Promoting Responsible Consumer Lending

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Submission to

Treasury

Re: the discussion paper
Financial System Inquiry – Draft Terms of Reference

Submitted via email to
fsi@treasury.gov.au

Friday 6th December 2013

Contact:

Philip Johns
CEO
National Financial Services Federation Ltd
P: 07 3269 3300
F: 07 3009 0606
M: 0412 509010
E: ceo@nfsf.org.au
Postal Address: Suite 156, 192 Ann St, Brisbane Qld 4000

Submission on the
Financial System Inquiry : Draft Terms of Reference
Friday 6th December, 2013

Thank you for the opportunity to comment on the Terms of Reference (TOR) for the Financial System Inquiry (FSI). While the TOR are necessarily wide ranging across the financial system, this submission will focus on issues which affect National Financial Services Federation (the Federation) members and the end users of their financial products.

The Federation is the peak industry association, representing over 300 ASIC-licensed short-term credit providers who serve over 650,000 consumers each year. The Federation has a diverse membership that covers Franchisors, Franchisees, private and publicly listed companies, small and large entities, who offer a range of credit products from both retail and dedicated online platforms – most products being governed by the National Consumer Credit Protection Act 2009. The amounts lent typical range from $100 to $10,000, for terms from a number of weeks to several years. Some members provide just the one type of loan and some provide a range of loan services and other financial products.

The Federation has been heavily involved in the Government consultation process and the Treasury consultation group since the then Minister Nick Sherry announced in July 2008 that the Commonwealth intended to take over regulation of credit from the States. The last five years has seen the Federation develop into a strong entity for lobbying, submission responses, and one-on-one consultation with key stakeholder entities such as ASIC, Commonwealth Treasury, ARCA[1] and the ATO.

TOR 1.2 Seeks to report on the consequences of developments since 1997 as they relate to domestic competition.

The Federation sees this TOR as particularly important to the continued viability of the licensed small-loans industry. A major unforeseen consequence of the

[1] Australasian Retail Credit Association http://www.arca.asn.au/

recent legislative and regulatory changes has been the continued operation of **unlicensed operators and/or unregulated credit.** Regulators must not only be given the legislative power and resources to swiftly shut down these activities, but also be mandated to do so by the respective Ministers. Greater consumer protection arises from the removal of unlicensed and unregulated credit, than "reviewing" and inspecting already licensed and compliant credit providers.

TOR 1.3 Seeks to report on the current cost,...safety and availability of financial... products...for all end users.

The Federation recommends this TOR to be particularly important as a focus on the consequences of recent developments. The Federations' members fill a vital credit segment not serviced by mainstream banks. Recent changes have now created a financially excluded class of consumer and has significantly reduced their access to legitimate, safe and suitable small loans. These consumers in particular are now turning to the unlicensed and regulated operators in the market. The changes to the NCCP Act has reduced the legitimate supply of credit, but it has done nothing to curb consumer demand.

It is stated that recommendations out of this FSI will focus on 'fairness'. The Federation believes that such **fairness cannot be achieved without freeing up credit availability to lower income consumers**. The Federation understands that, in relation to low income earners, financial counsellors and consumer advocates wish to minimise the availability of small-loan lending models that are more expensive than main stream models. Basically they suggest that if a lending model exists that is more expensive than what the 'normal' consumer can access in the main stream market, then that model should be removed from the small loan market or at least have very restricted access. This suggestion is made under the mistaken believe that it will provide more consumer protection but this path will only serve to create more financial exclusion as main stream lending models are simply not available to all Australians.

TOR 2.1 Speaks of balancing competition, innovation and efficiency, with stability and consumer protection.

While the Federation applauds and was the instigator of significant changes aimed at increasing consumer protection, it must be stated that too strong a focus on consumer protection has not been balanced against maintaining competition in the market, which is rapidly diminishing.

Too much focus on consumer protection has also negatively impacted on the number of underbanked consumers. Market innovation forced on the Federation members in an attempt to stay viable in the market, has also opened up more unforeseen consequences of increased consumer protection. More members are now operating solely on-line which opens up the field to fraudulent practices including overseas operators which effectively reduces consumer protection. The regulator has stated this is a very difficult area to police.

Further to the subject of providing strong consumer protection, the Federation firmly believes that any stakeholder, whether a financial counsellor, legal aid representative, or consumer advocate, must be licensed, trained, and be subject to ongoing training requirements to the same respective standard for their sector under the NCCP.

These are state based entities, and as yet, cannot guarantee that two consumers in two different states with the same credit issue will have the same outcome It is logical that all outcomes should be the same as all consumers come under the Commonwealth National Consumer Credit ProtectionAct 2009.

If the practice of 'credit repair' companies is to continue, as stakeholders operating in the credit sector, they too should also be licensed and practices governed under the NCCP Act. Current belligerent practices to force removal of a legitimate credit defaults because the lender cannot afford the cost of dealing

with such intimidating tactics, is simply outrageous and continues to corrupt the Australian's consumer credit file history in credit bureau entities.

Urgent changes are needed to focus on lenders' Internal Dispute Resolution (IDR) programs and ensure that External Dispute Resolution (EDR) schemes are a last resort. In most cases, any disputes between lender and consumer can be solved more easily and cheaply through the lender's own IDR processes and thus provide adequate consumer protection. The current over use of EDR schemes, effectively drive the overall cost of credit up as these unwarranted costs must be passed on.

TOR 2.3 Assessing the consequences of financial regulation, including its impact on compliance costs, flexibility innovation and financial services trade.

The Federation is especially concerned about the **huge imbalance** created by applying wide ranging and expensive compliance requirements on both large business and small business alike. A lender in the small-loans industry has the same credit license as a bank, and as a result faces the same compliance regulations and costs for (say) and $500 loan as a major bank supplying (say) a $50,000 loan. This places an enormous strain on the small-loan lender to meet all of the compliance costs and at the same time stay within a regulated interest/fee cap. The banks do not face such caps but are able to set interest/fees to cover costs, meet the demand and competition in the market place.

For small-loan lenders, the strain of adhering to such compliance costs are also hampered by recently introduced, but **unworkable regulations** such as the requirement for 90 days of bank statements. While this has placed an unnecessary burden on both the end user and the lender (small business), it is being compounded by some banks (big business) refusing to supply such information, or supplying at a reasonable cost to the consumer, or within a reasonable time. This is another example of increasing financial exclusion for

some end users. Recent examples show consumers parting with over $30 to gain these statements to apply for a loan, and then being rejected by lender during the application process. Consumers are being rejected if their bank statements, which require full analysis, are over 'x' pages, as it is now commercially unviable to review long statements under the unworkable price caps. Simply, this is creating financial exclusion and turning those consumers to unregulated credit as their need for credit has not be addressed. This unintended outcome for consumers has to be rectified.

In summary

Such possible changes as discussed above must be based on the recognition that the more regulatory burden imposed on lenders for **safer consumer products also equates to higher compliance and delivery costs.** These high costs, when added to more restrictive earning capacity, will further greatly impact on the viability of the small-loan industry. The industry has already seen a large exodus of independent small-loan lenders from the market which reduces competition and product choice in the market.

The Federation firmly believes that any and all changes which come out of this FSI for credit, must focus on the removal of price control, strongly back a legitimate, viable and profitable small amount finance credit sector which will help protect consumers from unlicensed and unregulated credit providers.