' February/March/April 2011 review of the current commercial small amount, short term lending industry sector, has observed that it takes 5 to 10 years for the larger small amount, short term lenders to effectively come to grips with the challenges above. In the new environment, to accommodate the number of transactions, a considerable number of the NFP lenders will have to operate as larger lending organisations.

### **The Delegation**

The Financiers Association of Australia/Industry/Smiles Turner Delegation (the Delegation), a representative group formed to liaise with Treasury, ASIC and Minister Bill Shorten on matters to do with consumer protection and the regulation of payday and microlending in Australia, is concerned to provide this submission.

As a delegation that represents some 147 lending outlets and 180 authorised credit representatives across Australia and 2 major service providers to the industry sector, we are concerned that your reviewers be aware of the governance challenges for a number of your NFP stakeholders that could emerge from the enactment of the Consumer Credit and Corporations Legislation Amendment (Enhancements) Bill 2011 this year.

This legislation, already introduced into the Parliament, is scheduled for Parliamentary debate during the first sittings this year commencing 7<sup>th</sup>

February and involves critical commencement dates of 1<sup>st</sup> July this year and 1<sup>st</sup> January next year.

As members of “*the wider public*” who have substantial experience in commercial money lending, or in providing a service to that industry sector, the Delegation supporters have chosen to accept Minister Shorten’s invitation to engage in the important issue of governance for NFPs.

We believe it is vital that the outcome of the current governance review reflects the challenges we raise.

### **90% of commercial short term small amount lenders to withdraw from the market**

Substantial industry sector research and analysis by Smiles Turner in February to April last year, and being repeated as this submission is being presented indicates, with almost total confidence, that if enacted largely in its current form, without significant amendment, the (Enhancements) Bill will lead to the withdrawal of most small amount, short term lenders from the industry sector. The only uncertainty is whether “most” will constitute 90%, or up to 94.6% of existing lenders. This withdrawal will take place in a finance environment where the banks, building societies and most credit unions left the small amount, short term sector 10 years ago, with no intention of ever returning.

Minister Shorten personally attempted to encourage all the major banks to return to the sector last year and was refused by every contact he made. None of these financial institutions have ever made a public statement to the contrary. The banks' involvement continues to be limited to public relations exercises primarily associated with two of the major banks (ANZ and NAB) subsidising relatively small joint projects with NFPs. As discussed later in this submission, while any involvement should be welcomed, these efforts satisfy far less than 1% of total demand.

The Minister expects the NFP sector to be able to accommodate greater demand and has made a number of statements encouraging borrowers to seek their finance from the alternative (non-commercial) NFP sector lenders, such as the Low Interest Loan Schemes (LILS) and No Interest Loan Schemes (NILS), on the basis of lower cost to the consumers.

### **History of the Bill - no fundamental changes anticipated**

To date, there is absolutely no indication that necessary changes to the current Enhancements Bill will be made, to avoid the new NFP governance paradigm. Further, the history of the Bill includes nearly 12 months of continuing responses to Treasury Discussion Papers, meetings with senior Treasury officials and communications with a designated senior Ministerial adviser, culminating in the current Bill. A Bill that reflects very little of what the industry sector had tried to repeatedly communicate during the process.

While the Consumer Credit and Corporations Legislation Amendment (Enhancements) Bill was the subject of two Parliamentary Committees’ reports (the Joint Committee on Corporations and Financial Services and the Senate Economics Legislation Committee) presented to the Parliament in November 2011, both of which recommended a substantial rewriting, or revision, of the legislation, Minister Shorten has not publicly embraced the common recommendations and has simply promised “discussions” with the payday and microlending industry sector.

Minister Shorten is also on continuing public record, with speeches in the House of Representatives, media releases and media interviews, indicating a

strong preference for the draconian interest rate cap provisions in the current Bill that, if introduced, will effectively abolish 90% or more of the industry sector. It may be significant that, on the 24th January, Treasury distributed a Consultation Paper, the content of which included an issue associated with the imposition of the 48% interest rate cap. This Consultation Paper reinforced this assessment.

Unfortunately for the commercial industry sector, the essential changes go right to the heart of the legislation and form the fundamental difference between the consumer advocates' position and the industry sector's position. Without the changes, the Bill will effectively abolish the commercial small amount, short term lender.

The consumer advocates have on their side the fact that, for at least 2,000 years, no one has liked money lenders. In addition, the leaders of the consumer advocate movement are very media savvy and have the necessary communications' skills to present an isolated "horror story" as being applicable to the whole industry sector. Consequently, they have little trouble generating anti-commercial lender media interest and political support, at both backbench and ministerial levels.

With this in mind, the consideration of governance arrangements for NFPs should proceed on the basis that the current Enhancements Bill will be enacted without amendment.

### **Another Discussion Paper soon**

Prior to last Christmas, an announcement was made that a Discussion Paper will be released by the Consumer Credit Unit of Treasury, to explore the alternatives to commercial sector provision of credit.

We have no doubt that this discussion process will confirm what the Delegation has been attempting to communicate to Treasury and the Minister for nearly a year, and was able to successfully communicate to the two Parliamentary Committees that reviewed the current Bill in October/November. It will also confirm what witnesses from Anglicare told the Joint Committee on Corporations and Financial Services, while giving evidence at the Committee's public hearing in October last year, and what ACOSS (Australian Council of Social Services) published in their 2011 annual review. That is - the NFP sector is unable to cope with current lending demand, let alone cope with a massive increase in that demand in the near future.

Hopefully, between the two "discussions", a clear picture will emerge as to the breadth of implementation requirements that will be associated with the development of the applicable 'national governance arrangements', for the NFP organisations who it appears will shortly fulfil a major credit provision role in our society.

### **Legislation to open demand floodgate**

Given the likely exit of most commercial lenders from the industry sector, it can be expected these NFP schemes will be required to accommodate a 100-fold increase in demand on the sector's current lending volume.

The Delegation has researched and communicated how extensive that demand could be, to the Consumer Credit Unit, Retail Investor Division at Treasury, the Senate Economics Legislation Committee and others (see our Submission to the Senate Committee, which is No. 33 on the Committee website at:

[http://www.aph.gov.au/Senate/committee/economics\\_ctte/consumer\\_credit\\_enhancements\\_bill\\_2011/submissions.htm](http://www.aph.gov.au/Senate/committee/economics_ctte/consumer_credit_enhancements_bill_2011/submissions.htm)).



Copies of a number of our submissions have been sent to the Minister's office (as will this submission). It is this extensive increase in demand for loans from the NFP sector that encourages this submission.

With the commencement dates included in the current Bill, this 100-fold increase will start to emerge before 1<sup>st</sup> July - less than 5 months away. As discussed below, due to cash flow issues, the increase in loans demanded from the NFP lending entities will commence before these dates.

Even the NFP organisations who have lent money before, do not have appropriate all-embracing governance arrangements in place that are designed to satisfy their forthcoming change in status, from relatively small lenders involved in lending annual total amounts measured in thousands of dollars, to large lending organisations handling amounts measured in hundreds of millions of dollars.

### **Major impact on governance arrangements**

In the absence of any indication that the Minister has accepted the need for the required major changes to the current Bill, it would be most unwise to ignore the very significant governance impost that could face the NFPs who are currently, or will become, involved in providing personal small amount, short term loans.

These are a very diverse group and include major organisations such as The Good Shepherd Youth and Family Service, Brotherhood of St Lawrence, the Salvation Army and Anglicare, as well as smaller organisations such as Muru Mittigar Aboriginal Cultural and Education Centre and Foresters.

### **Major regulatory demands and community expectations involved**

Because so much cash is involved and there are so many mandatory conditions imposed on lending by the National Consumer Credit Protection Act 2009 and associated Regulations, small amount, short term money lending requires particular attention to satisfying community expectations in regard to efficiency, transparency and accountability.

### **Governance arrangements must recognise forthcoming infrastructure development and Government funding increases**

Major NFP infrastructure development and associated major funding increases should also be recognised in the governance arrangements being considered for implementation nationally.

Any objective of developing a single governance system must recognise that, currently, delivering money lending services is likely to become a very big issue for possibly hundreds of not-for-profit organisations - whether individually or as local branches of major NFP organisations - operating from approximately 600 different outlets. These will be needed to replace the current 680 commercial lending locations across Australia.

### **Twin masters and community expectations**

Part of the challenge in developing appropriate governance arrangements is that the current thinking is for all not-for-profits to report back to the Australian Charities and Not-For-Profits' Commission (ACNC), which will establish the regulatory framework for all NFPs.

Unfortunately, this overlooks the fact that, as money lenders, the NFPs will become involved in the credit licensing, reporting and regulatory framework associated with ASIC, as prescribed for all money lenders under the National Consumer Credit Protection Act 2009 and associated Regulations.

Governance arrangements will have to accommodate both regulatory frameworks.

While it is appreciated that NFP lenders currently enjoy some exemptions from the National Consumer Credit Protection Act and associated Regulations, these exemptions have been provided in an expectation that they would apply to a small number of special circumstances, involving a relatively small number of loans. The environment being considered by this submission is one where the NFPs take over most of the lending currently being undertaken by commercial lenders. This is a very different scenario.

Further, the Government has strongly promoted its post-1 July 2010 involvement as the regulator of small amount, short term lending and has strongly emphasised the importance of the consumer protection measures it has introduced. The public will expect these now established consumer protection measures to continue if the NFP sector takes over from the commercial lenders and undertakes fundamentally the same role. The governance arrangements will have to recognise management systems for the implementation of a responsible lending regime, with clear responsibility to identify unsuitable loan applications via a rigorous application and verification process and providing towards 40 pages of mandatory documentation for every loan.

Any governance development objective must recognise community expectations concerning three possible misappropriations of the large sums of money that will be responsibility of the NFP sector:

1. NFP entity to employee;
2. NFP entity's lending finance division, to another area of activity of the same NFP, that should be the subject of separate and different funding; and
3. NFP entity to a third party or organisation.

It should also be anticipated that these community expectations will embrace the NFP entity's ability to factually and objectively undertake cost of service delivery analysis. This should be a major inclusion in all funding submissions and a determining factor in Treasury allocations of funding to the different NFP lending entities.

As the likely NFP entities that will be involved in money lending have never had any experience of major lending costs, a necessary cost analysis and appropriate economic modelling should be expected to form the foundation of any governance arrangements.

Finally, the development of the new governance arrangements will have to recognise the inherent conflict between the traditional understanding of what "not-for-profit" means and the expectation the community will have that the lending activity will be conducted as an economically viable activity, involving the need to at least break even, if not the need to generate profits.

This to not only to achieve the ideal of breaking even in any one period, but to allow a surplus (profits) to accumulate, to cover unforeseen losses that might threaten this break even status in the future.

The Delegation submits that there are fundamental differences between the appropriate governance arrangements for each circumstance.

### **Substantial Government funding ahead**

Government funding announcements must be expected. These will clarify the substantial funding amounts that the not-for-profit sector will have to be

granted by the Federal Government, in order to satisfy the demand created for NFP organisation's loans under any legislation that does not reflect a major change in the existing provisions in the current Bill.

Unfortunately, there does not appear to have been any provision made in the 2011-12 Federal budget. However, when appearing before the Joint Committee on Corporations and Financial Services, the consumer advocates were very confident that financial and funding arrangements would be in place in time for the commencement of the current Bill, because they all appeared to reject the Committee members' concerns that there would be nothing in place to replace the commercial lenders.

As we will briefly discuss below, the amounts of money involved are far greater than any amount managed and lent by the not-for-profit sector to date. In these circumstances you should assume that governance arrangements will be required to cover the major money lending role for the not-for-profit sector at the conclusion of your review and to be Incorporated in the proposed single governance system.

### **The new statistics**

In considering the design of new governance arrangements for the NFP sector, the Delegation believes that it is very important that the following statistics be kept closely in mind. On all current and past indications from the Minister, they reflect what lies ahead for the NFP sector that currently engages in lending small amounts, for short terms, to a small section of the community, when most of the commercial lenders have exited the market during this year.

1. As the 2011 RMIT University research and the Consumer Action Law Centre Victoria 2008 research found - around 80% of small amount, short term borrowing is for purposes that our society regards as non-discretionary.
2. Only 30% of current borrowers of these small amount, short term loans claim to have an alternative source of loan funds they could access if necessary (Smiles Turner research, November 2010, March/April 2011). Unfortunately, this number will drop when reflected in the actual percentage who will be able to access an alternative to their current commercial small amount, short term lender. There is always a tendency for people to be overconfident, particularly when they have not had to try. Over time, lending criteria may have changed and the relevant lenders faced with all 30% applying at once, may simply not have the resources to cope with all applications.
3. All commercial lending for loans under \$3,000, and most for loans between \$3,000 and \$5,000, will cease under the current Bill and the majority of borrowers will be turning to the NFP sector for lending help.
4. The total loan book involved was \$1.2 Billion in 2010 and there is no indication that lending has decreased over the last 12 months (Smiles Turner is currently conducting industry research that will clarify this demand).
5. That means governance arrangements for the NFPs engaged in the post-legislation commencement lending, will be responsible for establishing management protocols for lending in excess of \$1 Billion.
6. Currently, each year, 750,000 individuals borrow one or more small amount, short term loans (in excess of 1.5 million loans).

7. As previously mentioned, the above means that the NFP sector will face a 100-fold increase in demand which, in turn, means the NFP lenders will face:
  - (a) accommodating at least 525,000 extra people borrowing annually, many of whom borrow more than once (generously assuming all 30% of current borrowers who think they have access to an alternative source are successful), up from an absolute maximum of 25,000 one-time-only borrowers, currently handled by the NFPs. NFP sector analysis by Smiles Turner, in early 2011, revealed 18,500 loans were lent annually by NFP lenders. The larger figure is used to reflect public promises of lending growth in 2011/2012;
  - (b) lending the annual total of towards \$1.2 Billion in loan demand (at least \$1 Billion), up from the less than \$20 Million per annum currently being lent by NFPs. Again, we include a figure reflecting promises of growth from the NFP lenders' sponsors;
  - (c) reducing their application process time from an average of 4 to 6 weeks, to less than 2 hours for 90% of applicants, and less than 2 days for the remainder;
  - (d) changing their current criteria, so that the current 86% of all commercial loan applications that do not satisfy existing NFP lending criteria can be accommodated;
  - (e) recruiting and training approximately 2,500 full time equivalent employees. The average annual wage for each employee, including on-costs and reflecting applicable awards, is \$61,000;
  - (f) multiplying their lending offices by 4, according to the 2011 annual ACOSS report;
  - (g) introducing major and expensive (average \$60,000) security installations in all lending offices, to reflect the significant increase in cash that will be on the premises during trading hours;
  - (h) establishing major internet lending facilities to replace the current 58 internet lenders, and the 300 sites currently feeding leads to them;
  - (i) recognising that the demand for small amount, short term loans is growing at 18% per annum compound (2008-2010 inclusive); and
  - (j) Smiles Turner estimates \$830 million will be required to fund infrastructure and preparation, before 1 January 2013.
8. There is also the issue of the NFPs having to deal with the 90% of borrowers that the current NFP lenders decline for NILS and LILS loans. These borrowers will not have a commercial alternative to turn to if the current Bill is passed unamended.
9. In addition, the Government is strongly committed to encouraging longer loan terms, to reduce the amount of individual periodic repayments. Longer loans - for the same amount borrowed - means towards \$1 Billion more will have to be applied to the total loan book capital needing accommodation by NFP governance arrangements.
10. Given the above, the Federal Government funding will need to be approximately \$2.8 billion over the next 18 months. Thereafter, due to the regime the current Bill will impose on the NFP lenders, an annual subsidy of \$400 million will be required to ensure the NFP lenders at least break even.

As a consequence of the above, there is:

- an immediate need for governance arrangements to apply to the establishment period;
- a short term need for governance arrangements to apply to the lending surge associated with the 1 July commencement date of the current Bill;
- and a longer term requirement of governance arrangements, to accommodate the second surge of lending demand from the NFP lenders, associated with the 1 January commencement date of the remainder of the provisions in the current Bill.

### **A short timetable**

If the timetable included in the current Bill is maintained, a significant increased requirement for not-for-profit loans will formally commence July 1<sup>st</sup> this year and a potentially overwhelming demand will be created from 1<sup>st</sup> January 2013. These are the dates included in the current Bill.

Smiles Turner industry research indicates that 28% of all payday lenders will exit the market before the first group of provisions in the current Bill commence on 1<sup>st</sup> July 2012, because they will have assessed that they cannot break even operating under the intended provisions.

The remainder of the payday lenders, and most of the microlenders, will exit before 1<sup>st</sup> January 2013, when the remainder of the provisions in the current bill are scheduled to commence.

The exit will begin before the commencement dates noted in the legislation because lenders do not want to be caught with continuing high operating costs, while being limited to only being able to recover their outstanding loans.

The approach is to completely shut up shop before the commencement date, in order to ameliorate the loss. This is generally 1 to 3 months prior to the commencement of the any new prohibitive legislative provisions.

The first wave of demand will come from payday borrowers - those people borrowing \$100 to approximately \$1,000, with repayments scheduled over a number of weeks (not months), on payday. These people borrow an average of \$285 (Cash Converters) to \$325-327 (Smiles Turner industry research). That means the governance arrangements that result from the current review must be in place to recognise that, from April this year, the increasing demand for loans from the NFP lenders, by the small amount borrowers turned away from the commercials sector, will begin.

By June, many lenders will no longer be lending new loans and, in July, the demand will come from the former customers of the 28% of payday lenders who will have totally stopped providing new loans. In October there will be a surge in demand faced by the NFPs, which will increase dramatically through November and December (particularly with the heavy borrowing traditionally undertaken before Christmas) and roll on after 1<sup>st</sup> January, as the rest of the payday lenders and most of the microlenders (lenders of approximately \$1,000 to \$5,000 over months) exit lending in the small amount, short term sector.

In the fourth quarter of 2012, continuing lenders will be reluctant to lend to the increasing numbers of displaced borrowers. Unlike the period associated with 1 July regulatory commencements, there will be little take up of the borrowers who have been turned away by lenders closing, and who attempt to go to the remaining lenders for their loan. This is because the remaining lenders will also be preparing to exit the market. Significantly, overhanging the whole

industry sector during this latter period, will be an increasing reluctance on the part of wholesale providers of lending funds, to provide those funds to lenders they know will be shortly closing down.

The Delegation is not in a position to research the NFP sector, to explore that sector's timetable requirements for the necessary management and staff recruitment and training, lending office location sourcing and lending business preparation that will be required. Obviously, to meet the demand surges outlined above, their timetables will have to reflect action deadlines - ahead of the demand to be accommodated.

One major successful commercial lender, with the advantage of 11 years in payday and microlending, with existing trained and experienced management and lending staff to draw on if necessary, and with the experience of opening over 40 outlets over the years, allows 2 months from the time a decision is taken to open a new store and opening day, inclusive of staff recruitment and basic training. The lender allows at least another month to complete the staff training and withdraw intense head office involvement from the new outlet. This timetable is condensed as a result of a very highly entrepreneurial approach, outstanding regional managers and highly efficient very senior management and company owners who are amongst the most capable in the industry.

In establishing NFP governance arrangements for NFP lenders, it would be unwise to assume a similar NFP capability at the commencement of their new lending responsibilities. Consequently, the new governance arrangements should reflect that in terms of recognising standards of time management and efficiency and an almost complete lack of practical industry knowledge.

### **ACNC must also prepare**

We note that the newly formed ACNC is the NFP sectors' equivalent of ASIC.

As the ACNC is expected to have an educational role, as well as the ability to develop regulation and provide an effective report recipient entity, staff with knowledge of governance development for lenders, consumer credit protection regulation requirements and the business of money lending, will have to be recruited by the ACNC.

Recent ACNC recruitment advertisements do not show any indication that these roles have been anticipated.

### **Consumer expectations**

The new lending environment will be beyond anything experienced by any existing not-for-profit lender.

Part of that environment includes established consumer expectations. The new governance arrangements will have to accommodate the expectations from consumers that:

1. loans will be available within one to two hours from commencement of application, in contrast to the frequent arrangements currently in place for lending by not-for-profit organisations, where lead times of up to 6 weeks are common;
2. the loan amounts will vary from \$100 to \$5,000, in contrast to most of the current borrowing opportunities from not-for-profit organisations, where the amounts appear to be from approximately \$800 to \$1,500;

3. the loan terms will be predominantly for periods of less than 6 weeks, in contrast to the current loans provided by most not-for-profit lenders, which are for periods of 6 to 18 months; and
4. the purpose for which the loans are sought will represent a massive expansion on the current borrowing purposes approved by not-for-profit lenders. At present, numerous consumer surveys conducted by Smiles Turner indicate that at least 86% to 90% of the reasons for borrowing from the commercial sector, do not constitute approved reasons adopted by the not-for-profit sector. This change will require considerable adaptation of lending protocols, including risk assessment.

### **NFP lenders - starting from a small base**

The above means the magnitude of the changes for which the not-for-profit sector must be ready are massive and the base from which most have been working is extremely small, in comparison to that with which they will have to deal. For example:

- (a) Smiles Turner's comprehensive industry analysis conducted in February/March/April last year, revealed that not-for-profit lending locations were frequently lending less than 100 loans per year. Many of the current small commercial lenders provide 100 loans in less than a fortnight.
- (b) In recent years, a selection of community organisations associated with an ANZ Bank subsidised scheme facilitated less than 1,000 loans a year, in total. One commercial lender, with a similar number of outlets, lends an average of 10,000 loans, in total, per month.
- (c) Via a network of franchisees, the biggest commercial lender in Australia lends 850,000 loans per year. Smiles Turner has estimated aggregate loan figures, for all the low interest and no interest loan schemes, were less than 25,000 last year. The not-for-profit organisations involved in lending less than 25,000 loans per year are exactly the ones that will bear the major responsibility for lending in excess of 1 million loans per year.

### **Governance arrangements for 600 locations and new business operations**

Governance arrangements will have to be developed and implemented for not-for-profit lenders, who will be forced to establish fairly extensive branch networks, with all the challenges that senior management from a distance introduces. Consumers cannot be left in a supply vacuum.

Consumers expect reasonable physical location convenience (Smiles Turner 2003, 2006, 2010 and 2011 research). Without this number of retail outlets, it must be expected that criminal elements would move in to fill the void in the local areas not serviced by a not-for-profit lender. Biekie gangs have already had experience in payday lending in South Australia and, via pawnbroking, in Queensland, and the Lebanese/Australian and Vietnamese/Australian gangs in NSW are very experienced small to medium amount lenders in NSW casinos. There are already major criminal lenders on the Gold Coast and in Adelaide, whose collection techniques are inappropriate.

This issue was first raised with concern by a Queensland Office of Fair Trading Task Force, who investigated payday lending in South East Queensland, during 1999-2000.

Governance arrangements will have to be developed and introduced to assist with the tasks of outlet location selection and establishment, recruitment and training of staff, and effective advertising and marketing, to ensure a vacuum is

not left for the criminal element to exploit - with the attendant unwanted antisocial and anti-consumer consequences.

The Delegation cautions against having confidence in the statement included at page viii of the Discussion Paper, "*Most NFP entities will already have adequate governance procedures in place, and therefore we do not expect that they will have to make substantial changes to existing arrangements as a result of centralising the governance arrangements*". In regard to the substantial money lending role that, most likely, will soon be imposed on the NFP sector, if there are no fundamental changes to the (Enhancements) Bill, it is unlikely any of the relevant NFP entities will be able to avoid major changes and increases in their governance arrangements.

### **Governance issues**

To conclude this submission's general overview, before replying to Treasury's specific questions, the Delegation is concerned to emphasise the following governance issues that will have to be addressed, in order to maintain public confidence in the funding of the NFP organisations involved in the significantly increased money lending role, currently highly likely to be imposed on them:

1. The system of checks and balances will have to reflect the relationships between management, the lending staff, consumers, the ACNC, ASIC, credit reference agencies, EDR schemes, debt collection agencies and the courts.
2. Duties and minimum standards of responsibility will have to be set for the designated Responsible Managers and the credit representatives (see ASIC Regulatory Guides) . Such including responsible lending (according to the National Consumer Credit Protection Act), advertising (according to the ASIC Act) and levels of continuing professional development training and basic relevant Certificate IV attainment (according to ASIC Regulatory Guides).
3. Risk management must embrace the mandatory Professional Indemnity Insurance and effective evaluation of the suitability/unsuitability of providing a loan of the type for which the consumer has applied.
4. Minimum requirements for the NFP entities' lending rules will have to embrace the mandatory requirements included in the National Consumer Credit Protection Act and associated Regulations.
5. Relationships with borrowers will require the establishment of Internal Dispute Resolution Schemes, with a designated manager, and the membership of an EDR scheme.
6. There will be greater auditing requirements because the activity of money lending, using Government funds, demands a high level of confidence that the money is being allocated according to approved purpose, and that the money lending operation is entirely compliant with the law. This compliance does not just include consumer credit legislation, but also embraces four different acts setting standards for privacy, money laundering and terrorism legislation and strict regulation concerning debt collection.
7. The interface between the NFP organisation's traditional client and the NFP is likely to be very different to the interface involving a borrower. The fact that the borrower will be expected to pay back the loan, as opposed to the traditional client that does not face that responsibility and simply takes the money or other benefit, will be an important governance issue.



## RESPONSE TO CONSULTATION QUESTIONS

1. *Should it be clear in the legislation who responsible individuals must consider when exercising their duties, and to whom they owe duties to?*

Yes.

2. *Who do the responsible individuals of NFPs need to consider when exercising their duties? Donors? Beneficiaries? The public? The entity, or mission and purpose of the entity?*

The lending purpose of the entity, in accordance with the mandatory requirements of responsible lending.

3. *What should the duties of responsible individuals be, and what core duties should be outlined in the ACNC legislation?*

These must reflect the requirements clearly presented in the National Consumer Credit Protection (NCCP) Act and associated Regulations, the ASIC Regulatory Guides published from time to time, and the relevant provisions in the ASIC Act.

4. *What should be the minimum standard of care required to comply with any duties? Should the standard of care be higher for paid employees than volunteers? For professionals than lay persons?*

The standard of care is that prescribed under the responsible lending provisions included in the NCCP Act and as explained in the Relevant ASIC Regulatory Guides. In relation to small amount, short term lending, it would be legally and functionally unacceptable for volunteers to be involved in this area. This would raise insurance and awkward management issues, making it very difficult to be 100% compliant.

5. *Should responsible individuals be required to hold particular qualifications or have particular experience or skills (tiered depending on size of the NFP entity or amount of funding it administers)?*

ASIC demands that Responsible Managers have relevant Certificate IV qualifications and a minimum of 20 hours annual continuing professional development training and lending staff are expected to undertake approximately 10 hours continuing professional development annually.

6. *Should these minimum standards be only applied to a portion of the responsible individuals of a registered entity?*

In accordance with ASIC mandatory requirements, the minimum standards must apply to all relevant individuals.

7. *Are there any issues with standardising the duties required of responsible individuals across all entity structures and sectors registered with the ACNC?*

No, provided there is an effective interface between the ACNC and ASIC.

8. *Are there any other responsible individuals' obligations or considerations or other issues (for example, should there be requirements on volunteers?) that need to be covered which are specific to NFPs?*

A number of participating NFP entities may face a cultural change challenge which will have an impact on individuals assisting, given the large amounts of money that will be involved and the fact that the process is one of lending with expectations of repayment - not giving or granting to a client. Further, there may be more opportunities where NFP entities' staff

will have to decline applications from potential borrowers, in numbers far above current rejection rates. As mentioned in 4 above, it is not expected that volunteers will be involved in the NFPs' lending environment.

9. *Are there higher risk NFP cases where a higher standards of care should be applied or where higher minimum standards should be applied?*

Money lending is a case where higher standards of care and higher minimum standards are a significant issue.

10. *Is there a preference for the core duties to be based on the Corporations Act, CATSI Act, the officer holder requirements applying to incorporated associations, the requirements applying to trustees of charitable trusts, or another model?*

With money lending, the opportunity to indicate a preference has gone. ASIC is firmly entrenched as the legislated regulator.

11. *What information should registered entities be required to disclose to ensure good governance procedures are in place?*

The information disclosure requirements are clearly prescribed in the NCCP Act and associated Regulations and included in all applications for an Australian Credit Licence.

12. *Should the remuneration (if any) of responsible individuals be required to be disclosed?*

Absolutely, as this is an allocation of taxpayer provided funds.

13. *Are the suggested criteria in relation to conflicts of interest appropriate? If not, why not?*

The suggested criteria will have to reflect those prescribed by ASIC in its Regulatory Guides.

14. *Are specific conflict of interest requirements required for entities where the beneficiaries and responsible individuals may be related (for example, a NFP entity set up by a native title group)?*

Yes. The Delegation would expect arms' length, third party involvement for complete transparency.

15. *Should ACNC governance obligations stipulate the types of conflict of interest that responsible individuals in NFPs should disclose and manage? Or should it be based on the Corporations Act understanding of 'material personal interest'?*

The Delegation believes that the Corporations Act "material personal interest" does not go far enough in the circumstances of money lending and the ACNC should consider contact with ASIC to develop a clearer and more comprehensive criteria.

16. *Given that NFPs control funds from the public, what additional risk management requirements should be required of NFPs?*

Those risk management requirements detailed by ASIC in its Regulatory Guide.

17. *Should particular requirements (for example, an investment strategy) be mandated, or broad requirements for NFPs to ensure they have adequate procedures in place?*

Adequate procedures require specific mandated requirements, rather than diverse interpretations of broad requirements from people who have had limited or no experience with money lending before.

18. *Is it appropriate to mandate minimum insurance requirements to cover NFP entities in the event of unforeseen circumstances?*

Yes. In the circumstances of money lending, NFP entities must act on a level footing with commercial lenders in general, to maintain standards throughout the finance industry. The NCCP Act does not, and should not, provide any opportunity to differentiate between NFP lenders and commercial lenders.

19. *Should responsible individuals generally be required to have indemnity insurance?*

Yes.

20. *What internal review procedures should be mandated?*

Internal review procedures must include efficiency, effectiveness and accountability auditing - as well as financial auditing, the establishment of a compliance officer function/position and the preparation of compliance reports by that officer. These reports must be regularly presented to the controlling board/committee. This in an environment where ASIC compliance inspections must also be expected to occur from time to time.

21. *What are the core minimum requirements that registered entities should be required to include in their governing rules?*

These are prescribed in the NCCP Act and revolve around the concepts of "responsible lending" and loan suitability/unsuitability.

22. *Should the ACNC have a role in mandating requirements of the governing rules, to protect the mission of the entity and the interests of the public?*

Yes, in conjunction with ASIC, in regard to the money lending aspect of the entities' operations and with AUSTRAC, to ensure public funds are being used for money laundering purposes.

23. *Who should be able to enforce the rules?*

Enforcement may have to be undertaken with the ACNC being responsible for the non-money lending functions and ASIC being responsible for the money lending functions. Further, AUSTRAC, as the regulator of money laundering and counter terrorism, will also need to enforce their rules on the NFP lenders, just as currently do on the commercial lenders.

24. *Should the ACNC have a role in the enforcement and alteration of governing rules, such as on wind-up or deregistration?*

Yes, but with appropriate involvement of ASIC in regard to the money lending functions of the entity.

25. *Should model rules be used?*

Model rules may be an appropriate approach, at least during the introductory period, because of the lack of experience associated with major money lending activities.

26. *What governance rules should be mandated relating to an entity's relationship with its members?*

The Delegation believes that the NCCP Act and ASIC have already mandated the governance rules to apply to the money lending operations of any lender, including NFP entities.

27. *Do any of the requirements for relationships with members need to apply to non-membership based entities?*

Yes - identical requirements, no matter what the structure of the NFP entity.

28. *Is it appropriate to have compulsory meeting requirements for all (membership based) entities registered with the ACNC?*

Yes. Imposing a discipline avoids transgression by omission, or failure to recognise the significance or utility of meetings. In the circumstances of a money lending entity, it is very important to prescribe the opportunity for meetings so that the compliance, internal dispute and lending managers can report regularly.

29. *Are there any types of NFPs where specific governance arrangements or additional support would assist to achieve in better governance outcomes for NFPs?*

Yes. As the Delegation has presented in this submission, NFP entities that are, or will be, involved in major money lending activities require special attention.

30. *How can we ensure that these standardised principles-based governance requirements being administered by the one-stop shop regulator will lead to a reduction in red tape for NFPs?*

We do not have any confidence that there will be, or can be, any reduction in red tape. The increasing intrusiveness of government by legislation and regulation is a phenomena that must be accepted as knowing no bounds and which will continue for years to come - particularly in the money lending sector. It must be remembered that existing legislation allows for a great number of matters to be dealt with by regulation. This means there will be many moving targets and compliance issues to be addressed on an ad hoc basis, using appropriate governance arrangements. With large amounts of cash must come close and careful management, with prescribed rules of conduct that can be easily and effectively monitored.

31. *What principles should be included in legislation or regulations, or covered by guidance materials to be produced by the ACNC?*

In regard to the money lending function of the NFP entities, those espoused in the ASIC Regulatory Guides.

32. *Are there any particular governance requirements which would be useful for indigenous NFP entities?*

The Delegation has no experience with regard to specifically indigenous lending and we do not feel it is appropriate to comment.

33. *Do you have any recommendations for NFP governance reform that have not been covered through previous questions that you would like the Government to consider?*

Before finalising the governance arrangements for NFP money lending entities, it would be very useful to seek consultation with former commercial lenders, who could provide very practical advice and comment.

**Conclusion**

The Delegation hopes that this submission will be of assistance. Our lending company supporters will all have left the small amount, short term lending sector when the governance arrangements for money lending NFP organisations really take effect.

However, in the interests of what, by then, will be the Delegation supporters' former customers, we hope that the development of governance arrangements for the money lending NFP organisations will be appropriate and helpful, so that our former customers will continue to have access to the loans they need, whether to pay for food, electricity, car repairs and registration, buying cars, boats and caravans, funerals, overseas holidays, home renovations, birthday parties and gifts, Christmas presents, back to school costs, rent, rental bonds, removal expenses, medical and dental bills, travel to visit sick and dying relatives, tools of trade, computers for work or study, etc. (Smiles Turner research 2003-2011).

The Delegation thanks you for your consideration of this submission.