

Payday loans: Helping hand or quicksand?

Examining the growth of high-cost short-term lending in Australia, 2002–2010

A report by Zac Gillam and the Consumer Action Law Centre

September 2010



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It reviews the experience of payday loan borrowers by updating empirical research into the impact of high-cost short term lending in Australia conducted by Dean Wilson of the (then) Consumer Law Centre Victoria in 2002 and makes recommendations as to the appropriate policy and regulatory framework for the payday loan market.

The Consumer Action Law Centre is an independent, not-for-profit casework and policy organisation based in Melbourne, Australia.

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Executive Summary

ES.1.1 Introduction

What is high-cost short term lending and why does it matter?

Most Australians would be surprised, if not shocked, to hear that thousands of their compatriots regularly borrow money at interest rates that equate to 400% per annum or more. They may be further surprised to discover such borrowers are often on very low incomes and generally use the money to pay for recurrent basic living expenses, such as food and electricity.

High-cost short term lending is perfectly legal and business is booming. In the past ten years or so the industry has exploded in the Australian consumer credit market, yet the product receives very little mainstream policy, government or media attention.

Why is that? And what exactly is a "high-cost short term" loan?

High-cost short term loans are often described as 'payday loans', although descriptors range from 'short term finance' to 'cash advances' to 'personal finance solutions'.

Unfortunately, although the term 'payday loan' is well understood in the United States (where both the business model and the term were invented), in Australia it is often used to refer to a range of other fringe credit products. These include pawn-broking, appliance and furniture rental and longer term high-cost loans of twelve or eighteen months.

Given the confusion surrounding the term 'payday loan', this report has chosen to use the term, high-cost short term loan. Typically, high-cost short term loans are small loans most commonly ranging from \$200 to \$500, advanced to individual consumers. They are predominantly used to meet basic, recurrent living expenses. The loan is designed to be paid back within a short period of time, generally 2 to 4 weeks, and carries a significant fee and/or interest charge, relative to the principal advanced. Such loans exist as a unique and particular product type within the broader fringe credit market.

Whilst there are ‘typical’ characteristics amongst such loans, recognising the less typical yet still quite common usage of them, we adopt a definition that is slightly broader than the most common scenario. Thus, for the purposes of this report we define a high-cost short term loan to be a loan of up to \$2,000, repayable within 8 weeks.

The remainder of the introductory chapter provides background to the report, in particular noting that it seeks to:

- update empirical research into the impact of high-cost short term lending in Australia conducted by Dean Wilson of the (then) Consumer Law Centre Victoria in 2002; and
- examine the arguments for and against regulation of the high-cost short term lending industry

It also outlines the methodology in developing the report and defines important terminology.

ES.1.2 The Consumers

Demographic data

Core Market

The Consumer Action survey found the demographics of the high-cost short term lending consumer to have remained relatively stable since 2002, despite the fact that the size of the market has grown substantially.

The core market for high-cost short term loans continues to be low-income borrowers in their 20s and 30s, slightly under half of which have a young dependent child (or children) and slightly under half of which are in full-time employment.

Although difficult to confirm, between 20% and 30% of borrowers are likely to receive some form of Centrelink benefit. It is possible the figure is much higher.

Employment status and income

The Consumer Action survey found 45% of high-cost short term loan borrowers are in full-time employment, less than the 49% recorded by the Wilson Report.

In 2008 28.1% of borrowers were in part-time or casual employment, 21.9% of borrowers were unemployed and 5% of borrowers were full-time students.

Unfortunately, the 2008 survey did not identify the proportion of borrowers who receive social welfare. It is reasonable to assume the 21.9% of borrowers who identified themselves as unemployed are likely to receive Centrelink benefits.

When borrowers were in employment, 72.8% reported income levels below the average wage, with 23.4% reporting incomes of less than \$20,000. 12.7% preferred not to say what they earned.

Even when adjusted for inflation, income levels were higher than those reported in 2002, although they still confirm low-income earners as the core market for high-cost short term loans. This variance may be partly attributable to the differing research methods adopted by the two reports.

The online survey used in 2008 may have skewed data towards a slightly higher education and income demographic. This may also have affected results in relation to income, education, ethnicity and the use of alternative credit products.

Despite the difficulties of comparison, it is clear high-cost short term loan consumers remain low income earners in the main although slightly more average or just below average income earners appear to be utilising high-cost short term loans than in 2002. This is consistent with the increasing use of high-cost short term loans by consumers in a couple and could indicate high-cost short term loans have become 'normalised' to some extent in the period since 2002. The data suggests high-cost short term loan providers no longer serve strictly marginal income earners, although low and marginal income earners clearly remain the overwhelming consumer base.

Possible new trends

The Consumer Action and Wilson surveys do vary on some key demographic indicators, which may indicate a shift in the consumer base on those measures. Alternatively, the differing research methodologies adopted by the two studies may explain some of the variance.

If taken at face value, the variance would appear to show borrowers are increasingly likely to be female, to be in a relationship and to have higher educational outcomes. The two surveys also appear to show a huge shift in borrowers' access to credit with all respondents indicating they had accessed some other form of credit in the 12 months prior to responding to the survey. These results are summarised below:

Gender breakdown

The Consumer Action survey recorded a majority of female borrowers, by 55% to 45%. This represented a widening of the 2002 gender breakdown (52% to 48%) and may indicate a trend towards female borrowers.

Education levels

The Consumer Action survey recorded significantly more borrowers with some form of tertiary education and may show an upward shift in this demographic.

In 2002, 17.8% of borrowers had a TAFE or trade certificate and only 4.1% had a University degree.

In 2008, 23.9% of borrowers had a TAFE qualification and 24.3% had a University degree. A further 6.5% had post-graduate University qualifications. However, this result may be impacted by differing survey methodologies. The 2002 survey was a street survey conducted outside a number of high-cost short term lending outlets with results recorded by the interviewer. The 2008 survey was conducted online, requiring a degree of literacy and access to a computer.

Relationship status

Although the two studies used differing survey terms, the Consumer Action Report does show a higher proportion of borrowers are in some form of relationship or “couple”, rising from 26% in 2002 to 47% in 2008.

Conversely, the proportion of borrowers identifying themselves as single fell from 55% to 34%.

Use of other credit

In 2002, the Wilson Report found 40% of high-cost short term loan borrowers had not accessed any other form of credit in the 12 months prior to the survey and only 18% had used a credit card in that time.

In 2008, the Consumer Action Report found all borrowers had accessed at least some other form of credit in the same timeframe. 62.7% had used a credit card, 37.9% had sought loans from family and friends and 27.5% had accessed Centrelink Advance payments.

Certainly, the results indicate more high-cost short term loan consumers bear significant existing debts, which is consistent with the general, well-documented growth of consumer debt over the period 2002-2008. It also seems to suggest high-cost short term lending is increasingly utilised by consumers who have exhausted other forms of credit, rather than those who could not qualify for credit in the first place.

Qualitative data

Reasons for borrowing

Consumers overwhelmingly use high-cost short term loans to meet basic needs.

Since 2002, the four major reasons for taking out high-cost short term loans have not changed – to pay bills, to cover essential living expenses, to pay for car repairs or registration, to pay the rent - although their order of priority has. These results are summarised below:

Reasons for borrowing

The 2002 survey found 32% of respondents obtained high-cost short term loans to pay bills and 26% obtained the loans to cover essential living expenses. The next most common purpose was to pay for car repairs or registration (10%), followed by rent (7%).

Since then, car repairs or registration have become the most common reason for borrowing, accounting for 22.1% of high-cost short term loans. The next most common reason is to pay utility bills (21.0%), followed by food or other essentials (17.6%) and then rent (10.7%).

Housing costs were a noticeable driver of borrowing in 2008, with borrowing for rent and mortgage payments making up 14.3% of loans. Repaying debt also remains a reported reason for using high-cost short term loans (4% in 2002, to 6% in 2008).

In both surveys it is very clear that the majority of borrowing is reported as being directed toward meeting basic living expenses: comprising 75% of borrowings in both the 2002 survey (bills, living expenses, rent and car repairs or registration) and in 2008 (bills, living expenses, rent, car registration or repairs, mortgage). It is also clear many of these expenses are recurrent in the 2002 survey 68% (bills, essential living expenses and rent); in 2008, conservatively, 52.8% (utility bills, food and essentials, rent, mortgage).

Consumer understanding of price – price competition in high-cost short term lending

High-cost short term loan borrowers exhibit an astonishing lack of knowledge concerning the cost of lending, both in interest rate and dollar amount terms. This is despite the fact borrowers can clearly identify how much they have borrowed (or perhaps, how much they need).

Further data suggests a lender's location is the dominant reason for consumers to choose their particular provider, with 54.2% of respondents to the 2008 survey reporting choosing their high-cost short-term lender because they were nearby and convenient. A further 17% nominated a prior relationship with the lender.

Taken together, this would suggest price competition plays virtually no role in the high-cost short term lending industry and there is little or no pressure on lenders to compete on cost. Indeed only 9.4% of respondents to the 2008 survey reported making a decision based on cost. Consumption of high-cost short term loans seems far more dependent on the financial distress of borrowers than on the competitive efforts of lenders.

Consumer experience and perception of high-cost short term lending

The results illustrating lack of consumer understanding were evident both in the qualitative research and in the Consumer Action online survey.

Borrowers participating in focus groups or in-depth interviews frequently expressed a sense of shame or humiliation at having to resort to high-cost short term loans, combined with an antipathy toward the 'rip-off' practice of lenders. Borrowing is not something that is openly talked about and some borrowers confessed to concealing the practice from friends and family.

This makes qualitative research difficult, as borrowers are sometimes reluctant to fully relate their experiences - especially in relation to repeat borrowing.

At the same time, borrower circumstances can lead to an ambivalent, love/hate relationship with the product.

Although they resent the bind high-cost short term lending can represent (and openly talk in terms of a 'trap'), consumers often express relief at being able to meet basic expenses through short term borrowing. Although many borrowers do not like high-cost short term lending, they find it hard to imagine 'getting on' without it.

Repeat borrowing

This suggests that for many borrowers, high-cost short term loans are perceived as a 'necessary evil'.

In contrast to other data sources we have examined, the Consumer Action survey did not identify a high degree of repeat borrowing. This is also at odds with data reported by the Wilson Report (which reported 65% of borrowers having experienced repeat borrowing) and is difficult to reconcile with the levels of industry growth seen since 2002.

The 2008 survey reported that 46.4% of borrowers had only had one loan in the past 18 months, and a further 27.5% reported having only two. Collectively this represented 73.9% of respondents. It should be noted that the survey question requested an open text response, to the question "*How many payday loans have you taken out in the last 18 months?*", and it is possible that some borrowers have reported a repeatedly rolled-over loan as a single loan, or have simply chosen to under-report borrowing.

Qualitative research and case summary data drawn from a request to financial counsellors does seem to indicate repeat borrowing is a significant issue in the Australian market. Further, extensive American research suggests repeat borrowing is possibly a fundamental feature of the high-cost short term lending business model.

Finally, Australia's largest high-cost short term lender, Cash Converters, has publicly acknowledged the importance of 'loyal' repeat customers who are 'familiar with the product' and account for 'the vast bulk' of their lending business.

Clearly, the issue of repeat borrowing requires further research.

ES.1.3 The Industry

Industry development since 2002

Loan amounts and repayment periods

The Consumer Action Report found average loan amounts have increased significantly since 2002 and loan repayment periods have grown longer to accommodate this increase.

These results are presented below:

Loan amounts

In 2002, only 6% of loans were in excess of \$500. By 2008, this had grown to 39.9%.

In 2002, 52% of loans were for \$200 or less. By 2008, this had reduced to 24.3%.

Repayment schedules

In 2002, only 6% of loans had repayment schedules of between 5 to 8 weeks.

By 2008, this had grown to 32.1%.

In 2002, 3 to 4 weeks was the most common repayment period for a high-cost short term loan, representing 53% of loans.

Due to the increasing number of 'longer' term loans, the distribution of repayment periods in 2008 was broader than it had been in 2002. At the same time, the 0 to 2 week repayment period registered the highest proportion of loans in 2008 (34.6%). Despite being the largest category in 2008, this was a lesser proportion than recorded in 2002 (41%).

Industry growth

The high-cost short term lending industry in Australia has grown explosively since 2002 although exact figures are difficult to estimate due to the large number of small, private lenders in the market.

In an attempt to generate a reasonable estimate, Consumer Action has drawn heavily on publicly reported financial data from Cash Converters, a publicly listed company and the largest high-cost short term lender in the market, to extrapolate broader industry trends. A detailed study of the development of Cash Converters' high-cost short term lending business from 2002 to 2009 is also undertaken. The Consumer Action survey found 61% of borrowers obtained their loan or loans from Cash Converters.

Extrapolating from Cash Converters' figures, Consumer Action estimates approximately \$204 million in principal is currently loaned out for high-cost short term loans in Australia every year, to around 379,000 customers, across approximately 674,000 loans.

To give an indication of the rate of industry growth, the first high-cost short term lender in Australia began operating in Queensland in December 1998. By

2001, there were 82 outlets nation-wide. Industry commentators conservatively estimate this had grown to approximately 800 by 2008.

Consistent with the Wilson Report, the Consumer Action Report notes one strategy by which lenders have successfully sought to grow their business is by mimicking the style and appearance of mainstream credit providers and appropriating the language of 'micro-finance' or 'micro-credit'. Lenders often avoid terminology such as 'fringe credit' or 'payday loan'. Cash Converters, for example, describes its product as a 'cash advance'.

Data indicating substantial industry growth is summarised below:

Number of lenders in the market

The Wilson Report identified 8 lenders in Victoria in 2002, some with multiple outlets.

In 2010 an online Yellow Pages search for "Finance – Short Term Loans" in Victoria returns 16 results - again, many with multiple outlets.

The Consumer Action survey, which was a national survey, identified 28 different lenders.

Cash Converters

It should be noted that the Wilson Report does not identify Cash Converters as a lender, as at the time the survey that informed the study was undertaken Cash Converters was not active in the market.

In the 2002-2003 financial year Cash Converters lent \$11,601,407 in principal for high-cost short term loans, across 58,077 loans, at an average of \$199.75 per loan. Based on fees of \$35 per \$100 lent, this represents fee income of at least \$4,060,492.

By 2008-2009, the company was lending \$124,546,527 in principal, across 411,045 loans at an average of \$303 per loan. Based on fees of \$35 per \$100 lent, this represents fee income of at least \$43,591,282.

In terms of principal loaned, this represents a 973% increase in the six years since 2002–2003. Average loan size has also increased substantially by 51%.

Notably, the 2008-2009 principal loaned figure actually represented a slight reduction from 2007-2008 and was the first year since 2002-2003 in which the business declined.

It is possible this reduction was partly the result of a comprehensive interest rate cap introduced into Queensland on 1 July 2008. Queensland has traditionally been the largest Australian market for high-cost short term lending.

These developments are also charted graphically in Chapter 3 of this report.

Development of the online industry

Online high-cost short term lending has received little critical attention at this stage but has grown significantly since 2002. Indeed, there does not appear to have been an active online market for high-cost short term loans in 2002. A simple 2010 internet search now shows twenty or more Australian based online providers, including two brokerage services. Online business expansion is difficult to detect due to the lack of an obvious physical indicator such as new store-fronts. Further, online lending businesses are easy to establish and carry very few overheads.

Although the online environment currently represents only a small proportion of loan volume (a mere 4% of respondents to the Consumer Action survey had sourced their loan online), it does exhibit potential for significant growth. This may be attributed to a number of factors.

As noted in Chapter 2, consumers interviewed express a sense of shame and humiliation at borrowing from high-cost short term lenders. The anonymous nature of an online transaction arguably helps to overcome that barrier.

Online high-cost short term loans are, if anything, easier to obtain than in-store loans and can be processed even more quickly. If ease of access and processing speed have been major drivers in the growth of the industry generally, then the online environment would seem to offer even greater potential for growth.

Further, online lenders operating from states with comprehensive interest rate caps are able to easily lend to consumers in non-comprehensive interest rate capped states and territories. This has the effect of minimising the impact of State or Territory based regulation, as lenders can continue to grow their business by switching focus to new sales territories.

The Consumer Action Report surveyed the sites of a number of online high-cost short term lenders and noted a number of common marketing approaches. These are summarised below:

Marketing of online loans

Online loan providers generally emphasise the speed, ease and convenience of obtaining a loan. The lack of a credit check is often used as a major selling point, as is the 24 hour nature of the service.

Online loan marketing appears to target borrowers in their 20s and often blurs the line between being a credit provider and offering financial 'tips' and advice.

Online loan providers generally fail to disclose the cost of the loan on their home-page.

Most providers require the consumer to at least request a loan before disclosing cost and some only make the cost known when the consumer is in the very final stage of a three or four stage loan application process.

Finally, others do not disclose cost until the consumer has had direct contact with a company representative either over the telephone or via an internet 'chat' service.

If a consumer requests a loan or fills out an application but does not finalise the transaction they are likely to be subjected to significant follow-up sales pressure, in the form of e-mails and text messages, urging them to complete the sale.

ES.1.4 The American Experience

Historical development of the American payday lending industry

Since originating in Kansas City in the late 1980s, payday lending in the United States has undergone truly extraordinary growth.

In the early 1990s, there were less than 200 payday lending stores across America. By 2007, there were 25,000. To give a sense of perspective, this has been described as:

‘...more payday lending establishments than there are McDonald's and Starbucks locations combined’.

In 2000, \$10 billion was loaned in payday loans across America, a figure which grew to \$25 billion by 2003 and again to more than \$28 billion by 2006, with payday lenders thought to issue loans to approximately 15 million American households every year.

In terms of loan revenue, it is estimated American payday lenders generate approximately \$5.5 billion annually in loan fees.

This estimate does not include the online industry, which (as is the case in Australia) is comparatively small, but growing, with loan volume in 2008 estimated to be approximately \$7.1 billion.

In November 2006 the Centre for Responsible Lending reported nearly 90% of payday loans were made to customers who took five or more payday loans per year. The same study found approximately 62% of loans were made to borrowers who took twelve or more loans per year.

The Consumer Federation of America reported in November 2005 the typical payday loan consumer takes out 9 to 13 payday loans annually and often holds more than one payday loan simultaneously (obtained from multiple lenders).

The United States' leading payday lender, Advance America, consistently reports a ratio of approximately eight 'cash advances' originated for every customer served. The customer number reported is for customers of all of the company's credit products - not just their payday loans.

Such figures have given rise to the characterisation of payday loans as ‘debt traps’.

The industry was originally prohibited by traditional state-based anti-usury legislation, but gained exemptions from those laws throughout the 1990s and early 2000s until it reached the stage where it was authorised in 35 American states.

Even in states where it is not officially authorised, the American industry has exhibited great ingenuity in evading regulation designed to work against it. Indeed, it is a feature of the payday lending industry that it frequently adopts innovative approaches to avoid unfavourable legislation in every jurisdiction in which it is threatened and generally succeeds in continuing to operate under all but the most prohibitive regulation.

The growth of payday lending has led to fierce policy debates across many American jurisdictions. Consumer advocates increasingly characterise payday lending as a predatory lending model that causes debt spirals and harms low-income consumers.

The industry, on the other hand, expends considerable resources lobbying for further deregulation and opposing legislative attempts to curb growth.

Recent developments in the American payday lending industry

The period from 2004 - 2009 has seen a modest but significant winding back of high-cost payday lending in America. This trend seems set to continue, with an exemption for payday lenders having sunset in Arizona on 1 July 2010, rendering payday loans subject to that state’s 36% small loans comprehensive interest rate cap. Arizona has thus become the sixteenth American state to expressly cap interest in payday lending, along with the District of Columbia.

The American experience of payday lending tends to indicate reform is only effective when the legislative intent is not to modify the practice, but to strictly limit cost through the implementation of a comprehensive interest rate cap.

In almost every reforming state, the legislative intent to prohibit exploitative lending practices has been strongly resisted by a payday lending industry that

is highly creative in evading state based legislation. Amongst other examples, the tenacity of the payday lending industry is demonstrated by:

- The need in Ohio to bolster the 2008 *Short Term Loan Act* by introducing the *Issue 5 Payday Lending Enforcement Act* a year later, which itself gives efficacy to an anti-payday lending mandate gained by virtue of a state-wide referendum. At the time of writing this second Act had yet to be passed despite being introduced a year earlier;
- The need in Arkansas for a 2008 Supreme Court ruling to enforce the state's Constitutional provision against usury as well as a US Federal Board of Governors rule clearly countering the state's *Check Cashers Act* since October 2000 and;
- The need for the New Hampshire Banking Department to issue a declaratory ruling against Advance America, who was seeking to have its payday loan product deemed as something other than a payday loan.

In no state or district where payday lending has been prohibited has there been popular political pressure for it to be restored.

In those states where the issue has been tested in the electorate (namely the 2008 ballots in Ohio and Arizona), the public have affirmed broad support for an interest rate cap - despite intensive lobbying by industry.

Despite this clear trend, the winding back of payday lending in America should not be over-stated. Payday lending is still authorised in a vast majority of American states and of those states where it has been rolled back, only Ohio can be said to have had an industry of truly national significance.

Of the top six states, three of them easily dwarf Ohio's \$232 million industry (on 2005 figures). In the same year, Louisiana generated approximately \$345 million in fee revenue and Missouri approximately \$351 million. In California, the nation's largest payday lending industry loaned out almost \$2.5 billion in principal, through 2445 stores, generating \$405 million in payday loan fees. These numbers are particularly impressive when one considers the average loan amount in California was only \$253. Further, it should not be forgotten that those figures are based on a 2005 survey (the latest available comprehensive data) and are likely to have grown significantly since then.

The requirement to achieve payday lending reform on a state by state basis has made reform difficult, as the debate generally devolves into a lobbying contest between industry and those who favour a cap. The varying outcomes across different states are reminiscent (although obviously far more various) of the 'patch-work quilt' of regulation that has traditionally existed across Australian state jurisdictions (see Chapter 5).

As in Australia, there are indications payday lending regulation in America may be moving into the Federal sphere of politics. This presents the possibility that universally strong restrictions may be applied, or, conversely, that recently implemented state-based protections may be lost.

On 24 January 2008, the *Wall Street Journal* published an opinion piece entitled "*Beyond Payday Loans*". The piece was co-authored by the current Governor of California, Arnold Schwarzenegger and the former president of the United States, Bill Clinton. The piece commences:

"The American dream is founded on the belief that people who work hard and play by the rules will be able to earn a good living, raise a family in comfort and retire with dignity.

But that dream is harder to achieve for millions of Americans because they spend too much of their hard-earned money on fees to cash their paychecks or pay off high-priced loans meant to carry them over until they get paid at work."

The article essentially calls for a nationwide reduction in the use of fringe credit, particularly payday loans, on the basis that to do so is not only good for individuals but also has significant macroeconomic benefits:

"Imagine the economic and social benefits of putting more than \$8 billion in the hands of low- and middle-income Americans. That is the amount millions of people now spend each year at check-cashing outlets, payday lenders and pawnshops on basic financial services that most Americans receive for free – or very little cost – at their local bank or credit union."

If the U.S. experience has demonstrated nothing else, it is that the only reform that successfully curbs payday lending is a comprehensive interest rate cap.

Such a law requires significant political will, both to enact and subsequently enforce and is likely to be vehemently opposed by industry lobbyists.

America's experience of payday lending is highly pertinent to the Australian context and the particular stage at which the Australian payday lending now finds itself. This is discussed further in the following chapter.

ES.1.5 The Australian Policy Debate

Historical regulation of high-cost short term lending in Australia

Australia's various state and territory governments have traditionally regulated high-cost short term lending as part of their general regulatory responsibility for consumer credit.

These approaches have resulted in a 'patchwork quilt' of regulation for the industry:

State or Territory	Approach
Australian Capital Territory	48% comprehensive cap
New South Wales	48% comprehensive cap
Northern Territory	No regulation beyond UCCC
Queensland	48% comprehensive cap
South Australia	No regulation beyond UCCC
Tasmania	No regulation beyond UCCC
Victoria	48% interest rate cap
Western Australia	Licensing required but no cap

Transfer of consumer credit regulation to the Commonwealth

The 'patchwork quilt' era of regulation for high-cost short term lending in Australia will soon draw to a close, as the Commonwealth Government implements the National Consumer Credit Protection Act (**NCCP Act**). The NCCP Act will, for the first time, provide genuinely uniform national laws for consumer credit in Australia - including for high-cost short term loans.

The NCCP Act, representing the culmination of phase 1 of national consumer credit reform came into effect on 1 July 2010. The Act requires lenders to obtain a licence (as is already the case in Western Australia) and to join an

Australian Securities and Investments Commission (**ASIC**) approved external dispute resolution scheme.

In addition, new responsible lending obligations require lenders to make an assessment of whether the loan product they are offering is 'not unsuitable' for the consumer.

Although welcome reforms, the nature of high-cost short term lending and the circumstances of the typical high-cost short term borrower make it unlikely these reforms will have a significant effect on the industry.

There are three key reasons for this:

- the small amounts lent out as high-cost short term loans, at least when assessed in isolation, are unlikely to fail the test imposed to meet responsible lending requirements – that they are 'not unsuitable' for the borrower;
- the dynamics of the high-cost short term lending industry – where the majority of consumers are driven by financial desperation and borrow to meet basic needs – greatly increases the probability that borrowers will mislead lenders in order to obtain a loan (and lenders may be unusually inclined to be misled);
- the phase 1 reforms rely on individual complaints and a case by case approach by the regulator, a more costly and labour intensive method of regulation than the 'bright line' of a comprehensive interest cap.

Perhaps the best indication that the licensing, enforcement and responsible lending provisions of the National Credit Act are unlikely to have any great impact on high-cost short term lending is provided by the industry itself.

In their annual report of 2008-2009, Cash Converters stated of the phase one reforms:

"The company has devoted significant resources to addressing the legislative environment. As a result, legislation introduced into Parliament in August is consistent with all our recommendations made to Government and the Federal takeover of consumer credit does not currently threaten any of our lending products".

It is common for industry to advocate for 'effective regulation' without impeding profitability. Of course, this does nothing to prevent harm caused by very high interest rates and charges and could be seen merely as an effective public relations exercise for lenders.

Measures that have been introduced to counter payday lending in various American jurisdictions, without the introduction of an interest rate cap are:

- Renewal bans/cooling off periods
- Limits on number of loans outstanding
- Extended payment plans
- Loan amount caps based on borrower's income
- Regulations that narrowly target payday loans

In December 2007 the Center for Responsible Lending in the U.S released a study entitled '*Springing the Debt Trap: Rate caps are the only proven payday lending reform*'. In that report, the Center examined each of the above measures and found they comprehensively failed to prevent repeat borrowing.

The conduct of lenders was often a major factor in this failure.

For example, payment plans were found to be ineffective because lenders would frequently price the first instalment of the payment plan above the cost of 'flipping' the loan - thereby ensuring there was a very low uptake. In the example given, the Center for Responsible Lending found that for a \$325 payday loan, a customer could choose between renewing (or 'flipping') the loan for \$52 or paying \$94 to commence a payment plan. Not surprisingly, the Center found that in the four states in which they were offered, payment plans formed between 0.42% and 1.33% of total payday loan transactions - i.e. their uptake was negligible despite their potential benefits for the consumer.

Evidence from Australia and overseas strongly suggests the only proven method to counter high-cost short term lending is to apply a comprehensive interest rate cap.

The potential application of a national comprehensive interest rate cap will be considered by the Commonwealth Government during phase two of the credit reforms, which will include “...an examination of State approaches to interest rate caps...”.

Alternatively, phase two could result in the sunseting of current state-based interest rate caps without the introduction of any additional Commonwealth protections.

Clearly, this is a critical juncture for high-cost short term lending in Australia. Careful consideration must be made of the arguments both for and against a comprehensive interest rate cap.

Arguments against a national comprehensive interest rate cap

Recent developments in Queensland and the rolling policy debate in the United States illustrate that anti-cap (and pro-cap) arguments remain common across varying jurisdictions and timeframes.

The Consumer Action Report draws on a July 2008 submission by Cash Converters to the Federal Government's *Green Paper on Financial Services and Credit Reform* as representative of the arguments generally raised by industry.

In addition, the Consumer Action Report examines similar arguments raised by *Policis*, a UK based research firm commissioned by Cash Converters to conduct a number of studies into the Australian high-cost short term lending market, with a particular focus on the impact of interest rate caps.

A ‘fundamental need’ for short term credit

Proponents of this argument equate widespread use of the product and lack of access to alternate forms of credit with evidence of a need for high-cost short-term lending. Some go further to assert that fulfilment of this ‘need’ is some form of public good.

This argument can be critiqued on a number of grounds.

First, high demand exists for any number of products but that does not necessarily mean they serve a fundamental need. The demographics of borrowers and the purpose to which borrowings are applied strongly suggest that the demand for high-cost short term loans is primarily driven by insufficient income. Stating that insufficient income exists does not establish that the community needs high-cost short term loans.

Second, high-cost short term lending has a relatively short history in Australia. If the product is necessary, then it is surprising it commenced in the Australian market in 1998 and has only had a significant presence since the early 2000s. Insufficient income has existed as a social problem in Australia since well before 1998. High-cost short term lending has not.

Third, high-cost short term loans are not available in most countries, despite the fact insufficient income exists as a social problem in all countries.

Taken on a global scale, high-cost short term lending is a largely Anglo Saxon phenomenon. Major developed economies such as France and Germany do not permit high-cost short term lending. This undermines any claim the product is somehow a necessary feature of the consumer credit landscape.

Finally, describing high-cost short term credit as serving a fundamental need implies that it acts to solve a problem.

As discussed, if the problem is insufficient income, then it is difficult to see how high-cost short term credit can genuinely provide a solution unless consumer usage is truly intermittent and occasional. Otherwise, it is more likely the product perpetuates the problem and operates to generate its own demand.

Substitution argument: Illegal lending

A further set of arguments raised against comprehensive interest rate caps are based on a substitution or 'scare tactic' model which implies severe adverse consequences in the event a comprehensive interest rate cap is implemented.

One such argument is that the implementation of an interest rate cap will result in a surge in illegal lending or 'loan sharks'.

This argument can be critiqued on two main grounds.

First, despite being implemented in a number of jurisdictions both in Australia and elsewhere, no evidence has ever been provided to suggest an interest rate cap has led to a surge in illegal lending or loan sharks. If a surge had occurred in any jurisdiction, it is surprising industry advocates have not presented it as evidence in support of their argument.

Policis have undertaken surveys which it claims show higher levels of illegal lending in France and Germany (where a cap exists) than in the UK (where there is no cap). This data is highly contentious and is discussed at length in Chapter 5.

Second, it is logically flawed to state that prohibition of a product will automatically result in a black market for that product. It is highly doubtful that all or even a significant majority of current borrowers would turn to 'loan sharks' if high-cost short term loans were no longer available. Even if a cap were to cause an increase in illegal lending, that market would be subject to criminal law enforcement which would constrain the market and render it far smaller than the previously legitimate market.

On that basis, a cap arguably represents sound policy even if it does lead to an increase in illegal lending - which is itself an unproven and highly contentious claim.

Substitution argument: Cost to welfare

A further substitution argument suggests implementation of an interest rate cap will result in an increasing welfare burden for government. The argument implies high-cost short term credit prevents borrowers from accessing welfare

This argument can be critiqued on three main grounds.

First, as with the 'illegal lending' argument, industry advocates have failed to provide clear evidence of this occurring, despite the numerous jurisdictions in which interest rate caps have been introduced both here and abroad. If an increase to the welfare burden of government is an inevitable result of implementing an interest rate cap, then clear evidence should exist to support the assertion.

Second, a high proportion of borrowers already do access welfare, so the burden to government already exists. In effect, such borrowers access the product to supplement the insufficient income they receive through social welfare.

Finally, the argument again operates on the assumption the product assists borrowers and denies the capacity for the product to generate a debt spiral and progressively worsen a borrower's position.

If, as we assert, this assumption must be incorrect in other than instances of truly occasional borrowing, it is arguable that high-cost short term lending may actually lead to an increase in the cost of social welfare, by worsening the position of borrower's who may otherwise not need to draw upon it.

This remains to be tested, but is worth investigation.

Substitution argument: Rise in indebtedness

Under this argument, high-cost short term loans have the benefit of preventing consumers from accessing other forms of credit (primarily credit cards) and therefore help to reduce overall indebtedness.

This argument can be critiqued on a number of grounds.

First, at least some borrowers tend to access high-cost short term loans when they have no access to other forms of credit. This is generally because they are not considered credit worthy by mainstream credit providers, or if they are, they have already exhausted the mainstream credit available to them. Borrowers who do have access to alternate credit report utilising it prior to seeking a high-cost short term loan (Chapter 1).

Essentially, high-cost short term credit exists as an 'over-flow' or 'last resort' form of credit, not as a 'substitute'. On that basis, it is illogical to assert the existence of high-cost short term lending somehow reduces overall community indebtedness.

Second, high-cost short term lending is available in countries that exhibit high levels of household debt and is not permitted in others which exhibit lower levels of debt. This calls into question any causal link between the availability of high-cost short term loans and a reduction in indebtedness.

Third, this argument overlooks the ongoing indebtedness that can result from ongoing repeat borrowing. Although the high-cost short term debt may seem small at any given time, the capacity for the product to generate significant and pressing debt over extended periods of time should not be overlooked.

Finally, industry advocates often reverse this argument to state that an interest rate cap will not reduce indebtedness. This is a correct statement but incorrectly implies the purpose of an interest rate cap would be to reduce levels of household debt.

An interest rate cap will not achieve that purpose but it may improve the disposal income levels of consumers who would otherwise be servicing ongoing high-cost short term debt, enabling them to better meet basic expenses for them and their families.

Substitution argument: Rise in defaults

The final substitution argument asserts that access to high-cost short term loans prevents consumers from incurring higher costs in the form of penalty and default fees. Under this argument, it is considered better and cheaper to bear the cost of high-cost short term lending than to fall prey to an array of alternative charges.

Whilst this argument may have some merit, it should be noted the general trend for financial service providers is to drastically reduce or abolish penalty fees and this trend is also occurring in utilities. On the other hand, the clear trend for high-cost short term loans towards increasing loan amounts and charges, calls into question the likelihood of any genuine 'saving' to be gained from high-cost short term lending.

Further, it should be noted that even if a penalty is incurred, it is at least a 'one off' event (as opposed an ongoing rolling debt) which can occur in the event of repeat borrowing.

The role of Policis in the Australian high-cost short term lending debate

The Consumer Action Report extensively investigates the role of research organisation *Policis* in the Australian high-cost short term lending debate.

Policis appear to have produced more research into the role of credit for low income Australians and the potential impact of an interest rate cap than any other organisation - public or private.

This body of work consists of three significant reports:

- The dynamics of low income credit use - A research study of low income households in Australia;
- The impact of interest rate ceilings - The evidence from international experience and the implications for regulation and consumer protection in the credit market in Australia.
- Payday in Australia: A research study of the use and impact of payday lending in the domestic Australian Market.

It should be noted that these reports were commissioned by Cash Converters although the reports themselves do not declare the commissioning party.

Consumer Action has concerns regarding the profile of *Policis* in the Australian debate and the transparency of the research they have drawn on to reach key conclusions which is, in our view, unclear. Further, they do not provide raw numbers for survey results or disclose survey questions. Our concerns are outlined in more detail in Chapter 5.

The arguments in favour of a comprehensive interest rate cap

The argument for an interest rate cap is based on the premise that at a certain point credit becomes too expensive to benefit the consumer and becomes harmful. Put another way, credit is useful when it enables positive consumption at a sustainable price, but becomes counter-productive when the purchase price itself becomes a significant financial burden.

High-cost short term loans are harmful because, where used other than as a 'one-off', they worsen the consumer's financial position. The low incomes earned by the majority of borrowers, the application of a majority of borrowings to recurrent basic living expenses and the industry's own reference to its 'loyal' customers, all combine to create a picture of repeat borrowing which in turn could be termed an ongoing debt spiral.

The product is also harmful because it takes a 'first stake' in the consumer's income - impinging on their capacity to meet basic needs without further borrowing.

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

In addition to the social benefit of preventing harm, an interest rate cap arguably has economic benefits. By freeing up limited capital, an interest rate cap enables consumers to spend more of their income on productive consumer spending and less on servicing repetitive short term debt. This is not to say an interest rate cap will end financial hardship or indebtedness - it obviously will not - but it will prevent the ongoing and deepening financial hardship of a growing number of consumers. When this occurs on a large scale it has negative implications for the broader economy quite apart from the personal distress experienced by the individual consumer. This has most clearly been demonstrated in the United States, where the industry has developed to a far greater extent than in Australia.

Thus, although the individual amounts of high-cost short term loans may seem small, their cumulative impact causes significant harm. Minor regulation cannot address this harm because it is inherent to the product and, available information tends to suggest, a fundamental feature of the business model.

A comprehensive interest rate cap has been consistently shown to be the only mechanism that works to address the harm.

It should be noted the argument for an interest rate cap does not seek to provide a solution to the broader issue of insufficient income but instead seeks only to identify high-cost short term lending as a particularly harmful response. Although beyond the scope of this report, a more positive and sustainable response to this problem is likely to include a combination of approaches.

Such approaches may include an expansion of low-cost credit products available through the community and public sectors, greater use and promotion of hardship variation plans for consumers to pay for essential services, expansion of charity and welfare services and finally longer term solutions such as improved income support and wages policies for the low-paid.

These approaches could and arguably should, form the subject of their own report. They should not, however, be confused with the argument to implement a national interest rate cap, which is made to prevent the harm caused by high-cost short term lending.

The current legislative and political environment in Australia provides a unique opportunity to implement a nation-wide, comprehensive interest rate cap. In doing so, Australia would be joining the ranks of most developed economies in the Western world, which do not permit the selling of high-cost short term loans.

Further arguments are set out below:

An interest rate cap would have a targeted, measurable impact and carries little risk

Properly crafted, the application of a national 48% interest rate cap need have no impact on the broader consumer credit market as the vast majority of the market operates at interest rates well below 48%.

A cap would only affect a handful of fringe credit products and would primarily impact on high-cost short term lending - which is the purpose for its implementation.

Although a cap would clearly distort the market for high-cost short term credit, it is apparent the market does not operate efficiently in any event and does not exhibit healthy price competition.

Interest rate caps are generally supported by the community. It is notable that in the various jurisdictions in which interest rate caps have been introduced, both in Australia and elsewhere, there has not been a single case of popular support for its removal.

Administrative ease and opportunity

The implementation of phase two of the national credit reforms provides a unique opportunity to implement a national interest rate cap at a time of significant administrative change, lending administrative efficiency to the process.

Given New South Wales, Queensland and the ACT already have comprehensive interest rate caps, the implementation of a national cap would create no more disruption nationally than if the cap in those jurisdictions is removed.

The only effective approach

Industry advocates are likely to support some form of regulation for the high cost short term lending industry, but will resist the implementation of a national interest rate cap.

Industry suggestions for regulation are likely to centre on the promotion of responsible lending requirements. The dynamics of the industry, which is driven by the financial distress of borrowers, means responsible lending provisions will have little to no impact. Further, attempts to mitigate the harm of high-cost short term lending by imposing cooling off periods, implementing extended payment plans, capping maximum loan amounts and limiting the number of loans, amongst others, have all been shown to be ineffective across various American jurisdictions.

In Australia and elsewhere, high-cost short term lenders have exhibited a significant capacity to avoid or evade regulation designed to prevent high-cost short term lending. This is best illustrated by the need for recent enforcement action in Queensland and the need to close the 'brokerage fee' loophole in New South Wales.

If high-cost short term loans are an inherently harmful product, then they should be more than regulated - they should be prohibited. A comprehensive interest rate cap is the only proven mechanism to achieve that prohibition.

This prohibition already exists across much of the eastern seaboard of the country and should be extended to form a uniform, national, comprehensive interest rate cap.

Conclusion

This report attempts to provide a comprehensive overview of the high-cost short term lending industry in Australia.

The American industry is approximately ten years older than its Australian counterpart and provides a sobering indication of the potential scale of high-cost short term lending (on a per capita basis) and its potential social impact. The recent trend in America has been towards comprehensive interest rate caps, implemented as a direct response to harm caused by the industry. The American example also shows that alternative legislative approaches have been unsuccessful.

In both Australia and America, lenders have been consistently creative in their attempts to avoid regulation designed to limit harmful payday lending. Only a comprehensive interest rate cap has been proven to have the desired effect.

On that basis, this report takes a clear position in favour of a national interest rate cap as a positive and necessary consumer protection measure to shield consumers from harmful high-cost short term lending.

High-cost short term lending is a form of 'sub-prime' lending - it is the extension of credit to those who cannot afford to borrow. This creates the inherently unsustainable dynamic of increasing the cost of living for those who are already struggling to meet that cost.

In the case of high-cost short term loans, any risk to the lender is mitigated by the repayment structure of the product. The risk of default is shifted from the lender to the borrower, so when loan repayments cause further financial stress, the borrower borrows again - and so commences the cycle of repeat borrowing. That this does not impact on the lender does not mean it is sustainable, or safe, for the borrower.

High-cost short term lending creates the perverse situation where those with the least resources pay the highest price for credit. From an equality or social justice perspective, this is indefensible.

Once obtained, high-cost short term lending takes a 'first stake' in the borrower's income. Repayment of the loan is prioritised above all other expenses. Again, this is indefensible.

The collective drain, when applied to hundreds of thousands of consumers, can have a broad negative impact and prevents consumers from becoming stable, economically productive participants in the mainstream economy.

A comprehensive national interest rate cap has the potential to end this practice in Australia.

It should be made clear that an interest rate cap will not solve the problem of financial hardship, nor is it intended to. A cap will merely act to prevent a particularly poor – and illusory – ‘solution’ to that problem.

A more genuine solution to the problem of financial hardship is likely to depend on a range of measures; from better income support for vulnerable consumers, to the provision of assistance in reducing debt, to the means to build assets – amongst many, many others.

At some point, lenders should be prevented from extending credit to those who cannot afford to pay. If they are not, then the provision of credit becomes counter-productive and causes harm to the borrower.

This is usury.

It is up to every society to decide for itself the point at which acceptable credit ends, and usury begins. In Australia, that point has traditionally been set at 48% APR. The coming months will determine whether or not that point remains.

In the meantime, the only certainty is that for as long as usury is permitted, desperate borrowers will continue to borrow – and lenders will continue to lend.

Chapter 1 Introduction

1.1 What is high-cost short term lending and why does it matter?

Most Australians would be surprised, if not shocked, to hear that thousands of their compatriots regularly borrow money at interest rates that equate to 400% per annum or more.¹ They may be further surprised to discover such borrowers are often on very low incomes and generally use the money to pay for recurrent basic living expenses, such as food and electricity.

High-cost short term lending is perfectly legal and business is booming. In the past ten years or so the industry has exploded in the Australian consumer credit market, yet the product receives very little mainstream policy, government or media attention.

Why is that? And what exactly is a "high-cost short term" loan?

High-cost short term loans are often described as 'payday loans', although descriptors range from 'short term finance' to 'cash advances' to 'personal finance solutions'.

Unfortunately, although the term 'payday loan' is well understood in the United States (where both the business model and the term were invented), in Australia it is often used to refer to a range of other fringe credit products. These include pawn-broking, appliance and furniture rental and longer term high-cost loans of twelve or eighteen months.

Given the confusion surrounding the term 'payday loan', this report has chosen to use the term, **high-cost short term loan**. Typically, high-cost short term loans are small loans most commonly ranging from \$200 to \$500, advanced to individual consumers. They are predominantly used to meet basic, recurrent living expenses. The loan is designed to be paid back within a short period of time, generally 2 to 4 weeks, and carries a significant fee and/or interest charge, relative to the principal advanced. Such loans exist as a unique and particular product type within the broader fringe credit market.

¹ This is expressing interest as an Annual Percentage rate (APR). APR is described further in the terminology section, at 1.4. This section also describes how to calculate the APR for a high-cost short term loan.

Whilst there are 'typical' characteristics amongst such loans, recognising the range of conceptions of them and the less typical yet still quite common usage of them, we adopt a definition that is slightly broader than the most common scenario. Thus, for the purposes of this report we define a high-cost short term loan to be a loan of up to \$2,000, repayable within 8 weeks.

A typical scenario:

A low income consumer finds she is unable to pay her power bill. Unable to borrow from any other source and not knowing of the power company's hardship program, she borrows \$300 from a high-cost short term lender. Borrowing is quick and easy - all she needs is proof that she is at least 18 years old and has a regular income. An ongoing Centrelink payment will do.

Industry rates vary slightly, but \$35 for every \$100 loaned is a typical fee or interest charge. Critically, the term of the loan is very short. In most cases the lender arranges for a direct debit transaction from the borrower's bank account, scheduled for the date of the borrower's next income payment.

For the \$300 loan described above, the borrower repays \$405. If the loan period was set for two weeks, the interest rate on such a loan, when annualised, works out to 912.5%. If the loan period is set for a month (probably the more typical scenario) then the rate is 425.8%.

Repayment of the loan can leave the borrower with another shortfall - perhaps this time to pay the rent. Although often described as 'small amount' loans, high-cost short term loans are not necessarily small, relative to the income of the borrower. For a borrower on the minimum wage of \$569.90 a week, a \$300 loan with a repayment fee of \$405 is a significant expense - especially when one considers the typical borrower has no savings and is likely to carry other debt.

To meet this further shortfall, the borrower may return to the lender, who having already established a relationship with the borrower is able to process another loan.

The subsequent repayment may lead to yet another shortfall so the borrower returns to the lender again. And so the cycle continues.

Essentially, the borrower has acquired an ongoing debt at a very high interest rate. Put another way, you could argue this represents an ongoing deduction - or pay cut – from her already limited income.

Many consumer advocates regard high-cost short term loans as an inherently harmful product. The view is taken that high-cost short term loans exacerbate, even exploit, the financial distress of borrowers and perpetuate hardship. The cycle of repeat borrowing is described as a debt trap and the practice of lenders is described as predatory.

Lenders, on the other hand, claim their product is simply designed to assist consumers to meet temporary shortfalls. The loans exist as a 'bridging' mechanism, not as permanent financial solutions. Lenders usually argue that they are simply helping consumers to 'get on with their lives'.

Whilst the position of lenders does have a superficial appeal, the logic of most borrowers' circumstances would suggest acquiring debt at such high interest is unlikely to assist them in the medium or longer term and may actually harm them unless truly occasional or one-off.

Without a significant improvement in the income level of the borrower, it is difficult to see how high-cost short term credit could not cause repeat borrowing or a 'debt spiral'. This is particularly so when one considers more than half of the high-cost short term loans taken out are spent on recurrent, basic living expenses.

1.2 Background

In May 2008 the Consumer Action Law Centre (**Consumer Action**) received funding through the Consumer Credit Fund (**CCF**), administered by Consumer Affairs Victoria (**CAV**), to conduct research into the high-cost short term lending industry in Australia (**Consumer Action Report**).

Consumer Action's application to the CCF expressed two major aims:

- To update empirical research into the economic and social impact of high-cost short term lending in Australia; and

- To examine the economic arguments for regulation of the high-cost short term lending industry, including the effect of comprehensive interest rate caps.

High-cost short term loans have been an under-researched area of the Australian consumer credit market and are not well understood by policy makers or the community at large.

Payday Lending in Victoria – a research report by Dean Wilson of the Consumer Law Centre Victoria Ltd (**Wilson Report**), has stood as the only significant empirical analysis of the industry since its publication in 2002.

The Consumer Action Report makes extensive reference to the Wilson Report and specifically seeks to update and compare the data compiled in 2002, with the more recent data gathered by Consumer Action. In this manner, it is hoped an empirical base may be built from which to generate a better understanding of consumers of high-cost short term loans and the purposes for and manner in which the loans are used. Broad consistencies between the reports do indicate the industry has a clearly definable consumer base and this is discussed at length in the following chapter.

In seeking to explore the economic impact of high-cost short term lending, the Consumer Action Report also attempts to examine borrowing behaviour and track industry growth since 2002.

Although a lack of available data does make this task difficult, it is clear the industry has undergone extraordinary growth since the early 2000's and has substantial potential for further growth. The rapid rise of what remains a relatively new and controversial product in the Australian consumer credit market in itself suggests careful consideration is warranted regarding the economic and social impact such growth may have.

In order to enhance this discussion, the Consumer Action report examines the high-cost short term ('payday') loan industry in the United States, as an example of an older, more developed industry that provides some guidance as to how the industry may develop in Australia, if allowed to do so.

High-cost short term loans have been the subject of lively policy debates in Queensland and New South Wales in recent years and remain a significant consumer policy battleground in both the United States and the United

Kingdom. These debates usually polarise consumer advocates, who generally regard the product as harmful and industry practitioners, who have a significant vested interest in further growth. For reasons explored in Chapters 4 and 5 of the Consumer Action Report, most consumer advocates regard comprehensive interest rate caps (such as those which currently exist in Queensland and New South Wales) as the only genuinely effective legislative measure to be taken against high-cost short term lending.

For this reason, the Consumer Action Report undertakes significant discussion of the policy issues surrounding the implementation of comprehensive interest rate caps, including an analysis of the arguments generally raised in favour of them and the arguments raised by industry in opposition to such measures. This discussion includes close analysis of prominent research commissioned by Australia's largest high-cost short term lender, Cash Converters and of submissions made to government by Cash Converters itself.

Finally, the Consumer Action Report attempts to provide some historical context for the regulation of high-cost short term lending in Australia to provide some background to the current policy debate.

At the time of release, the Consumer Action Report enters a policy environment where for the first time the Commonwealth Government has taken responsibility for the regulation of consumer credit.

As part of this transition the Commonwealth will consider whether or not to apply a comprehensive national interest rate cap, inclusive of all fees and charges.²

1.3 Methodology

In compiling this report, Consumer Action has utilised a range of methodologies to provide empirical data and access relevant research and information. These are outlined below.

² The Commonwealth Government's Green Paper on Phase Two of the National Credit Reform, "*National Credit Reform - Enhancing confidence and fairness in Australia's credit law*" was released on 7 July 2010. Submissions to the Green paper were due on August 6 2010. Chapter 5 of the Green Paper considers regulation of short-term small-amount lending. The Chapter considers four regulatory options: 1. Maintain the status quo. 2. Implement a national interest rate cap. 3. Require warnings on high-cost products. 4. Prohibit roll-overs.

Quantitative Research

Pure Profile online survey

In order to generate empirical data, Consumer Action contracted research company Pure Profile to undertake a survey of high-cost short term loan borrowers.

For the purposes of our study, we defined a high-cost short term loan as a cash loan of under \$2,000 from a registered institution that must be repaid within an 8 week period. Although the amount and repayment period are well in excess of the average high-cost short term loan, we felt it was necessary to cast the terms broadly, in order to fully capture the desired respondent base. Further, the terms are still narrow enough to ensure we did not capture other small amount loans, for example, in-store finance arrangements for the purchase of furniture or white-goods.

The survey was conducted on-line and generated 448 responses during May 2008. A full copy of the survey questions is included at *Appendix A*, along with a web-link to the raw data generated.

Qualitative Research

Open Mind Research Group study - "Exploring payday loans"

To investigate the borrower's experience of high-cost short term lending, Consumer Action contracted the Open Mind Research Group to undertake a small scale qualitative study (**Open Mind Report**). This study employed a combination of group discussion, in-depth interviews and extended in home interviews of high-cost short term loan borrowers.

The aim of the Open Mind report was to identify the sociological and psychological drivers of payday lending and the impact on borrowers.

Group discussions and in-depth interviews were undertaken in Melbourne at Open Mind Research offices, extended interviews were conducted in borrowers' homes.

The following sample was adhered to:

	Outer (e.g. Footscray*)	Regional (e.g. Geelong)
Singles (18-35 years)	1 standard depth 1 in home	1 standard depth 1 group
Families (at least 2 children at home, any age)	1 in-home 1 group	1 standard depth 1 group
Older singles (35+)	1 standard depth 1 group	1 standard depth 1 in home
TOTAL:	4 Group Discussions 5 Standard Depth Interviews 3 In Home Interviews	
Note:	To be recruited from Consumer Action Law Centre lists or via in-house resources: 'have taken out at least one short-term (i.e. 1 week-2 months) loan from a non-bank provider in the past two years'	

Field work was conducted in 2008, between October 28 and November 6.

A copy of the Open Mind Report is included at *Appendix B*.

Case Study Template

In September 2009, Consumer Action distributed a case study template to financial counsellors. The template was posted on the Consumer Action website and sent through both the Financial Consumer Rights Council (FCRC) and the Australian Financial Counselling and Credit Reform Association (AFCCRA) networks.

The case study template sought anonymous case studies from financial counsellors who had assisted clients with a history of high-cost short term loans.

The case study template generated eleven responses.

A copy of the Case Study template is included at Attachment C.

Desktop Research

Literature Review

As part of the CCF funding agreement, Consumer Action conducted a broad based literature review of current writing on high-cost short term lending, both within Australia and internationally.

The literature review was conducted by Neil Ashton, Consumer Action Policy Officer/Solicitor and was submitted as part of an interim report to CAV as a condition of the initial CCF grant.

A copy of the Literature Review was provided to CAV as part of a progress report in November 2008. A web-link to the Literature Review is included at Attachment D.

Other Sources

The Consumer Action Report draws on a wide range of sources.

Chapter 2 examines the consumer base for high-cost short term loans and draws primarily on the online survey, the Wilson Report, the Open Mind Report and the case study templates.

Chapter 3 concerns the growth of the high-cost short term lending industry in Australia from 2002 to 2009. It draws heavily on Cash Converters' annual reports for the period in addition to other financial data provided by the company. The chapter also draws on an extensive study of online high-cost loan provider websites.

Chapter 4 investigates the high-cost short term lending industry in the United States and draws extensively on media reports and published material by consumer advocates. The chapter tracks the development of the policy debate in America, particularly as it relates to the use of comprehensive interest rate caps.

In particular, the chapter makes extensive use of reports published by the Center for Responsible Lending (a leading American consumer advocacy group specialising in consumer finance) and material from the Consumers' Federation of America.

Chapter 5 explores the history of high-cost short term credit regulation in Australia and discusses recent developments.

Finally, Chapter 5 examines the arguments for and against interest rate caps. The chapter closely examines material published by the UK-based research group, *Policis*, which has published three major studies into the Australian high-cost short term lending market. At least two and probably all three of those reports, were commissioned by Cash Converters.

1.4 Other terminology

Interest rate cap

An interest rate cap imposes a limit on the legally allowable rate of interest that can be charged for credit and has traditionally been used to prohibit usury.

In Australia and elsewhere, interest rate caps typically take two forms – caps that apply to interest only³ and caps that include fees and charges for the purpose of calculating an 'effective' interest rate (often referred to as a 'comprehensive interest rate cap'⁴).

Annual percentage rate (APR)

Interest for a loan, expressed as an APR, is an industry standard method of measuring the annual cost of credit and is provided to allow the consumer to objectively compare the relative cost of competing credit products.

Unless otherwise expressly indicated, any reference to an interest rate in the Consumer Action report is intended as a reference to the APR of the product, loan, or legislative measure in question.

³ See for example section 39 *Consumer Credit (Victoria) Act 1995*

⁴ See for example s.14 *Consumer Credit (Queensland) Act* and s.4 *Consumer Credit (Queensland) Special Provisions Regulation 2008*

For example, if it is stated that "*New Hampshire implemented a 36% interest rate cap*", then it is implied that the 36% is expressing an APR value.

Calculating the effective interest rate for a high-cost short term loan

For the purpose of this report and to enable some comparison between the cost of credit under a high-cost short term loan and other credit products, we calculate an 'effective interest rate'. This is done by including not only interest charges but any credit fees and charges in calculating the annual percentage rate⁵.

For example, a borrower takes out a high-cost short term loan for \$300, with an interest charge of \$35 for every \$100 borrowed. This equates to a charge of \$105 for the loan. The loan is to be repaid in four weeks via two fortnightly instalments.

Step One:

Divide the charge (i.e. \$105), by the amount borrowed (i.e. \$300).
 $\$105 \text{ divided by } \$300 = 0.35$

Step Two:

Multiply this number (i.e. 0.35) by the number of days in the year (365).
 $0.35 \text{ multiplied by } 365 = 127.75$

Step Three:

Divide this number (i.e. 127.75) by the term of the loan (i.e. 30 days)
 $127.75 \text{ divided by } 30 = 4.258$

Step Four:

Multiply this number (i.e. 4.258) by 100
 $4.258 \text{ multiplied by } 100 = 425.8$

The effective interest rate for the above loan is 425.8%.

⁵ See above – n.4

It should be noted the repayment period of the loan has a significant effect on the APR.

For example, if the same loan charged at the same amount was to be repaid within 14 days via a single payment then the effective interest rate would be 912.5%.

Repeat borrowing

Repeat borrowing is frequently cited as a major risk of high-cost short term lending and can take a few forms.

Under a **roll-over**, the consumer may pay a fee to extend the period of the loan. This will usually equate to the interest charge due on the loan and 'buys' the consumer another period in which to fully pay back the loan.

For example, for a one month loan of \$300 with a \$105 charge, the consumer may pay \$105 to extend the loan for another month. At the end of that month, they may pay another \$105 for a further extension and so on. Alternatively, if they are able, they could pay the full \$405 to finalise the loan.

This form of repeat borrowing is less common in Australia than in other countries, particularly the United States.

Another form of repeat borrowing is to take out **back-to-back** loans.

Under this form, the consumer fully pays out the loan at the end of the month but then immediately takes out another loan on the same terms, in order to supplement their reduced income. At the end of the month, the same process is repeated and so on.

In terms of cost to the consumer, there is no difference between a roll-over and a back-to-back loan.

Finally, repeat borrowing can be less systematic.

For example, a consumer may pay out the loan at the end of the month and not feel an immediate need to re-borrow. Two weeks later, however, they discover they have insufficient income to cover their living expenses and so

they return to the lender for another loan. Although less systematic, this is still a form of repeat borrowing.

In each case, the cost of the original loan is instrumental in creating a demand for further loans and can initiate an ongoing cycle of borrowing or debt spiral.

Chapter 2 The Consumers

2.1 Introduction

It is well understood low-income wage earners and/or welfare recipients constitute the primary market for high-cost short term lending. This is to be expected as the product requires borrowers who have a regular income yet are in need of financial assistance from one income period to the next. Beyond this general perception, there is a lack of detailed and reliable data concerning the consumer base for high-cost short term lending in Australia. In the period since 2002 most major studies of the high-cost short term lending market have been industry funded.⁶

The current lack of objective consumer data has obvious implications for the high-cost short term loan policy debate. If nothing else, it makes it extremely difficult to assess the real economic and social impact of high-cost short term lending. It is clear the role of high-cost short term lending cannot be properly debated without fully understanding the market it serves and its various impacts on that market.

Given this context, Consumer Action's research sought to update research on four fundamental questions concerning high-cost short term loan consumers in Australia:

- Who uses high-cost short term lending?
- For what purposes do consumers use high-cost short term lending?
- How do consumers view their experience with high-cost short term lenders?

⁶ In particular, the UK based research group Policis has produced three substantial reports commissioned by Cash Converters International, Australia's largest high-cost short term lender. Those reports are:

- Anna Ellison and Robert Forster, *The dynamics of low income credit use - A research study of low income households in Australia*, Policis;
- Anna Ellison and Robert Forster, *The impact of interest rate ceilings - The evidence from international experience and the implications for regulation and consumer protection in the credit market in Australia* Policis and ;
- Anna Ellison and Robert Forster, *Payday in Australia: A research study of the use and impact of payday lending in the domestic Australian market*, Policis,.

The role of Policis in the Australian high-cost short term lending debate is discussed in detail in Chapter 5 of this report.

- To what extent does the use of high-cost short term lending resolve and/or exacerbate financial problems for consumers, in the short, medium and longer term?

The results of this research are presented below and, where possible, are directly compared to the results generated by the 2002 Wilson Report. The 2002 Wilson Report examined payday lending in Victoria and was commissioned by Consumer Action's predecessor organisation, the Consumer Law Centre Victoria.⁷ This has been done in order to both update the 2002 results and draw out potential trends over the 2002 to 2008 period.

It is acknowledged the Wilson Report focussed specifically on Victoria, whereas the 2008 study is national. It is also acknowledged the Wilson Report drew on a much smaller sample size and conducted a street survey of 73 consumers as opposed to the 448 consumers surveyed online in 2008.

These factors do detract slightly from the ability to make comparisons. That being said, most survey categories showed a consistency of result that would indicate a degree of reliability.

Beyond the statistical focus of the survey Consumer Action also sought to elucidate the high-cost short term loan consumer base through the use of qualitative research, conducted by Open Mind Research, presented in a report entitled *Exploring payday loans (Open Mind Report)*. The Open Mind Report is attached as *Appendix B* to this document.

Qualitative research is useful to contextualise data and 'humanise' statistics and provides background context for the reasons given by consumers for taking out high-cost short term loans. Determining the reasons for borrowing is often quite easy, but drawing out the background circumstances and underlying economic drivers for borrowing is rarely quite as simple. Nevertheless, the circumstances of borrowers and the drivers for borrowing must be fully examined and understood if appropriate high-cost short term lending policy is to be developed.

The results of this research is outlined and discussed below.

⁷ Dean Wilson, *Payday Lending in Victoria - A research report*, Consumer Law Centre Victoria, 2002.

2.2 Who Uses High-Cost Short Term Lending?

2.2.1 Gender, Age, Marital Status and Dependents

Gender

The 2002 Wilson Report found females represented a very slight majority of high-cost short term loan borrowers, by a factor of 52% to 48%.⁸

This margin has widened over the past six years. The 2008 survey found a 55% to 45% split in favour of females, with women outnumbering men in every age category. The gender split was most pronounced in the 45 to 54 year-old category but was also high in the 18 to 24 year-old category. This is outlined in the table below:

Gender	Age Category						Total
	18-24	25-34	35-44	45-54	55-64	65+	
Male	41.6% (37)	47.2% (76)	46.3% (50)	40.7% (22)	48.4% (15)	40% (2)	45.1% (202)
Female	58.4% (52)	52.8% (85)	53.7% (58)	59.3% (32)	51.6% (16)	60% (3)	54.9% (246)
Total	20% (89)	36% (161)	24% (108)	12% (54)	7% (31)	1% (5)	100% (448)

⁸ Wilson, *Payday Lending in Victoria*, p. 53.

It is difficult to determine why the gender split has increased although it may be related to the number of sole parent high-cost short term loan consumers, a demographic which is overwhelmingly female.

This is discussed below under the heading ***Marital Status and Dependents***.

Age

The age spread for high-cost short term loan consumers has remained remarkably consistent over the 2002-2008 period although there has been a slight increase in the proportion of older high-cost short term loan consumers.

The 2002 study found the 26 to 35 year-old age category was the most common age category for high-cost short term loan consumers, accounting for 38% of the survey sample.⁹ The 2008 survey found a 36% majority for a similar age category (25 to 34).

In both surveys, the mid-thirties to mid-forties year-old age bracket was the next most heavily represented group (25% in 2002,¹⁰ and 24% in 2008). Following that, the eighteen to mid-twenties age group were the next most common representing 20% of the survey total in both 2002 and 2008.

Again, the surveys produced similar results for the late forties to early fifties category. In 2002 it was found that 14% of high-cost short term loan consumers were between 46 and 55 years old.¹¹ The 2008 survey found 12% of consumers lay in the 45 to 55 year old category.

As mentioned, the surveys did display some minor variance when it came to older age categories.

In 2002, Wilson found only 3% of high-cost short term loan consumers were over 56 years of age.¹² In 2008 it was found that 7% of high-cost short term consumers were in the 54 to 64 year-old age category. The 2008 survey also found 1% of high-cost short term loan consumers were 65 years old or older.

⁹ Wilson, *Payday Lending in Victoria*, p. 53.

¹⁰ Wilson, *Payday Lending in Victoria*, p. 53.

¹¹ Wilson, *Payday Lending in Victoria*, p. 54.

¹² Wilson, *Payday Lending in Victoria*, p. 54.

These results are displayed below:

Age Category	2002	Age Category	2008
18 - 25	20%	18 - 24	20%
26 – 35	38%	25 - 34	36%
36- 45	25%	35 - 44	24%
46 - 55	14%	45 - 54	12%
56+	3%	55 - 64	7%
		65+	1%
Total	100%		100%

Despite the small increase in older high-cost short term loan consumers,¹³ both surveys overwhelmingly show high-cost short term lending is primarily used by younger consumers.

Marital Status and Dependents

2002 RESULTS

In 2002, it was found that 55% of high-cost short term loan consumers were single, forming the most common relationship status category by a considerable margin.¹⁴ The next most common relationship status was partnered (those married or living in a de facto relationship), representing 26% of high-cost short term loan consumers.¹⁵ Nineteen percent of high-cost short

¹³ In 2002, 17% of consumers were 46 years old or older. In 2008, 20% of high-cost short term lending consumers were above the age of 45.

¹⁴ Wilson, *Payday Lending in Victoria*, p. 58.

¹⁵ Wilson, *Payday Lending in Victoria*, p. 54.

term consumers were separated or divorced and one survey respondent was widowed.

When broken down by gender it was found that 65% of male high-cost short term consumers were single, considerably higher than the 42% figure for women. For partnered respondents, there was no significant proportional difference between men and women.¹⁶

The largest gender difference lay amongst those consumers who were separated or divorced. The 2002 study found 31% of female respondents fell into this category, which accounted for only 6% of men. It was noted this was significant in that:

“...92% of separated or divorced female payday loan consumers also have dependant children. This suggests that female sole parents are a significant minority of payday loan consumers.”¹⁷

2002 COMPARED TO 2008

Unfortunately, the 2008 study was conducted on alternative lines to the 2002 study and did not make a distinction between the ‘single’ and ‘separated and divorced’ categories.

Instead, the 2008 survey simply distinguished between being in a ‘couple’ and ‘single’ and then differentiated between those with children and those without. The 2008 survey also added the category ‘shared household with two or more adults’, a category not included in the 2002 survey.

The 2008 results show coupled consumers have increased their usage of high-cost short term lending and now account for 47% of the customer base. This is a large increase on the 26% recorded in 2002. Conversely, singles now represent a much smaller proportion of high-cost short term loan consumers having dropped to 34% from the 55% majority registered in 2002. It is unclear whether some of this increase in the number of coupled consumers is due to some separated and divorced consumers categorising themselves as coupled rather than single, even if this did occur it would not account for all of the change.

¹⁶ Wilson, *Payday Lending in Victoria*, p. 58.

¹⁷ Wilson, *Payday Lending in Victoria*, p. 58.

Nineteen percent of consumers fell into the 'shared household' category. This might account for some of the drop in consumers who categorised themselves as single.

On the 2008 results, female high-cost short term loan consumers are now just as likely to be single as men, with 34% of each gender registering as either single or single with children. Some of this change may be due to some separated and divorced females now categorising themselves as single.

As was the case in 2002, it was found that female respondents were more likely to have dependent children.

In 2002, it was found that 63% of female respondents had dependent children, far more than the 23% of male respondents.¹⁸

This number had shifted by 2008 (it is now 50.4% for women and 37.6% for men) but still represents a significant imbalance.

Significantly, of the 44 survey respondents who clearly registered as sole parents in 2008 ("single with children"), 39 of them were women.

This means 88% of sole parent high-cost short term loan consumers are female, which is only slightly lower than the 2002 figure of 92%.

In 2002 it was found that 47% of all female high-cost short term loan consumers were sole parents, whereas this figure had dropped to 16% by 2008.

However, the 2002 figure included both single and separated or divorced women, thus the change may be explained by the significant increase in high-cost short term loan consumers registering as in a couple.

More generally, it is worth noting nearly 9% (8.7%) of all high-cost short term loan consumers are female sole parents.

This confirms female sole parents remain an over represented minority amongst high-cost short term loan consumers - despite other changes that may have taken place.

¹⁸ Wilson, *Payday Lending in Victoria*, p. 59.

The results are shown below:

MARITAL STATUS AND DEPENDENTS – PROPORTIONAL GENDER COMPARISON (2008)

Gender	Single	Single with children	Couple no children	Couple with children	Shared household (2 or more adults)	Total
Male	31.2% (63)	2.5% (5)	19.3% (39)	24.3% (49)	22.8% (46)	100% (202)
Female	18.3% (45)	15.9% (39)	15.9% (39)	34.10% (84)	15.9% (39)	100% (246)

MARITAL STATUS AND DEPENDENTS – TOTAL SURVEY COMPARISON (2008)

Gender	Single	Single with children	Couple no children	Couple with children	Shared household (2 or more adults)	Total
Male	14% (63)	1% (5)	8.7% (39)	10.9% (49)	10.2% (46)	45% (202)
Female	10% (45)	8.7% (39)	8.7% (39)	18.7% (84)	8.7% (39)	55% (246)
Total	24% (108)	9.7% (44)	17.4% (78)	29.6% (133)	18.9% (85)	100% (448)

Looking at the question of dependents more widely, the 2008 survey found 44.6% of all high-cost short term loan consumers had children under the age of eighteen.

Although results were evenly spread, the most common age group for dependent children was 6 to 9 years (36%), with 10 to 14 being the next most common (32%).

Of the 200 respondents with children under the age of eighteen, only 27.5% had children above 14 years old.

AGE OF DEPENDENTS - DISTRIBUTION AMONGST BORROWERS WITH DEPENDENTS - 2008

Age Category of Dependents	Borrowers with Dependents (200 TOTAL)
0 - 2	31% (62)
3 - 5	27% (54)
6 - 9	36% (72)
10-14	32% (64)
15 - 18	27.5% (55)

2.2.2 Employment Status, Income and Education

Employment Status

In 2002 it was found that 49% of high-cost short term loan consumers derived their income from full-time employment.¹⁹ This had dropped slightly by 2008 to approximately 45%.

In 2002 part-time or casual employment accounted for only 12% of respondents²⁰ but had risen to 28.1% by 2008. The 2008 study also found 21.9% of respondents were not currently working and 5.1% were full time students.

	Full-time	Part-time or Casual	Not Working	Full-time student	Centrelink benefits	
2002	49%	12%	-	-	38%	99%
2008	45%	28.1%	21.9%	5%	-	100%

The 2002 study found 38% of high-cost short term loan consumers were in receipt of Centrelink benefits and that 50% of those were receiving the sole

¹⁹ Wilson, *Payday Lending in Victoria*, p. 54.

²⁰ Wilson, *Payday Lending in Victoria*, p. 54.

parent benefit.²¹ The 2002 study also found Centrelink was the major source of income for 55% of female high-cost short term loan consumers, probably driven by the high proportion of female sole parents. By contrast, only 20% of male high-cost short term loan consumers received Centrelink payments.²²

Without appropriate data on 2008 Centrelink income patterns amongst high-cost short term loan consumers, it is not possible to compare results between 2002 and 2008 or speculate on trends. It would be very surprising, however, if those registered as not working in 2008 and those registered as sole parents, do not receive at least some form of Centrelink assistance.

Income

The 2002 study found the majority of high-cost short term loan consumers were low-income earners. The average yearly earnings for a high-cost short term loan consumer were \$24,482.²³ The median annual income was slightly lower, at \$22,360.²⁴

It was found that 85% of high-cost short term loan consumers earned less than \$31,304 per annum; and 22% of high-cost short term loan consumers were either below or only marginally above the Henderson Poverty Line for a single person (\$15,600 per annum).²⁵

As in other areas, the 2008 survey was conducted using an alternative research methodology to the 2002 survey, making direct comparisons difficult. Analysis of the 2008 results is also hampered by a reasonably large proportion of consumers who did not wish to say what they earned (12.7%).

In broad terms, the proportion of high-cost short term loan consumers with incomes above \$30,000 seems to have increased, although 50% of high-cost short term loan consumers still earn less than \$40,000 and only 14.5% are known to earn more than \$60,000.

Further, it must be noted average weekly earnings for a full-time adult employee in Australia increased over the period 2002 to 2008, from \$888.50 to \$1,164.90 per week. Put in annual terms, this describes an increase from

²¹ Wilson, *Payday Lending in Victoria*, p. 54.

²² Wilson, *Payday Lending in Victoria*, p. 56.

²³ Wilson, *Payday Lending in Victoria*, p. 56.

²⁴ Wilson, *Payday Lending in Victoria*, p. 56.

²⁵ Wilson, *Payday Lending in Victoria*, p. 57.

\$46,202 to \$60,574.80 per annum.²⁶ Thus, nearly three quarters of respondents (72.7%) reported they earned below average weekly earnings.

In 2008, 23.4% of high-cost short term loan consumers, in earning less than \$20,000 per year, continued to sit below or only marginally above the Henderson Poverty Line for a single person (\$19,775 for June 2008).²⁷

Despite the difficulties of comparison, it is clear high-cost short term loan consumers remain low income earners in the main although slightly more average or just below average income earners appear to be utilising high-cost short term loans than in 2002. This is consistent with the increasing use of high-cost short term loans by consumers in a couple and could indicate high-cost short term loans have become 'normalised' to some extent in the period since 2002. The data suggests high-cost short term loan providers no longer serve strictly marginal income earners, although low and marginal income earners clearly remain the overwhelming consumer base.

As far as is possible, the results of the two surveys are compared below:

2002		2008	
Income Level (Annual)	Respondents (%)	Income Level(Annual)	Respondents (%)
0 - \$10,400	5%	Under \$20,000	23.4%
\$10,400 - \$20,800	38%		
\$20,800 – \$31,200	42%	\$21,000 - \$40,000	27.9%
\$31,200 - \$41,600	10%		
\$41,600 - \$52,000 (2002 avg. wage:\$46,202)	4%	\$40,001 - \$60,000 (2008 av. wage:\$60,574)	21.4%
\$52,000 +	1%		

²⁶ Figures quoted are drawn from Australian Bureau of Statistics (ABS), 6302.0 - *Average Weekly Earnings*, November 2002 compared to November 2008. Both figures quoted are "Full-time adult ordinary time earnings".

²⁷ Melbourne Institute of Applied Economic and Social Research, *Poverty Lines: Australia - June Quarter 2008*. For couples and singles or couples with children, the required income to sit above the poverty line is higher.

2002		2008	
Income Level (Annual)	Respondents (%)	Income Level (Annual)	Respondents (%)
\$52,000+	1%	\$60,001 - \$90,000	8.3%
		\$90,001 - \$120,000	4%
		\$120,001 +	2.2%
		Prefer not to say	12.7%
	100%		100%

Education

The 2008 survey appears to show the educational profile of high-cost short term loan consumers has shifted significantly, with consumers now exhibiting a much higher standard of education than was the case in 2002.

In 2002, only 5% of survey respondents had a university degree²⁸ as opposed to 30.8% in 2008. The 2002 survey also showed 36% of respondents had no education beyond year 10²⁹ whereas this had dropped to 22.8% by 2008. The proportion of trade qualified respondents increased, from 17.8% to 23.9%.

It should be noted that this variance may be more reflective of differing research methodologies than of any underlying demographic shift. In 2002, the Wilson report generated data through a street survey whilst the Consumer Action survey was conducted online and required participants to voluntarily engage in a text based process. This obviously required a degree of literacy and access to a computer, as opposed to the street survey. It is quite possible this in turn skewed the educational profiling of high-cost short term borrowers and may account for the stark variance between 2008 and 2002.

Taken together with income findings, the education findings appear to show high-cost short term loan consumption has moved into a slightly higher demographic, although again, this may be a false conclusion more attributable to research methodology than underlying societal factors. It would not be

²⁸ Wilson, *Payday Lending in Victoria*, p. 61.

²⁹ Wilson, *Payday Lending in Victoria*, p. 61.

surprising if the income profiling directly related to education profiling which in turn was impacted by the research methodology, as discussed above.

Alternatively, the results might indicate that well educated consumers, on average or near average incomes, are increasingly suffering financial stress and are resorting to high-cost short term loans to alleviate that stress. This argument is supported by a notable increase in household personal debt over the period 2002-2008, even for middle income households.³⁰

The comparative findings are presented below:

Education Level	2002	Education Level	2008
Not specified	8.2% (6)	-	-
Year 10 or earlier	35.6% (26)	Some secondary school	15.4% (69)
		School certificate	7.4% (33)
Year 11/12	34.2% (25)	Higher school certificate	19.2% (86)
Trade certificate/TAFE	17.8% (13)	TAFE	23.9% (107)
University Degree	4.1% (3)	University (Undergraduate)	24.3% (109)
		Other college	3.3% (15)
		University (Postgraduate)	6.5% (29)
Total	100% (73)		100% (448)

³⁰ Australian Bureau of Statistics, 4102.0 - Australian Social Trends March 2009.
<http://www.abs.gov.au/AUSSTATS/abs@.nsf/Lookup/4102.0Main+Features60March%202009>
 (28/6/2010)

2.2.3 Country of origin

Neither the 2002 nor the 2008 surveys revealed any particular concentration of high-cost short term loan consumers along national lines.

In 2002, 71% of respondents were Australian born.³¹ This had increased slightly to 75.4% by 2008. In 2002, New Zealand born borrowers accounted for 7% of respondents.³² This had dropped to 2.5% by 2008. Of the other nationalities represented, only UK-born borrowers accounted for more than 2% of respondents, registering 5.1% in the 2008 survey. This was slightly more than the 2002 result, where 4% of respondents were UK-born.³³

Unfortunately, the data does not provide for a more sophisticated reading. It may be possible high-cost short term lending is more common amongst certain ethnic groups which may nonetheless be Australian born - and such an outcome would be consistent with the industry in the United States, where high-cost short term loan consumption is known to be more concentrated amongst some US born ethnic minorities. This in turn is linked to lower income levels in those communities, facilitating the conditions which lead to borrowing.³⁴

Further, it should be noted that the use of an online survey to gather borrower statistics may well have skewed the ethnic make-up of respondents and that borrowers from non-English speaking backgrounds may be under-represented. This is an area requiring further research.

2.2.4 Summary – Demographics 2002-2008

By some measures, the high-cost short term loan consumer base does not appear to have altered greatly in the period since 2002.

The major consumer base for high-cost short term lending consists of low income earners, in the 18 to 35 year-old age bracket. Certainly, consumers above their mid-40s are in the minority of borrowers, the proportion of which has varied only slightly over a six year period (17% to 20%).

³¹ Wilson, *Payday Lending in Victoria*, p. 62.

³² Wilson, *Payday Lending in Victoria*, p. 62.

³³ Wilson, *Payday Lending in Victoria*, p. 62.

³⁴ Steven M. Graves, *Landscapes of Predation, Landscapes of Neglect: A Location analysis of payday lenders and banks*, *The Professional Geographer*, 55(3) 2003.

The proportion of borrowers with dependent children has been even more consistent and has hovered at around 44%. As expected (given the young age of borrowers), the age profile for dependent children is also quite young, with only a quarter or so registering as fourteen years or older.

These factors are significant and usefully highlight ongoing fundamentals of the high-cost short term loan consumer base. On that basis, these factors alone are sufficient to draw a picture of the high-cost short term lending market, albeit a limited one.

Beyond these factors, however, the picture becomes more complex.

In the period from 2002 to 2008, significant demographic shifts may have occurred within the high-cost short term loan consumer base and these shifts call for further examination. The factors are:

- A previously narrow gender gap increased and women now form a clear majority of high-cost short term loan consumers (55%). Female sole parents remain a significant minority within that group and represent almost 9% of borrowers overall – a disproportionately high representation.
- Far more borrowers now report they are in a couple. Those reporting as either married or in a de facto relationship rose, from just over a quarter in 2002 to almost half of all borrowers by 2008 (although it should be taken into account that the 2002 study had a separate category for separated and divorced, not included in the 2008 survey).
- There was a sharp increase in the education level of borrowers, most notably amongst those who hold a university degree. This figure rose from 4% in 2002, to almost 31% by 2008. As noted below, this may be at least partly attributable to the differing research methods adopted by the two studies.
- The proportion of respondents who reported an average or above average income rose from about 3% in 2002, to a small but significant 14.5% by 2008. Although it is clear low income earners remain the core consumer base for high-cost short term lenders (with nearly a quarter of all 2008 respondents earning less than \$20,000, nearly three quarters of respondents earning below average income and another

13% preferring not to say what they earned) the 2008 results show high-cost short term lending is being used by consumers who would not previously be expected to borrow from fringe lenders.

In some ways, the 2002 survey presents a clearer and more predictable picture of the high-cost short term loan consumer base. The 2002 survey indicates a borrower base that is predominantly single, separated or divorced, on a low income and with a low level of education.

By contrast, the 2008 survey shows a significant increase in the proportion of borrowers who are in couples. There is also a sharp rise in the proportion of borrowers with a tertiary level education. Although income levels generally remain low, a higher percentage of borrowers now have an average or above average income level. As discussed earlier, it should be noted these shifts may be to do with the online nature of the survey which may have skewed the results towards a slightly higher demographic than the 2002 street survey. On that basis, it is fair to say the similarities between the two studies are potentially more reliable and more telling, than the differences.

Certainly, there is no question the practice remains deeply rooted in a low-income demographic for its core business.

In order to examine this further, it is necessary to consider the reasons consumers give for borrowing from high-cost short term lenders.

2.3 Why do consumers use high-cost short term lending?

2.3.1 Survey results - Primary Reason(s) for Borrowing

The 2002 and 2008 surveys are consistent in that they show consumers primarily use high-cost short term loans in order to meet basic needs.

The 2002 survey found 32% of respondents obtained high-cost short term loans to pay bills and 26% obtained the loans to cover essential living expenses. The next most common purpose was to pay for car repairs or registration (10%), followed by rent (7%).³⁵

³⁵ Wilson, *Payday Lending in Victoria*, p. 66 -67.

Overall, the 2002 report stated 79% of high-cost short term loans were used “...to maintain existing living standards and compensate for shortfalls in income.”³⁶ This was despite the 2002 survey being conducted close to the Christmas period, presumably inflating the proportion of loans used to buy gifts, to 7%. The survey also recorded a high proportion of loans taken out for ‘other’ purposes (14%), some of which could also be considered as falling into a broad category of ‘maintaining living standards and compensating for shortfalls in income’, such as buying a fridge and financing moving house.³⁷

Since 2002, the four major reasons for taking out high-cost short term loans have not changed, although their order of priority has.

Car repairs or registration have become the most common reasons for borrowing and now account for 22.1% of high-cost short term loans. The next most common reason is to pay utility bills (21.0%), followed by food or other essentials (17.6%) and then rent (10.7%).

Housing costs were a noticeable driver of borrowing in 2008, with borrowing for rent and mortgage payments together now making up 14.3% of loans.

Repaying debt also remains a reported reason for using high-cost short term loans (4% in 2002 to 6% in 2008).

These results are shown below:

Purpose	2002	2008
Bills	32%	21%
Living Expenses (incl. Food)	26%	17.6%
Rent	7%	10.7%
Car repairs or registration	10%	22.1%

³⁶ Wilson, *Payday Lending in Victoria*, p. 67.

³⁷ Wilson, *Payday Lending in Victoria*, p. 67.

Purpose	2002	2008	
Repay Debt	4%	6%	
Gifts	7%	-	
Other	14%	Mortgage	3.6%
		Medicine	1.1%
		To help a family member	6.7%
		To help a friend	4.2%
		Other	6.9%
Total	100%	100%	

The results serve to underscore that financial stress remains the underlying driver for high-cost short term lending.

Consumers do not generally take out high-cost short term loans for discretionary purposes but instead borrow when they are struggling to cope and have insufficient purchasing power to maintain a basic living standard. When examined cumulatively, 52.9% of high-cost short term loans reported in the Consumer Action survey were used to meet recurrent basic living expenses.

“Consumers do not generally take out high-cost short term loans for discretionary purposes but instead borrow when they are struggling to cope and have insufficient purchasing power to maintain a basic living standard.”

This figure is derived from grouping expenditure on bills, living expenses, rent or mortgages and does not include expenditure on car registration which would conservatively inflate the proportion to 60%, or even 65%, of loans.

The significance of this is that recurrent basic living expenses of their nature reoccur on a regular basis. If consumers are unable to meet those expenses through their basic income on one occasion, then the likelihood is further borrowing may

occur on future occasions where those expenses are again due for payment. Borrowing high-cost short term credit to meet basic, recurrent living expenses is a clear indicator of financial stress.

In order to examine the nature of this stress and to understand the position borrowers find themselves in when borrowing, qualitative research can be more useful than quantitative research. To generate such research, Consumer Action commissioned the Open Mind Research Group, to produce a report into high-cost short term lending, entitled *Exploring High-cost short term Loans (Open Mind Report)*.

2.3.2 Qualitative Research

Exploring High-cost short term Loans indicates the causes of financial stress are multi-faceted and as varied as borrowers themselves.

The Open Mind Report relates circumstances ranging from difficulties with drugs, to ongoing and expensive health problems, to forced homelessness, to difficulties servicing existing debts (such as credit cards), to relationship breakdowns, to unemployment and general difficulties associated with a rising cost of living.

Commonly, the report found:

“...respondents often recount long and usually complex financial histories leading up to the situations where high-interest, short-term loans become necessary.”³⁸

The report identifies three distinct categories of high-cost short term loan consumer. Open Mind labels these types as ‘The Financial Desperates’ (**Desperates**), the ‘Keeping up with the Joneses’ (**Joneses**) and the ‘Young and Irresponsibles’ (**Young**).

In the case of the Desperates, “...high-cost short term loans supplement other loans to pay for real necessities...in what is a systemic cycle of debt and borrowing.”³⁹ Desperates are likely to arrive at this position following a variety

³⁸ Open Mind Research Group, *Exploring payday loans*, Consumer Action Law Centre, 21 November 2008. p.8.

³⁹ Open Mind, *Exploring payday loans*, p. 3.

of difficult life circumstances which have caused them to struggle with debt “for many years”.

By contrast, the Young are more likely to borrow because they “...*struggle to manage money...*”. Such borrowers eventually reach a point where they feel “...*the only way to pay rent or bills is to take out a loan.*”⁴⁰

The Joneses are unique in that their reason for borrowing is more likely to be discretionary, funding a lifestyle beyond their means. In their case, financial distress would be more likely to arise for a less vital reason, such as financing a “...*dress for a wedding, a holiday for the family, a down-payment on a new car...*”.⁴¹

The report found the Desperates and the Young were likely to take out loans for core living expenses (such as bills or rent). On the basis of the reasons given for borrowing in the Consumer Action survey, these groups clearly appear to constitute the majority of high-cost short term loan consumers, although the Open Mind data does not provide a statistical breakdown to confirm this. If the Joneses do form only a small minority, then perhaps they account for some of the upward spread in the consumer demographic found in the 2008 Consumer Action survey.

However, it is worth noting the discretionary items the Joneses used high-cost short term loans to fund were not necessarily extravagant items. Many of the reasons the Joneses gave for borrowing were matters that, while not essential, might typically be considered ordinary living expenses in modern Australian life such as buying a dress for a wedding or funding a holiday for the family.⁴²

Given the variety of borrower circumstances and borrower types, the Open Mind report shows it is not possible to identify a finite number of background circumstances which precipitate borrowing from a high-cost short term lender. It is, however, possible to determine broad patterns.

The report found respondents (with the possible exception of the Young) were “...*often remarkably resourceful in attempting to stretch very finite resources...usually employing a range of strategies in an effort to manage*

⁴⁰ Open Mind, *Exploring payday loans*, p. 3

⁴¹ Open Mind, *Exploring payday loans*, p. 3.

⁴² Open Mind, *Exploring payday loans*, p. 3.

*their money.*⁴³ There was significant variance in the approaches taken by consumers to do this, with young single consumers clearly less likely to budget than others.

Across all borrower categories, the Open Mind report found high-cost short term lending is regarded by consumers as “...a *last resort*...” and is often viewed as a “*shameful and embarrassing thing*”.⁴⁴ Borrowing from a high-cost short term lender is likely to be concealed from friends and family and is generally not talked about. This in itself makes it difficult to compile qualitative research. Despite this difficulty, the report clearly indicates that for many consumers (if not most), resorting to a high-cost short term loan is perceived as a humiliating personal failure.

Again, this clearly characterises high-cost short term loans as a product dependent on financial stress. Consumers do not ‘choose’ high-cost short term loans in the normal sense, but instead resort to them as a final alternative in a period of financial duress.

Across borrower types, financial distress typically results from a single financial emergency which, when overlaid on ongoing financial problems, acts to push consumers into borrowing.

***“Consumers do not
'choose' high-cost short
term loans in the
normal sense, but
instead resort to them.”***

This pattern has not changed since 2002. In 2002, Wilson found “*Obtaining a high-cost short term loan is usually the result of ongoing financial problems*”⁴⁵ exacerbated by a “...*financial 'shock' to fragile finances*...”⁴⁶

The particular financial emergency can be as varied as the borrower, but the presence of some sort of emergency seems universal. The prevalence of car repairs as the most common reason for borrowing seems to support this finding; as such costs are often expensive and unexpected.

Drivers of ongoing borrowing are described further below, under the heading ***Borrower behaviour.***

⁴³ Open Mind, *Exploring payday loans*, p. 14.

⁴⁴ Open Mind, *Exploring payday loans*, p. 10.

⁴⁵ Wilson, *Payday Lending in Victoria*, p. 71.

⁴⁶ Wilson, *Payday Lending in Victoria*, p. 71.

2.4 How do consumers view the high-cost short term lending experience?

2.4.1 Consumer understanding of high-cost short term lending

A striking feature of the high-cost short term lending industry is the degree of ignorance amongst consumers regarding interest rates charged by lenders.

Open Mind found of their Geelong respondents “*not one study participant*” was able to correctly name the interest rate they had been charged and instead they tended to:

“...greatly under-estimate the rate they believe they were charged (some guessing 13%, 15% or up to 20%). They tend to think more in terms of amount borrowed vs. amount repaid, rather than interest rate per se. Amongst Melbourne participants, many stated an interest rate of 33%, 35% and 38% - considerably higher than the rates supposed by Geelong participants.”⁴⁷

These reports are echoed by the survey results, where consumers were asked to give an open text response indicating the interest charge for their loan.

“A striking feature of the high-cost short term lending industry is the degree of ignorance amongst consumers regarding interest rates charged by lenders ...”not one study participant” was able to correctly name the interest rate they had been charged.”

The most common response to this question was 20%, but this was only provided by 8.7% of consumers. The next most common responses were 15% interest (provided by 6.5% of consumers) and 30% interest (provided by 6.3%). After that, 5.4% of respondents stated the charge was 18% and 4.5% said it was 25%. These results are striking not only because of their variance, but because they all greatly under-estimate the usual interest charge for a typical high-cost short term loan.

⁴⁷ Open Mind, *Exploring payday loans*, p. 25.

The effective interest rate for high-cost short term loans can vary greatly, anywhere from 300% to 1,000% per annum but are much higher than the figures named by consumers.

The survey also asked respondents to state the dollar amount charged for their loans. Again there was a high degree of variance. Curiously (particularly given the apparent lack of knowledge regarding interest rates), the most common response was \$0, provided by 12.9% of respondents.

The most common plausible response was \$50 which was still only provided by 11.2% of respondents. The next most common response was \$100, provided by 7.1% of respondents. After that, 5.1% of respondents nominated \$20 and 3.8% nominated \$10. There were a number of figures nominated by 3.6% of respondents (equating to 16 out of the 448 respondents), ranging from \$30 to \$150 to \$200. Anything beyond that becomes negligible in number and ranged all the way from \$1 to \$6400.

In reality, for an average \$300 loan, a charge of around \$100 would be typical.

The amount charged for loans should be contrasted with the loan amounts themselves. Although these will be discussed more fully in the following chapter, they are worth discussing here for the reason that far less variance existed in respondents' response to this question, than existed in responses to the question of how much the loans cost. Loan amounts ranged from less than \$50 to a maximum of \$2000. The most common bracket for borrowing lay between \$200 and \$500 and accounted for 35.7% of loans. Loans from \$500 to \$1000 accounted for 26.1% of all loans and loans from \$51 to \$200 accounted for 20.5%. Therefore, 82.3% of loan amounts lay between \$200 and \$1000 representing a reasonably narrow range.

***"... it seems clear
borrowers know how
much they are
borrowing but not
how much they are
paying."***

On this basis, it seems clear borrowers know how much they are borrowing but not how much they are paying. This is an unusual feature of the high-cost short term lending industry. Indeed, it is rare in any industry for the consumer to be largely unaware of the cost of the product they are buying.

Again, this lends support to the notion consumers do not choose high-cost short term loans but instead resort to them in times of financial stress. Essentially, it seems cost is not a consideration when borrowers frequent a high-cost short term lender – they are simply in a position where they are desperate for money and will essentially pay anything to access it. The Open Mind report found high-cost short term loan consumers felt they were “...being ‘ripped off’ with very high charges”,⁴⁸ but felt they had no other choice but to borrow.

The Consumer Action survey found 54.2% of respondents chose their lender because they were nearby and convenient. The next most common reason for using a lender was because the borrower had used them before (17%) and after that it was because the lender was ‘the only one who would lend me the money’ (14.7%). Only 4.9% said it was because the lender had low fees and only 4.5% nominated ‘good rates’ as the reason for choosing their lender. Put together, this means only 9.4% of consumers reported making a decision based on cost.

“54.2% of respondents chose their lender because they were nearby and convenient. The next most common reason for using a lender was because the borrower had used them before (17%) and after that it was because the lender was ‘the only one who would lend me the money’ (14.7%).”

Consumers generally have a poor understanding of the cost of high-cost short term lending and there is little market pressure on lenders to compete on price. When most consumers choose their lender purely on the basis of location, it would seem it is clearly more important to secure a shop-front in a lucrative location than it is to provide a competitively priced product.

2.4.2 Consumer perceptions of high-cost short term lending

The Open Mind report found borrowers “...often express a sense of shame and guilt at having to resort to such a loan.”⁴⁹ Borrowing from a high-cost short term lender is associated with a sense of humiliation and failure. Because of

⁴⁸ Open Mind, *Exploring payday loans*, p. 26.

⁴⁹ Open Mind, *Exploring payday loans*, p. 26.

this, borrowers are sometimes reluctant to talk about their experience of high-cost short term lending, making it difficult to compile accurate research. This is particularly the case for qualitative research however, it is clear borrowers commonly perceive a power imbalance between lenders and themselves. There is a commonly held notion that high-cost short term lenders prey on misfortune.

A sample of the statements best indicating this kind of response are reproduced below:

“They almost laugh at you so it upsets you. I think they feed off your anxiety and your needs and they make you feel there’s no other option.”

[young single mother, Geelong]⁵⁰

“Cash Converters just make you feel little, degrading.”

[single mother, Geelong]⁵¹

“I don’t tell anyone that I do this to get by....I don’t want people to know about it.”

[male, northern suburbs, Melbourne]⁵²

“They know the game...they make a lot of money...a lot of profit”

[female, Melbourne]⁵³

“They know they’ve got the advantage over us...they have the power.”

[male, northern suburbs, Melbourne]⁵⁴

The high-cost short term lending industry commonly argues a high level of financial distress amongst its consumer base is hardly a reason to condemn the industry and if it were, then many charity organisations could be condemned on the same basis.

High-cost short term lenders also argue that they play an important social role in assisting people temporarily facing financial difficulties beyond their means.

⁵⁰ Open Mind, *Exploring payday loans*, p. 26.

⁵¹ Open Mind, *Exploring payday loans*, p. 26.

⁵² Open Mind, *Exploring payday loans*, p. 10.

⁵³ Open Mind, *Exploring payday loans*, p. 26.

⁵⁴ Open Mind, *Exploring payday loans*, p. 26.

According to this argument, high-cost short term loans constitute an important 'public good' enabling consumers to overcome their difficulties. Many consumers themselves express gratitude for the existence of high-cost short term loans, which have assisted them to meet a particularly difficult expense.

"Many consumers themselves express gratitude for the existence of high-cost short term loans ... At the same time, this relief is often tempered with resentment at the cost of the product and humiliation at feeling forced into a situation where borrowing seems to be the only option."

At the same time, this relief is often tempered with resentment at the cost of the product and humiliation at feeling forced into a situation where borrowing seems to be the only option.

Under the public good argument, high-cost short term lenders cast high-cost short term loans as small 'once off' loans that assist consumers in rare moments of real need. To assess this

characterisation, it is necessary to examine the typical behaviour of borrowers once they have borrowed from a high-cost short term lender and determine the extent to which high-cost short term loans genuinely meet those needs.

2.5 To what extent does high-cost short term lending resolve or exacerbate financial difficulties?

2.5.1 Borrower behaviour

Repeat Loans

There is an unfortunate lack of comprehensive Australian data regarding repeat borrowing behaviour by high-cost short term loan borrowers. That said, sufficient anecdotal evidence exists to suggest the practice may be extremely common.

Certainly, extensive evidence from the United States indicates repeat borrowing largely fuels the high-cost short term lending business model with one study finding 76% of loan volume was generated by 'churned' loans (i.e.

new loans taken by customers within two weeks of paying off their previous loan).⁵⁵

The Consumer Action survey asked for an open text response to the question:

How many payday loans have you taken out in the last 18 months?

Perhaps surprisingly, the results did not reveal a high degree of repeat borrowing.

The survey found 46.4% of respondents (208 of 448) had only taken one loan out, whilst a further 27.5% stated they had only had two loans (123 of 448). A further 8.9% had only taken three loans and 3.6% had taken four. Taken together, this indicates 86.4% of respondents had taken out four or less high-cost short term loans over an eighteen month period, with over half of those reporting only one loan.

Responses that may be said to align with repeat borrowing behaviour were limited. For example, five respondents (or 1.8% of the survey) reported ten loans, whilst five respondents reported twelve and twenty loans respectively (or 1.1% of the survey). These results are presented in table form below:

Number of loans indicated in 18 month period	Proportion of borrowers	Number of borrowers
1	46.4%	208
2	27.5%	123
3	8.9%	40
4	3.6%	16
5	2.2%	10
6	2.7%	12
10	1.8%	8
0	0.9%	4

⁵⁵ Leslie Parrish and Uriah King, Phantom Demand: Short-term due date generates need for repeat payday loans, accounting for 76% of total volume, Center for Responsible Lending, 9 July 2009.p.11.

Number of loans indicated in 18 month period	Proportion of borrowers	Number of borrowers
12, 20	1.1% (x2)	5 (x2)
8, 9, 18	0.4% (x3)	2 (x3)
7, 14, 15,16, 25, 30,50,60,78,90,100	0.2% (x11)	1 (x 11)
Total	100%	448

It should be noted the question did produce some anomalous results, with four respondents claiming to have taken no loans at all and many respondents providing a unique response. One respondent claimed to have had one hundred loans.

The Consumer Action survey may have been better constructed by providing a range of options, or brackets for consumers to choose from, rather than calling for an open text response to the question of repeat borrowing.

Repeat borrowing is a difficult area in which to gather data as many consumers are reticent to reveal the extent of their borrowing and others may conflate a loan that has been repeatedly rolled over into a 'single loan'. Either way, the Consumer Action survey exhibits significant divergence from other research and warrants further investigation.

In 2002 the Wilson Report provided some evidence of repeat borrowing, reporting 65% of borrowers experienced repeat borrowing.⁵⁶ On a qualitative level, many consumers spoke of the 'addictive' nature of high-cost short term lending. The average number of repeat loans taken out by consumers over 12 months was six, with 37% of consumers having five or more loans within the previous 12 months.

The Wilson Report also noted 'a sub-group of consumers in a cycle of back-to-back loans' with 15% of consumers having taken out 10 or more loans in the previous 12 months.⁵⁷

⁵⁶ Wilson, *Payday Lending in Victoria*, p. 65, 75.

⁵⁷ Wilson, *Payday Lending in Victoria*, p. 65.

Further, the Wilson Report cited the speed and convenience of further borrowing (once the customer has already established a relationship with the lender) as a major factor in encouraging repeat borrowing.

As one consumer put it:

*"...it was too easy to get. It was just yeah, walk in, ask for the loan and you'd pretty much as soon as you'd ask for the loan they'd look it up, yep this is how much you'd be paying, that's all right, here's your money..."*⁵⁸;

and as another said:

*"...really it's a catch. I'm sucked in. If I go and tell my friends they're going to get sucked in...like I know this girl, I know for a fact that she's just lock, stock and barrel in there. And so is her friend. I've seen her friend in there and she was trying to get more money off them one day and I was standing behind her thinking you poor girl, this is terrible, but they have got you. I mean they had me too...."*⁵⁹

The 2008 Open Mind report produced similar qualitative evidence:

"I am still feeding the cycle. I haven't had a loan for a couple of months but my partner has fallen into the trap and once he pays one off he goes back for another one."
[young partnered mother, Geelong]⁶⁰

"I am still feeding the cycle. I haven't had a loan for a couple of months but my partner has fallen into the trap and once he pays one off he goes back for another one."

"It's had a huge impact on my finances and my life. You are constantly paying the money back and are constantly stuck at home. I feel better now that I have broken out of it."
[older single mother, Geelong]⁶¹

⁵⁸ Wilson, *Payday Lending in Victoria*, p. 75.

⁵⁹ Wilson, *Payday Lending in Victoria*, p. 75.

⁶⁰ Open Mind, *Exploring payday loans*, p. 27.

⁶¹ Open Mind, *Exploring payday loans*, p. 27.

"It can result in financial hardship because if you don't have the money in the first place and they look at your wage and say you should be able to pay this back and you end up getting further behind."
[young partnered female, Geelong]⁶²

*"They are a trap. They give you a false sense of security because the money is not yours, it has to be paid back. It doesn't help you deal with reality, it just puts it off. It just adds to your debt and you can be facing bankruptcy."*⁶³

In an effort to generate more data on repeat borrowing, Consumer Action issued a 'Payday Lending Case Study Template' to Victorian financial counsellors in September 2009. Although the level of response was not high, the anecdotal evidence was strong. For instance, there was a clear indication high-cost short term lending has the capacity to fuel problem gambling - of the eleven case studies returned, five cited gambling as a reason for borrowing.

Further, in response to the question:

In your opinion, did your client have difficulty breaking a debt cycle created and/or exacerbated by payday loans?

All eleven returned case studies stated 'Yes'. Some counsellors provided additional information:

"Extreme difficulty too easy to obtain loan and can no longer pay the amount back even with extension."

"Yes. Interest rate so high she cannot break the cycle."

"Extreme difficulty - in fact it became impossible."

In response to the question:

Describe the duration of repeat borrowing exhibited by the client. (i.e. to your knowledge, how long had the client been repetitively borrowing from payday lenders)

⁶² Open Mind, *Exploring payday loans*, p. 27

⁶³ Open Mind, *Exploring payday loans*, p. 33.

Four of the responses stated 'Years' or 'Some years'. Of the others, 'six to twelve months' was the briefest period ranging up to two years.

One of the difficulties in obtaining accurate data on repeat borrowing is the perceived shame of the practice, potentially causing some borrowers to deny or under report their repeat borrowing.

This is particularly true in group focus discussions such as those conducted by Open Mind. The Open Mind report states:

*"Most people claim to have taken out such a loan between one and three times. Digging deeper, however, some reluctantly concede to far more borrowing occasions. It is difficult to be precise about actual numbers, but a figure of five to six borrowing occasions may be closer to the truth for many."*⁶⁴

The Open Mind report indicates a clear sense of shame or failure, common amongst borrowers:

"It made me feel like I wasn't smart enough, just stupid to get to that point."
[female, Geelong]⁶⁵

Further, it should be noted many borrowers exhibit a strong sense of ambivalence towards high-cost short term lending. Although they are uncomfortable with the practice and clearly resent the high charges, they nevertheless express some relief at the short term solution high-cost short term loans can provide:

"You are relieved. When you have paid what you need to pay, there is some relief and there is even bigger relief when you've paid off the loan. You use it as a tool to get through but it's very easy to become a habit."
[single mother]⁶⁶

⁶⁴ Open Mind, *Exploring payday loans*, p. 22.

⁶⁵ Open Mind, *Exploring payday loans*, p. 10.

⁶⁶ Open Mind, *Exploring payday loans*, p. 26.

"It takes the pressure off. You pay the bill."
[single mother, Geelong]⁶⁷

"It gets you out of a pinch short-term but it's too convenient. There's too many in Geelong."
[young partnered female]⁶⁸

Clearly, there is an urgent need to explore the extent of repeat borrowing in the Australian high-cost short term lending market and to generate accurate and reliable data on the proportion of borrowers who find themselves caught in a debt spiral.

Most available indications are that this proportion is significant and may be growing.

Certainly, the logic of high-cost short term lending would suggest for many borrowers a debt spiral is almost inevitable. It is difficult to conceive how an individual in financial distress can borrow at extremely high rates of interest

"Certainly, the logic of high-cost short term lending would suggest for many borrowers a debt spiral is almost inevitable. It is difficult to conceive how an individual in financial distress can borrow at extremely high rates of interest and by doing so, alleviate that distress, particularly when the loan must be repaid in such a short period of time - even when the loan amount is relatively small. This is particularly so when one considers the majority of borrowing occurs to fund recurrent basic living expenses."

and by doing so, alleviate that distress, particularly when the loan must be repaid in such a short period of time - even when the loan amount is relatively small. This is particularly so when one considers the majority of borrowing occurs to fund recurrent basic living expenses.

The likelihood such a dynamic will lead to repeat borrowing seems extremely high, unless there is a significant positive change in the borrower's income within a short timeframe.

⁶⁷ Open Mind, *Exploring payday loans*, p. 27.

⁶⁸ Open Mind, *Exploring payday loans*, p. 27.

For many consumers, high-cost short term lending may simply be seen as a regular and almost unavoidable expense. Such a culture certainly appears to have developed in the United States, which is discussed in further detail in Chapter 4.⁶⁹

As the Wilson report stated in 2002:

*"Most consumers hoped they would not be using payday loans indefinitely. Several were actively attempting to stop using them but hadn't done so yet. Unfortunately, without a major change in income, this can be very difficult as the loans are so easily obtained and become absorbed into week-to-week budgets."*⁷⁰

Perhaps the most convincing evidence for repeat borrowing comes from the industry itself. Cash Converters, Australia's largest high-cost short term lender (discussed in chapter 3), has stated:

*"The vast bulk of our lending business is conducted with repeat customers who are familiar with the product and use the credit facilities from time to time to meet short term needs."*⁷¹

"The vast bulk of our lending business is conducted with repeat customers who are familiar with the product and use the credit facilities from time to time to meet short term needs." - Cash Converters

⁶⁹ This is explained clearly by Daniel Brook, *Usury country: Welcome to the birthplace of payday lending*, Harpers magazine, April 2009, p. 3-4:

"Like a sharecropping contract, a payday loan essentially becomes a lien against your life, entitling the creditor to a share of your future earnings indefinitely. Even the industry- sponsored research cited on the Check Into Cash website shows that only 25.1 percent of customers use their loans as intended, paying each one off at the end of their next pay period for an entire year. Government studies show even lower rates of customer payoff. North Carolina regulators found 87 percent of borrowers roll over their loans; Indiana found approximately 77 percent of its payday loans were rollovers. This is hardly surprising, of course: if your finances are so busted that a doctor visit or car repair puts you in the red, chances are slim you'll be able to pay back an entire loan plus interest a few days after taking it out."

⁷⁰ Wilson, *Payday Lending in Victoria*, p. 75.

⁷¹ Cash Converters International, *Financial Report for the year ended 30 June 2007*, p. 3.

2.5.2 Use of other credit sources

The 2002 study found 40% of high-cost short term loan consumers had not used any other form of credit in the twelve months prior to the survey, presumably because no other form of credit was available to them.⁷²

The Wilson Report stated:

“60% of consumers had used other credit...38% of consumers had used only one other form of credit, while 20% had used two or more. Only 18% had used a credit card.”⁷³

On the basis of the 2008 survey, this has changed considerably since 2002.

All respondents to the 2008 survey indicated they had accessed at least one other form of credit. Unfortunately, the 2008 survey did not specifically ask borrowers to state if they had used two or more sources of alternative credit but the high overall result for alternative credit sources indicates it is likely that two or more other sources of credit is common.

It is also clear the type of alternative credit being accessed has shifted. Of those who had accessed other forms of credit in 2002, the Centrelink Advance payment was the most common type (20%) followed by credit cards (18%).⁷⁴

By 2008, credit cards were easily the most common form of other credit accessed (62.7%) followed by loans from family and friends (37.9%) - Centrelink Advance Payments were still very common (27.5%). This reflects the high proportion of low income earners among high-cost short term loan consumers.

Certainly, the results indicate more high-cost short term loan consumers bear significant existing debts, which is consistent with the general, well-documented growth of consumer debt over the period 2002-2008. High-cost short term lending is increasingly utilised by consumers who have exhausted other forms of credit, rather than those who could not qualify for credit in the first place.

⁷² Wilson, *Payday Lending in Victoria*, p. 67.

⁷³ Wilson, *Payday Lending in Victoria*, p. 67

⁷⁴ Wilson, *Payday Lending in Victoria*, p. 68

“High-cost short term lending is increasingly utilised by consumers who have exhausted other forms of credit, rather than those who could not qualify for credit in the first place.”

Nevertheless, the huge fall in the proportion of consumers who had not accessed any other form of credit in the 12 months prior to lending (from 40% to 0%) could be anomalous and may warrant further investigation.

The 2008 alternative credit results, particularly relating to credit cards, may reflect the increasing accessibility of consumer credit in the period 2002 to 2008. They may also indicate a widening of the high-cost short term lending market to encompass more of the lower middle class. It should be noted, however, that the 2008 proportion of consumers who had accessed a bank loan actually dropped slightly from the 2002 figure of 11%⁷⁵ to 9.4%.

Finally, the divergence in results may be more reflective of the alternative research methods adopted by the two studies, than any other factor.

A table comparing the 2002 results to 2008 is presented below:

Other Credit Used	2002	2008
None	40%	-
Credit Card(s)	18%	62.7%
Centrelink Advance Payment	20%	27.5%
Loans from family/friends	14%	37.9%
Pawnbroker	15%	13.4%

⁷⁵ Wilson, *Payday Lending in Victoria*, p. 68

Other Credit Used	2002	2008
Finance Company Loan	11%	10.5%
Bank Loan	11%	9.4%
Other		5.1%

Chapter 3 The Industry

3.1 Introduction

The high-cost short term loan industry in Australia is made up of many small lenders, the majority of which are private companies and are not required to publicly report financial data. This, in turn, makes it extremely difficult to accurately measure the size of the industry or assess its rate of growth.

This difficulty is exacerbated by the burgeoning online high-cost short term lending market, where new lenders have proliferated in recent years in a largely unmonitored environment.

Further, most states do not require lenders to be licensed, so there is no single register of high-cost loan providers and no simple way to keep track of emerging new lenders.

Thankfully, the *National Consumer Credit Protection Act 2009* (Cth) will soon alleviate some of these difficulties by implementing a national licensing regime for consumer credit providers, to be supported by a new National Credit Code commencing from 1 July 2010. The Australian Securities and Investments Commission (**ASIC**) will administer the licensing regime which will include a public register of licensed lenders.

In the meantime, attempts at measurement must be undertaken by examining leading indicators and extrapolating out to form a broader picture. Although imperfect, this method at least provides some sense of industry development and forms the basis of the following chapter which attempts to gauge the size and growth of the high-cost short term lending market in Australia over the period 2002-2008.

Primarily, the chapter draws inferences from the Consumer Action survey to examine apparent trends since 2002, particularly in relation to the number of lenders, the size of loans and the average length of repayment periods. Media and industry reports do provide some guidance concerning industry development although media reports often fail to distinguish between high-cost short term lending specifically and fringe lending generally, sometimes causing media sources to overstate the size of the high-cost short term lending industry.

Finally, the chapter draws on the financial records of Cash Converters Pty Ltd, a publicly listed company. On the basis of the Consumer Action survey, Cash Converters is the largest high-cost short term lender in Australia.⁷⁶

Some inference can be drawn by examining the financial records of the company and extrapolating outwards, although this clearly represents a crude method of measuring industry growth and provides only a rough indication of the industry's potential size. Again, it is noted that any attempt to gain a truly definitive grasp of the high-cost short term lending industry in Australia is clouded by the recent rise of the online industry which appears to be growing quickly. Both Cash Converters and the online industry are discussed more fully below.

On the above indicators, it appears clear high-cost short term lending occupies a prominent position in the Australian fringe lending market and has grown significantly since 2002.⁷⁷

Beyond assessing the scale of industry growth since 2002, the following chapter seeks to provide some explanation for that growth, by examining what have arguably been causal factors originating both from within the industry and from without.

Such factors include the marketing strategies of high-cost lenders (and the extent to which they may have led to a degree of supply driven demand), consumer behaviour and the general economic and cultural context of the period since 2002.

It is important to note the period covered was largely a period of strong economic growth during which the high-cost short term lending market grew substantially, despite being driven by the financial hardship of borrowers. As economic growth falters in the wake of more recent international economic events, it is possible an increase in financial hardship will lead to an even greater rise of high-cost short term loans.

⁷⁶ The Consumer Action survey found that 61% of borrowers had obtained their loan, or loans, from Cash Converters.

⁷⁷ The first Australian payday lender commenced operations in Queensland in December 1998. Dean Wilson, *Payday Lending in Victoria - A research report*, Consumer Law Centre Victoria, 2002, p.34.

The following chapter asks two key questions in order to frame the above issues:

- How has the high-cost short term lending industry developed in Australia since 2002, and;
- What factors have led to this development?

3.2 How has the high-cost short term lending industry developed in Australia since 2002?

3.2.1 Loan amounts and repayment periods

Although definitive figures are difficult to obtain, there are strong indications the average size of high-cost short term loans has increased substantially over the 2002 to 2008 period.

In 2002, the Wilson study found the average amount of all high-cost short term loans surveyed was \$258.60 and the median loan amount was \$200.⁷⁸ The Wilson study found 52% of high-cost short term loans were for less than \$250 and over 80% were for less than \$350.⁷⁹

At that stage, many Victorian providers did not extend loans over more than 28 days.⁸⁰ A large proportion of loans were taken out for four weeks (44%), with 24% being taken out for two weeks (the next most frequent loan period).⁸¹ Overall, 77% of loans were taken out for between two and four weeks and only 6% were taken out for a period exceeding four weeks.⁸²

As an indicator of industry trends, the Wilson study made price comparisons between different lenders for a \$200 loan taken over 14 days, as in 2002 this could reasonably be said to represent a ‘typical’ high-cost short term loan.⁸³

By contrast, the Consumer Action survey indicates fortnightly loan periods now account for only 20% of high-cost short term loans and \$200 would now be considered a small amount for such a loan.

⁷⁸ Wilson, *Payday Lending in Victoria*, p.64.

⁷⁹ Wilson, *Payday Lending in Victoria*, p.10.

⁸⁰ Wilson, *Payday Lending in Victoria*, p.11.

⁸¹ Wilson, *Payday Lending in Victoria*, p.64.

⁸² Wilson, *Payday Lending in Victoria*, p.64.

⁸³ Wilson, *Payday Lending in Victoria*, p.46.

The Consumer Action survey found the majority of loans were for amounts between \$200 and \$500 (35.7%) and the next most common bracket was for amounts between \$500 and \$1000 (26.1%). Loans between \$51 and \$200 now account for only 20.5% of the overall total. These figures are shown in table form below.

A comparison of loans between \$500 and \$2000 is also illustrative. In 2002 loans in this range accounted for just 6% of borrowings. In 2008 loans in this range accounted for 39.9% of borrowings.

In addition to an upward shift in loan amounts, the survey also found an extension in loan repayment periods.

Four weeks is still the most common repayment period although it now represents only 28.3% of loans - a significant drop from 44%. The two week period remains the second most common loan period and has dropped slightly, to represent 20.5% of loans, as opposed to 24%.⁸⁴

A major shift has occurred in loan periods of more than four weeks. A six week repayment period now applies to 9.6% of loans and eight weeks applies to 16.3%. Overall, 32.1% of high-cost short term loans are now taken out over a repayment period of between five to eight weeks – a marked difference from the 6% in the 2002 survey.

Reflecting the nature of the loans, the majority of repayment periods were for two week multiples which coincides with pay periods or Centrelink payment periods. Nevertheless, one week loans still made up a significant number of the loans (and as a proportion have not shifted since 2002, remaining at 14%).⁸⁵

These figures are represented in table form below, comparing data from the 2002 Wilson study to data collected in the 2008 Consumer Action survey.

⁸⁴ Wilson, *Payday Lending in Victoria*, p.64.

⁸⁵ Wilson, *Payday Lending in Victoria*, p.65.

Comparison: Size of Loans 2002 - 2008

2002	Proportion of Loans	2008	Proportion of Loans
\$1 - \$100	22% (16)	\$0 - \$50	3.8% (17)
2002	Proportion of Loans	2008	Proportion of Loans
\$101 - \$200	30% (21)	\$51 - \$200	20.5% (92)
(\$0 - \$200)	52% (37)	(\$0 - \$200)	24.3% (109)
\$201 - \$300	28% (20)	\$200 - \$500	35.7% (160)
\$301 - \$400	10% (7)		
\$401 - \$500	4% (3)		
(\$200 - \$500)	42% (30)	(\$200 - \$500)	35.7% (160)
\$501 +	6% (4)	\$500 - \$1000	26.1% (117)
		\$1000 - \$2000	13.8% (62)
(\$500 - \$2000)	6%(4)	\$500 - \$2000	39.9% (179)
Total	100% (71)	Total	100% (448)

Comparison: Loan Repayment Periods 2002 - 2008

2002	Proportion of Loans	2008	Proportion of Loans
Less than 7 days	3% (2)	-	-
1 week	14% (10)	1 week	14.1% (63)
2 weeks	24% (17)	2 weeks	20.5% (92)
0 - 2 weeks	41% (29)	0 - 2 weeks	34.6% (155)
3 weeks	9% (6)	3 weeks	4.9% (22)
2002	Proportion of Loans	2008	Proportion of Loans
4 weeks	44% (31)	4 weeks	28.3% (127)
3-4 weeks	53% (37)	3-4 weeks	33.2% (149)
-	-	5 weeks	4.2% (19)
-	-	6 weeks	9.6% (43)
-	-	7 weeks	2% (9)
8 weeks	6% (4)	8 weeks	16.3% (73)
5-8 weeks	6% (4)	5-8 weeks	32.1% (144)
Total	100% (70)	Total	100% (448)

Although industry growth would appear to be driven by an increasing consumer base, these figures do suggest increasing loan amounts may also be a contributing factor. This in turn may lead to longer repayment periods to facilitate the repayment of higher amounts by consumers.

The significance of this trend relates to the fee structure typically applied to high-cost short term loans. Lenders generally link a sliding scale of increasing fees to the amount being lent – often expressed as a charge per \$100, or proportion thereof.

Loan fees therefore operate essentially as an interest rate charge – and lenders are able to achieve a broadly consistent rate by using a sliding fee scale. The impact of this system, as with any interest rate lending system, is to

provide incentive to make larger loans. The more the consumer borrows, the more they pay and the greater the lender's profit.

This dynamic has particular implications for high-cost short term loans. As outlined in the previous chapter, high-cost short term loans are generally taken by consumers in order to meet recurrent basic living expenses. The obvious risk is that the loan itself creates a need to borrow again. This risk is exacerbated by increasing loan amounts, which represent a greater proportion of a borrower's income – and are therefore more difficult to repay.

3.2.2 Size of the industry

In 2002, the Wilson study estimated the national volume of high-cost short term loans had grown from the reasonably small number of 2000 a month in the year 2000 to 12,800 a month by 2002, representing a 640% increase in just two years and an annual total of 153,600 loans.⁸⁶

It should be noted this measure was reasonably crude and probably only gives a rough estimate of the true figure, as it appears to have taken the Victorian figure of 800 loans per week and extrapolated out, applying the same figure across different states.

The Wilson study further stated that industry estimates in early 2001 suggested the size of the Australian high-cost short term loans market was \$200 million a year, serving a national customer base of between 100,000 and 150,000 people.⁸⁷ A Queensland Office of Fair Trading report, written in 2000, anticipated rapid industry growth and predicted the number of high-cost short term lending outlets in Australia (then 82) may grow by up to ten times that amount by 2005.⁸⁸

As previously noted, it is difficult to determine the true extent of industry growth since 2002, although leading indicators and industry and media reports tend to suggest it has been rapid and largely in line with the Queensland Office of Fair Trading estimate.

⁸⁶ Wilson, *Payday Lending in Victoria*, p.34.

⁸⁷ Wilson, *Payday Lending in Victoria*, p.34.

⁸⁸ Queensland Office of Fair Trading, *Payday Lending - A Report to the Minister of Fair Trading*, 2000. p. 5.

In an ABC TV *Lateline* report broadcast on 16 June 2008, Mr Nick Auchincloss, CEO of leading online high-cost short term lending company *Cash Doctors.com.au*, stated:

*"...assumptions were that there was about 800 stores in 2006."*⁸⁹

This quote was given in the context of a story which stated the "payday" loans industry in Australia was approaching the:

*"...billion dollar-a-year mark, with as many as half a million borrowers..."*⁹⁰

These figures are difficult to verify and may well overstate the size of industry by expanding the category of high-cost short term loans to encompass the broader fringe lending industry.⁹¹

As previously noted, for the purposes of the Consumer Action survey, a high-cost short term loan was defined as a loan of no more than \$2,000 (usually much less), with a repayment period of no more than eight weeks.

This excludes other high-cost small to medium size loans, which are typically for amounts between \$1,000 and \$5,000, with short to medium term repayment periods of no less than 12 months and up to 24 months.

It is possible the figures quoted in the *Lateline* programme conflate the two types of products but this does not mean high-cost short term loans have not grown substantially in their own right.

One measure of such growth is the number of lenders in the market. In 2002, the Wilson study found there were eight high-cost short term loan businesses

⁸⁹ Conor Duffy, *Pay day loans on the rise*, ABC Lateline, 16 June 2008, <http://www.abc.net.au/lateline/content/2007/s2276421.htm> (23 May 2010).

⁹⁰ Conor Duffy, *Pay day loans on the rise*, ABC Lateline, 16 June 2008, <http://www.abc.net.au/lateline/content/2007/s2276421.htm> (23 May 2010) quoting Conor Duffy.

⁹¹ As a side-note, a Sunday Herald Sun report published on 30 November 2008, "*Fringe lenders prey on desperate*", stated that "*...an estimated 15,000 Victorians have sought pay-day loans in the past year...*", which equates to 1,250 customers per week – which, based on available industry figures, is likely to be an underestimate. The same article stated that "*Pay-day*" *lending has risen to more than a \$20 million a year because of the economic downturn.*", again understating the size of the industry

operating in Victoria, two of which had five stores each, with the others being sole shopfronts. Overall, this represented sixteen storefronts.⁹²

An outline of the Victorian industry in 2002 is set out below:

Lender	Number of stores	Location(s)
Australian Money Exchange (AMX)	1	Brunswick
Blue Star Capital	1	Moonee Ponds
Cash Stop Financial Services	5	Geelong, Dandenong, Springvale, Sunshine, Werribee
Lender	Number of stores	Location(s)
Cash Loans*Cheques Cashed*	1	Collingwood
ChequEXchange Frankston	1	Frankston
Money Centre Croydon	1	Croydon
Money Plus	5	Geelong, Dandenong, Glenroy, Greensborough, Northcote
The Money Tree	1	Huntingdale

In 2008, the Consumer Action survey identified 28 different high-cost short term loan providers. Whilst this was admittedly a nation-wide survey it does seem to indicate lenders have proliferated since 2002.

A 'rule of thumb' comparison may be gained from a simple Yellow Pages search for lenders in Victoria in 2010. At the time of writing, an online search of the Yellow Pages Australia website for *Finance - Short Term Loans, Victoria* returns 28 results naming 17 different lenders.⁹³

⁹² Wilson, *Payday Lending in Victoria*, p.41.

⁹³ Search conducted on 17 August 2010 from www.yellowpages.com.au.

It is worth noting this may constitute an underestimate of the industry in Victoria and is by no means a comprehensive search. For example, the search identifies only one Cash Converters store (Geelong), whereas Cash Converters' own website lists 33 Victorian store-fronts, all of which offer personal finance.

Strikingly, Cash Converters is only given an oblique mention by the 2002 Wilson study. Cash Converters is described as a lender that trialled a payday loan product in several stores in 2001 but had since 'withdrawn from the market'.⁹⁴

Given the paucity of general industry data, Cash Converters' publicly available financial records offer some reliable insight into the scale of the industry.

In their annual report for 2008, Cash Converters reported serving 239,774 customers through the provision of approximately 476,103 high-cost short term loans.⁹⁵ Given industry estimates in 2001 cited a possible nationwide total of 150,000 loans to 100,000 customers, the Cash Converters figures are stunning – coming as they do from just one participant in the market, albeit the dominant one. The commissions earned by Cash Converters on high-cost short term loans were reported as \$9,014,306, generated from a principal loaned of \$133,785,001.⁹⁶

The following year, 2009, Cash Converters saw a decline in loan volume and principal loaned out in cash advances for the first time since at least 2003. Principal loaned fell to \$124,546,527 and loan numbers to about 411,044, made to 231,262 customers.⁹⁷ Most significantly for the company, commissions on cash advances dropped from \$9,014,306 to \$6,916,040.⁹⁸ In their annual report, Cash Converters stated:

⁹⁴ Wilson, *Payday Lending in Victoria*, p.43.

⁹⁵ These figures are extrapolated from a reported 18.7% increase in customer number from the 2007 figure of 202,000 and by dividing the average loan amount given (\$281) by the principal loaned out (\$133,785,001 - itself an extrapolated figure, based on a reported 7.4% increase in principal loaned from the previous year).

⁹⁶ Cash Converters International Limited, *2008 Annual Report*, p. 20. (The principal loaned figure is calculated based on a reported 7.4% increase on principal loaned from the previous year, whilst the profit figure is directly reported).

⁹⁷ Loan numbers figure is based on a division of principal loaned, by the reported average loan amount of \$303.

⁹⁸ Cash Converters International Limited, *2009 Annual Report*, p.18.

*"The main shortfall was the result of a new fee scale offered to the franchise network to encourage them to increase the volume of their cash advance business."*⁹⁹

The report does not mention whether a comprehensive interest rate cap, introduced in Queensland in July 2008, may also have had an impact on results - but it is likely it did. This is discussed further in Chapter 5.

Given the Consumer Action survey reported 61% of respondents had obtained their loan or loans from Cash Converters, Cash Converters' financial data provides some basis on which to estimate the overall size of the industry.

If applied to the data reported above, Cash Converters' apparent market share would suggest the total principal loaned for high-cost short term loans in Australia currently sits at around \$204 million, lent to about 379,000 customers through the course of approximately 674,000 loans a year. Although the measure is crude, the figures are significantly less than some media estimates (yet more than others) and are likely to provide at least a rough indication of the industry's true size.

If such estimates are correct, the speed of development of high-cost short term lending in Australia has been remarkable. At the very least, high-cost short term lending has grown from a single store in Queensland in December 1998¹⁰⁰ to 82 nationwide by 2001¹⁰¹ and again to approximately 800 by 2008 – note this is probably a conservative estimate. In addition, a booming online market has emerged.

"Australia's largest high-cost short term lending company alone serves almost a quarter of a million customers every year and provides almost half a million loans. Collectively, the industry is likely to be approaching half a million customers and nearing three quarters of a million loans a year. In a nation of only 22 million people, these are significant figures."

⁹⁹ Cash Converters International Limited, 2009 Annual Report, p.18.

¹⁰⁰ Wilson, *Payday Lending in Victoria*, p.34.

¹⁰¹ Queensland Office of Fair Trading, *Payday Lending - A Report to the Minister of Fair Trading*, 2000. p. 5.

Australia's largest high-cost short term lending company alone serves almost a quarter of a million customers every year and provides almost half a million loans. Collectively, the industry is likely to be approaching half a million customers and nearing three quarters of a million loans a year. In a nation of only 22 million people, these are significant figures. Some attempt should be made to identify the factors that have contributed to such explosive growth and forecast how that growth may continue.

Before doing so, it is worth examining the growth of both the online industry and of Cash Converters, to understand how the industry has developed to this stage.

3.2.3 The development of the online industry

The 2002 Wilson study makes no mention of an Australian online high-cost short term lending industry, except for a brief reference to a single Victorian based online lender that had, by the time of the report, '...ceased trading'.¹⁰²

A simple internet search shows Australia now has a strong online lending industry, with more than twenty providers offering an exclusively net based lending service. It does appear that some websites are alternative 'virtual store-fronts' which actually relate to the same traditional retail entity. In addition, at the time of writing, two 'brokering' services are currently operating and appear to act to direct traffic to high-cost short term lenders, presumably in return for a fee from the lender.¹⁰³

As with shopfront based lenders, the private company status of online lenders makes it difficult to assess the scale of the industry but the rapid rise of the industry and rate of new entries would indicate it is growing strongly.

The Consumer Action survey indicates only 4% of the current Australian high-cost short term lending industry is conducted online which, based on the estimates above, would make it a relatively small industry – worth somewhere in the vicinity of \$8 or \$9 million per annum. It should be noted, however, that this is a very rough estimate and is difficult to verify.

¹⁰² Wilson, *Payday Lending in Victoria*, p.43.

¹⁰³ Payday Finder: <http://www.paydayfinder.com.au/> Cash Advance Finder <http://www.cashadvancefinders.com/> (23 May 2010)

One of the difficulties of measuring the online industry is that increased loan volumes are not detectable by the emergence of new store-fronts. A single high-cost short term lending website may be processing an exponentially increasing number of loans, but there is no way to detect the increase. Certainly, industry sources are bullish on the future of online payday lending.

In the June 2008 *Lateline* programme referred to above, Mr Nick Auchincloss, CEO of online payday lender *CashDoctors.com.au*, stated his business had:

*"...actually seen an increase in turnover of over 200 percent in just the last six months."*¹⁰⁴

It is likely part of the appeal of online payday lending lies in the anonymous nature of the transaction. As discussed in chapter 2, Open Mind qualitative data strongly suggests borrowing from a payday lender continues to carry a social stigma, which may act to deter some customers.¹⁰⁵ The appeal of online pay day lending may therefore lie in the 'invisible' nature of the transaction.

"The lack of a credit check is frequently cited as a major advantage, as is the lack of administrative process and the small amount of documentation required."

A perusal of the listed websites reveals common marketing strategies emphasising the speed, ease and convenience of obtaining a payday loan.

The lack of a credit check is frequently cited as a major advantage, as is the lack of administrative process and the small amount of documentation required.

To give a sense of the style of the sites and the marketing approach generally adopted, text from *CashDoctors.com.au* (<http://www.CashDoctors.com.au/>) is reproduced below.

¹⁰⁴ Conor Duffy, *Pay day loans on the rise*, ABC Lateline, 16 June 2008. <http://www.abc.net.au/lateline/content/2007/s2276421.htm> (23 May 2010)

¹⁰⁵ Open Mind Research Group, *Exploring pay day loans*, 2008. For example, see p.26: "I felt subhuman, I think it's the best word to describe it." [female, north-west suburbs, Melbourne]

Need cash? Apply online 24 hours a day, anywhere in Australia

Don't worry. Get up to \$600 in your hands within 60 minutes.

We understand you need cash fast. We're dedicated to getting you up to \$600 within 60 minutes.

We realise you don't like paperwork. Our application is all online and only takes 5 minutes.

We know you're concerned about costs. Our fees are clear so there are no surprises.

NEW! Your first cash advance costs you just \$2. Try us today.¹⁰⁶

Further perusal of the website (the 'how it works' section) sets out the process, claiming an application can be completed within 5 minutes and all necessary checks can be conducted within an hour at which time the requested loan can be deposited directly into the borrower's bank account.

The speed and ease of the process is consistently emphasised throughout the instructions, with particular emphasis on the ease of any subsequent borrowing:

"The payroll call only happens when you first join.¹⁰⁷ After that, your applications are processed and paid in seconds automatically 24/7.

First time clients are paid during business hours, but once you're a member it's 24/7 within 5 seconds of a 1 minute application."

Cash Doctors manage loan repayments by setting up an automatic direct debit payment from the borrower's bank account, scheduled for their next income period. This method is commonly used by high-cost short term lenders and is generally marketed as a convenience measure. Cash Doctors states:

"Even repayment is hassle free - coming out of your bank account automatically on your next payday."

¹⁰⁶ www.CashDoctors.com.au (4 August 2010).

¹⁰⁷ The "payroll call" describes the process whereby the lender contacts the borrower's employer to ensure that they do in fact work where they claim to and are on the payroll.

The Open Mind survey identified speed and ease of application as a significant factor in borrowers' decisions to use payday loans:

"It gets you out of a pinch short-term but it's too convenient. There's too many in Geelong."

(young partnered female)¹⁰⁸

"You give your banking details and driver's licence, no other security."

(young partnered female)¹⁰⁹

"Even repayment is hassle free – coming out of your bank account automatically on your next payday." – Cash Doctors

Of the sites examined, none mention loan cost on the company home-page and only four provide a schedule or calculator of costs anywhere on their website.¹¹⁰

In the case of *Cashpal*, the customer is required to request a loan before they are given an indication of cost. In the case of *Cash Doctors* and *Payday Online*, the customer is required to complete a full application, listing all contact and banking details, before the cost of their requested loan is disclosed.

Advancecash and *Paydaymate.com.au* take this process even further and require the customer to have contact with a company representative, either by telephone or over a web-based 'chat room' before they disclose any fees.

Requiring the customer to invest time and effort in applying to purchase a product before disclosing its cost may render them less likely to reject the sale. In the case of high-cost short term loans, the tactic may have added potency as the applicant is likely to urgently require the requested funds and may therefore be willing to complete the transaction, even in the face of excessive cost. This is particularly so if all that is required in order to accept the offer is a click of the mouse. As an additional psychological trigger, marketing is often couched in terms of congratulating the customer that their application has

¹⁰⁸ Open Mind Research Group, *Exploring pay day loans*, 2008, p.27.

¹⁰⁹ Open Mind Research Group, *Exploring pay day loans*, 2008, p.25.

¹¹⁰ Refer to Appendix E: The Online High-cost short term lending industry (Table).

been accepted and all they need to do to claim 'their' funds is take one or two simple steps.

Although distinguishable, this sales approach is reminiscent of the well established banking practice of mailing out unsolicited credit card limit increase offers to credit card holders, advising consumers they have been pre-approved for a higher credit card limit. Typically, the consumers need only take one simple step in order to 'claim' their extra credit.

In a study commissioned by Consumer Action in 2008, marketing psychologist Dr Paul Harrison described unsolicited credit card limit increase offers as having an 'endowing action', whereby the customer is invited to feel the product being offered is property they already own, waiting to be claimed.¹¹¹ The psychological effect of presenting a sales offer in this manner has the effect of framing a rejection of the offer the offer as a potential loss (i.e. you may end up losing something that is rightfully yours), which in turn plays to the well established bias for individuals to be loss averse. Studies have shown individuals generally put more effort into preventing a loss than winning a gain.¹¹² This has implications for the manner in which online payday loans are marketed beyond the consumer's initial application.

If an online loan consumer completes the application form enough to ascertain the cost of the loan but then declines to purchase the credit, they are likely to receive significant 'follow-up' sales pressure. Within five hours of lodging an application with *Cash Doctors* but then failing to accept the offer, the author received two e-mails and a mobile phone text message inviting him to complete the sale.

Paydaymate.com.au took a similar approach. After engaging with a representative over the online 'chat' system to ascertain loan cost and then declining the loan terms, the author received two e-mails from *customercare@paydaymate.com.au* within the space of ten minutes, congratulating the author on having his application accepted and requesting he contact the company as soon as possible to 'avoid any further delay'. The online 'chat room' style of application gives the impression of being designed primarily for a younger demographic.

¹¹¹ Dr Paul Harrison, *Congratulations, you're pre-approved! An analysis of credit limit upselling letters*, Consumer Action Law Centre, 2008, p. 30 -31.

¹¹² Emma Dawnay, Hetan Shah, *Behavioural Economics: Seven Principles for Policy Makers*, New Economics Foundation, 2005, p 9 -10.

Indeed, much of the online payday lending industry appears to market its product at a reasonably young demographic. Certainly, the 'happy borrowers' depicted on various websites appear to be predominantly in their 20s. Cash Doctors' personal emails to the author requesting completion of the loan application come with a brief post-script, stating:

"Cash Doctors is owned and operated by people just like you. We're all professionals in our 20's and 30's. We know what it is like to need a quick cash injection..."

Read the Cash Doctors Story.

<http://www.Cashdoctors.com.au/story>"

Indeed, Cashdoctors.com.au and its affiliated companies, Paydayonline.com.au and Paydaycashloan.com.au are particularly persistent in following up loan enquiries. In the case of Paydayonline.com.au, the author received four e-mails in four days following his application.

In the case of the first three e-mails the text (which appeared to be an automated, pro-forma communication) stated in part:

"I noticed that you didn't complete your application with us.

Was there anything specific that concerned you that I can help you with?

I've included some of our FAQ's below that answers some of the most common questions I get. Those might help you in the mean time.

Worried about getting approved because of something on your credit file?

We only reject people with very bad credit ratings. So if it's just a bill don't worry about it."

In applying for a high-cost short term loan with Cash Doctors (or an affiliated company), the consumer is required only to provide the barest of financial details (the amount they receive in salary, their pay cycle and their regular rental or mortgage payment). On the strength of this data, Cash Doctors makes a decision to approve the loan. The resulting contract includes the term:

“This is a continuing contract. Total amount of credit available [in a twelve month period]: \$8,100.00. This is the total amount of credit you can access from ICR Finance Pty Ltd in a one year period.”

In addition, the contract includes late charges – no mention of which is made on the website:

“Cash Doctors Card Fees: The card provider may charge fees for individual transactions. (A full list of these will be provided when you receive your card)

Late Fee (for all payments more than 3 working days late): \$50.00

Additional Late Charges: \$6.00 per day overdue

Any Legal Costs Reasonably Incurred

Direct Debit Fee: See section 12 (sic) (Direct Debit Authority)”

Section 13 - Direct Debit Authority – states:

“For new clients a direct debit charge of \$1.54 applies when your first advance is direct debited. On subsequent advances a direct debit charge of \$0.77 applies.”

A high-cost short term loan with Cash Doctors or its affiliated companies, therefore, effectively creates a contract for a line of credit to the value of \$8,100.00 over a twelve month period - for which only the barest of income verification is required.

Certainly the ‘checks’ cannot reasonably be described as thorough credit checks.

Cash Doctors charges 677.8% APR for its payday loans, assuming the repayment period is 14 days. Over a 30 day repayment period, this reduces to 316%. This charge is based on a quoted fee of \$65 for a \$250 Cash Doctors loan, calculated as an APR as set out in the terminology section in chapter 1. The company itself lists the APR figure for its loans as 44.90%, which must be based on interest rate alone (excluding fees and charges).

A further e-mail, titled *You can Still Finish What You Started*, was sent the Tuesday following a Friday 'application'.

The text is reproduced in full below:

"Hi Zachary,

Greg here again. I hope you're getting my emails ok.

*****As I mentioned in my last email, if you have any questions or concerns feel free to contact me.*****

You've started and you're pretty close to having the extra cash you need.

As soon as you submit your application form, I can process it and pay you pretty fast.

We're doing hundreds today, so hopefully I can process yours soon. Better keep moving!

Cheers

Greg Ellis

Provider of Instant Cash Relief

<http://www.cashdoctors.com.au/home/>

Cash Doctors is owned and operated by people just like you. We're all professionals in our 20s and 30s. We know what it's like to need a quick cash injection ...Read the Cash Doctors Story>

<http://www.cashdoctors.com.au/story/>

Extra Info You Might Want To Know

Published By:

CASH DOCTORS .COM.AU

Suite 203, 40 Nerang St

Southport
QLD 4215
Australia

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<http://getresponse.com/>

The assertions that *"We're doing hundreds today, so hopefully I can process yours soon"* and *"Cash Doctors is owned and operated by people just like you"* seem designed to normalise the applicant's view of high-cost short term lending.

Psychologically, the idea that others just like the applicant are doing it helps to ameliorate any concerns the applicant may have about taking on debt. Beyond that, the communication is couched in friendly and personal terms, attempting to create the notion a relationship of sorts exists between the lender and the borrower:

*"Greg here again. I hope you're getting my emails ok.,
...hopefully I can process yours soon. Better keep moving!"* and
"Cheers."

This 'relationship' is further 'developed' by the next e-mail in what appears to be an automated sequence, this time entitled *Why you'll thank Cash Doctors in 10 years*.

The first of such e-mails was sent over a week after the initial 'application' was lodged (yet never completed). The content of the e-mail is reproduced below:

"Hi Zachary,

*Greg Ellis here. I know what it's like to need extra cash.
When I was fresh out of uni, I blew every penny I earned. I
was 'king for a day –and fool for a fortnight.'*

*Gradually I learned - but it took a lot of rough fortnights
living on rice and soy sauce.*

*After all I did have two business degrees and worked as a
financial advisor – helping people with their money –*

so I ought to know.

But years later, I had another spell of tight times...

In 2005 we started Cash Doctors and put every cent into it - and struggled BIG TIME - For over a year, we had to mow lawns part time until Cash Doctors started working out.

Now everything we do is built around those raw experiences.

That's why we're so different...

Today Cash Doctors is Australia's most respected short term lender - but we're not just some massive company that's lost touch with the real world. We're young, ordinary people. We know what it's like and haven't forgotten what it feels like to need extra money fast.

But it's about more than just fast little online loans...

Cash Doctors helps you have money and freedom both now - and in the long run. That's why you get free financial advice.

When you get emails from me, I won't be selling you payday loans. Consider me a friend with an interest in finance. You can ask me questions specific to your situation anytime.

I've made mistakes before but I've learnt from them – and so can you.

If you want to know more about me and Cash Doctors watch this 3 minute video:

<http://www.cashdoctors.com.au/cash-doctors-story-minidoc/>

I hope you're ready to learn something useful. Bye for now.

Greg Ellis

Provider of Instant Cash Relief

<http://www.cashdoctors.com.au/home/>

Cash Doctors is owned and operated by people just like you. We're all professionals in our 20s and 30s. We know what it's like to need a quick cash injection ...Read the Cash Doctors Story>

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To unsubscribe or to change your contact details, visit:

<http://getresponse.com>"

Again, a familiar tone is adopted throughout the e-mail (*"Consider me a friend with an interest in finance"*) and the writer works hard to communicate the message 'we've all been there, don't worry' (*"Gradually I learned - but it took a lot of rough fortnights living on rice and soy sauce"*). Notably, the e-mail purports to establish Cash Doctors as a source of 'financial advice'. The conflict of interest in a high-cost short term money lender presenting itself as a 'financial advisor' to customers is obvious and need not be elaborated on here.

A table showing a selection of online high-cost short term lenders operating in the Australian market is included at the back of this report as *Appendix E*. The table shows ASIC registration dates and key loan terms for each provider.

Finally, it should be noted that although the focus of this section of the report has been online payday lending, a new market in 'SMS' based payday loans may be emerging.

In March 2009, the Consumer Action Law Centre was made aware of advertising material that had been distributed in a low-cost housing estate in inner-city Melbourne. The company distributing the material, Your Credit Pty. Ltd, made the following offer:

"Once you have registered you can request \$10 - \$25 - \$50 credit to be paid into your bank. Limit of 1 loan at a time per customer.

It is Fast and Easy

Just SMS, or leave a voice message, anytime or you can talk to one of our friendly staff

Simply tell us your

- 1) Centrelink Customer Reference Number*
- 2) Your password*
- 3) How much you would like to borrow*

Your loan repayment will be withdrawn from your bank account by Direct Debit on your next Centrelink pay day.

A schedule of fees and charges states the following:

*\$10.00 Loan + \$4.00 application fee, + .40c GST = \$14.40 repayment
\$25.00 Loan + \$7.50 application fee + .75c GST = \$33.25 repayment
\$50.00 Loan + \$11.00 application fee + \$1.10c GST = \$62.10 repayment."*

For the loans above, the application fee is equivalent to an interest charge of 1042%, 782% and 573% APR respectively - plus GST (all calculated over a 14 day period).

Although the loan limits offered by Your Credit Pty. Ltd. are very small, the fact they are targeted specifically at Centrelink recipients and can be accessed by SMS may signify a new trend in high-cost lending to low-income borrowers.

3.2.4 The development of high-cost short term lending - Cash Converters

Despite the growth of the online high-cost short term lending industry, the Consumer Action survey figures suggest the industry remains dominated by traditional “store-front” lenders and Cash Converters is clearly the leading business in the market.

As mentioned earlier, Consumer Action found approximately 61% of all respondents had obtained their loan or loans through Cash Converters. Cash Converters has become so dominant that for some participants in the Open Mind research project the company name is synonymous with the general high-cost short term lending industry – the name Cash Converters is

used to describe a high-cost short term loan, much as some people describe vacuum cleaning as ‘Hoovering’.

“...the name Cash Converters is used to describe a high-cost short term loan...as some people describe vacuum cleaning as ‘Hoovering’.”

“Cash Converters’ rise to prominence has been swift and is worth charting as an indicator of the speed of growth of high-cost short term lending in Australia.”

Cash Converters’ rise to prominence has been swift and is worth charting as an indicator of the speed of growth of high-cost short term lending in Australia.

Cash Converters entered the high-cost short term lending market in August 1999 in conjunction with a small Perth based company called Mon-E Pty Ltd (**MON-E**) which provided the operating

and software support to the Cash Converters franchise network to make the loans (Cash Converters acquired MON-E in the second half of 2006).¹¹³

Under this system, franchisees received the greatest revenue from high-cost short term lending and carried the risk (of any loan defaults) while paying Cash Converters a commission for each cash advance. MON-E also received a commission of 20% of the standard fee collected from loan customers, which was equal to about 7% of ‘every dollar collected’. Further, MON-E paid

¹¹³ Cash Converters International, *Annual Report 2006*, p. 11.

royalties to Cash Converters for the right to use Cash Converters' intellectual property.¹¹⁴

The business seems to have taken a few years to develop. By the 2003 financial year however, Cash Converters were reporting they had made \$399,775 in commissions on high-cost short term loans (described as 'cash advances' and formerly known as payday loans).¹¹⁵ The figure was generated from loaning out a principal of \$11,601,407 over 58,077 loans, which equates to an average loan amount of \$199.76.¹¹⁶ Based on fees of \$35 per \$100 lent, this represents fee income of at least \$4,060,492.

The following financial year, Cash Converters reported a 99.8% increase in commissions from their cash advance business, up to \$798,808.¹¹⁷ This was made on the basis of \$29,458,924 loaned out in principal over 137,737 loans (itself a 137% increase on the previous year). The average loan amount was \$213.88. At that stage fifty-eight Cash Converters stores were offering payday loans or cash advances, eleven of which were located in Victoria.¹¹⁸

The year after that, 2005, Cash Converters reported a further 119.8% increase in cash advance commissions to \$1,755,754, boosting their principal loaned to \$63,496,993 over 280,908 loans at an average of \$226.¹¹⁹ Cash Converters reported the number of customers accessing their high-cost short term loan product in 2005 in the following year's annual report – the figure reported was 92,927.¹²⁰ This equates to an average of 3.02 loans per customer.

In October 2005, Cash Converters wrote to the ACCC notifying them of proposed exclusive dealing conduct that would, save for the notification, contravene provisions of the *Trade Practices Act 1974*, specifically subsection 47(6) and 47(7), which relate to third line forcing.

In their letter, Cash Converters described the proposed conduct as follows:

¹¹⁴ Cash Converters International, *Annual Report 2006*, p. 11; Cash Converters Pty Ltd, *Annexure A to Form G: Exclusive Dealing Notification – Third Line Forcing*, 6 October 2005, p. 1, 3.

¹¹⁵ Cash Converters International, *Annual Report 2004*, p. 2-3.

¹¹⁶ This figure refers to the revenue made by Cash Converters out of commissions. Given that Cash Converters outlets charge \$35 for every \$100 loaned, a 35% calculation on the principal loaned should reflect closer to gross loan revenue, much of which flowed to franchisees – that figure is \$4,060,492.40 – much more than the \$399,775 quoted above.

¹¹⁷ Cash Converters International, *Annual Report 2004*, p. 3.

¹¹⁸ Cash Converters International, *Annual Report 2004*, p. 3.

¹¹⁹ Cash Converters International, *Annual Report 2005*, p. 4.

¹²⁰ Cash Converters International, *Annual Report 2006*, p. 3.

“CCPL wishes to require the following with respect to franchise offerings outside of South Australia and the Northern Territory:

- (a) that all existing franchisees who wish to offer cash advances, must use the Mon-e system;*
- (b) that all new franchisees who join the Cash Converters system must offer cash advances and must use the Mon-e system and may be required by CCPL to offer Western Union agency services and Safrock personal loans;*
- (c) that all existing franchisees who wish to offer cash advances may be required by CCPL to also offer Western Union agency services and Safrock personal loans.”¹²¹*

The notification was opposed by the Consumer Law Centre Victoria, Ltd., the Australian Financial Counselling & Credit Reform Association Inc., the Consumer Credit Legal Centre (NSW) Inc. and the Tasmanian Office of Consumer Affairs and Fair Trading. Despite the objections, the ACCC decided to take no action in relation to the notification, which provided legal immunity for the requested practices from 20 October 2005.

The following financial year Cash Converters recorded yet another large increase in cash advance commissions, up to \$3,213,266 – an 83% increase on the previous year. This was generated by 439,913 loans at an average of \$234 each, made to 154,458 customers.¹²² The loan to customer ratio was 2.85. Given Cash Converters charges a flat rate of \$35 per \$100 borrowed and the average loan amount was \$234, this means on even the roughest of measures, the hypothetical ‘average’ customer paid \$233.42 in fees or interest to Cash Converters over the course of the year.

On 13 October 2006 Cash Converters acquired MON-E and thus became the owner of the system used to sell high-cost short term loans through Cash Converters franchisees and corporate stores. For Cash Converters company stores, profits made by high-cost short term lending were now entirely captured by the company. For franchise stores, Cash Converters now received two types of commission revenue for cash advances.

¹²¹ Cash Converters Pty Ltd, *Annexure A to Form G: Exclusive Dealing Notification – Third Line Forcing*, 6 October 2005, p. 6.

¹²² Cash Converters International, *Annual Report 2006*, p. 3.

As would be expected, the acquisition of MON-E had a significant impact on Cash Converters' high-cost short term loan profits. In its half-yearly results to 31 December 2006, Cash Converters compared Cash Advance commissions of \$3,499,091 against \$1,467,482 for the corresponding period in the previous year and noted this 138% increase was due to both the growth of the business and the acquisition of MON-E.¹²³

Cash Converters' high-cost short term loan customer base increased over the 2006-2007 period to break the 200,000 mark for the first time, up to 202,325. Nearly \$124.6 million was loaned and the average loan amount rose 9.4% (or \$22) to reach \$256.¹²⁴ This means the hypothetical average customer, taking out approximately 2.4 loans at \$256 each over the year, would pay \$215.04 in fees or interest to Cash Converters.

The 2007-2008 financial year was the first year since 2003 that Cash Converters had recorded anything less than an 80% increase in its payday lending business.

Over the 2007-2008 period, Cash Converters experienced 'modest' growth of 12.7% making \$9,014,306 in commissions on payday loans. Despite the lower growth, the customer base over the same period grew 18.7% and there was a healthy 9.7% (or \$25) increase in the average value of a loan (up to \$281).¹²⁵

The latest full year results are for 2008-2009. Cash Converters reported the total principal loaned decreased by 0.2% to \$124,546,527 but that total customer numbers increased by 11.9% to 231,262.¹²⁶

Most strikingly, the average loan amount had increased to \$303 - the first time it has exceeded \$300. Cash Converters state this represents an increase of

"In summary, by 2008-2009 the Cash converters chain was lending out principal of \$124,546,527 through its high-cost short term loan business.

In 2002-2003 this figure had been \$11,601,407."

¹²³ Cash Converters International, *Financial Report for the half-year ended 31 December 2006*, p. 2.

¹²⁴ Cash Converters International, *Annual Report 2007*, p. 4.

¹²⁵ Cash Converters International, *Annual Report 2008*, p. 4.

¹²⁶ Cash Converters International, *2009 Annual Report*, p. 4.

14.2% from the 2007-2008 average of \$286 (although their 2008 report stated this amount was \$281). \$303 represents a 52% increase in the average loan amount in the six years since 2002-2003 (from a base of \$199.75).

This equates to 411,045 loans in 2008-09, with a loan to customer ratio of 1.78 for 2008-2009. The 'average' Cash Converters payday loan customer therefore paid \$188.77 in interest over the course of the year.¹²⁷ Based on fees of \$35 per \$100 lent, this represents fee income of at least \$43,591,282.

In summary, by 2008-2009 the Cash Converters chain was lending out principal of \$124,546,527 through its high-cost short term loan business.

In 2002-2003 this figure had been \$11,601,407.

On that measure alone, Cash Converters' high-cost short term lending business grew by 973.5% over six years from 2002-2003 to 2008-2009, despite suffering a slight decline from 2007-2008 to 2008-2009.

In collating this data we have relied predominantly on Cash Converters' annual reports from 2004 to 2009. Unfortunately, revenues from their high-cost short term lending division were reported in a different manner from year to year making it somewhat difficult to compare apples with apples. For the purposes of this report, some of the figures not explicitly reported from year to year have been derived by calculating figures from comments such as "*principal loaned increased by 7.4%*"¹²⁸ where we know the amount of principal loaned from the previous year.

In fact, in a number of cases, Cash Converters' own reports contradict themselves from year to year.

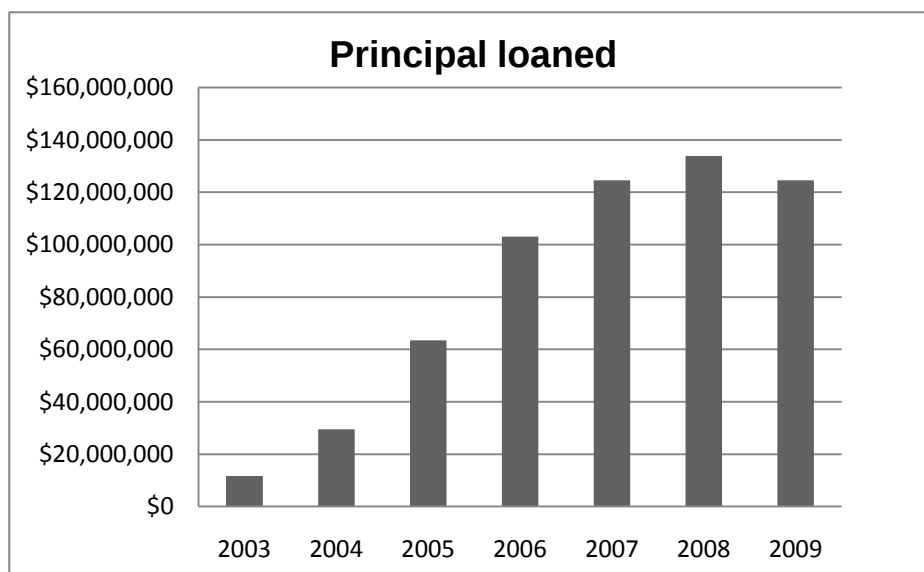
In the table below, those figures not explicitly stated in an annual report but derived from comments therein are shaded in grey. A full and detailed analysis is available in *Appendix F*.

¹²⁷ Cash Converters International, *2009 Annual Report*, p. 4.

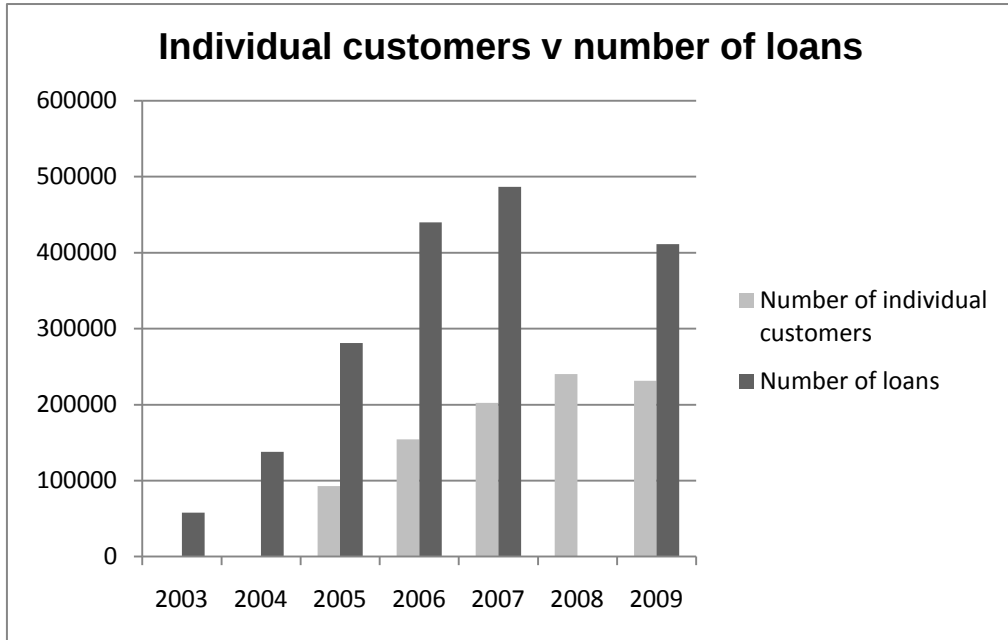
¹²⁸ Cash Converters International, *2008 Annual Report*, p. 4.

Cash Converters Revenue	Principal Loaned	Commissions on loans	Number of individual customers	Number of loans
2003	\$11,601,407	\$399,775	Unavailable	58,077
2004	\$29,458,924	\$798,808	Unavailable	137,737
2005	\$63,496,993	\$1,755,754	92,927	280,908
2006	\$103,037,193	\$3,213,266	154,458	439,913
2007	\$124,567,170	\$7,992,806	202,325	486,590
2008	\$133,785,141	\$9,014,306	240,160	Unavailable
2009	\$124,546,527	\$6,916,040	231,262	411,045

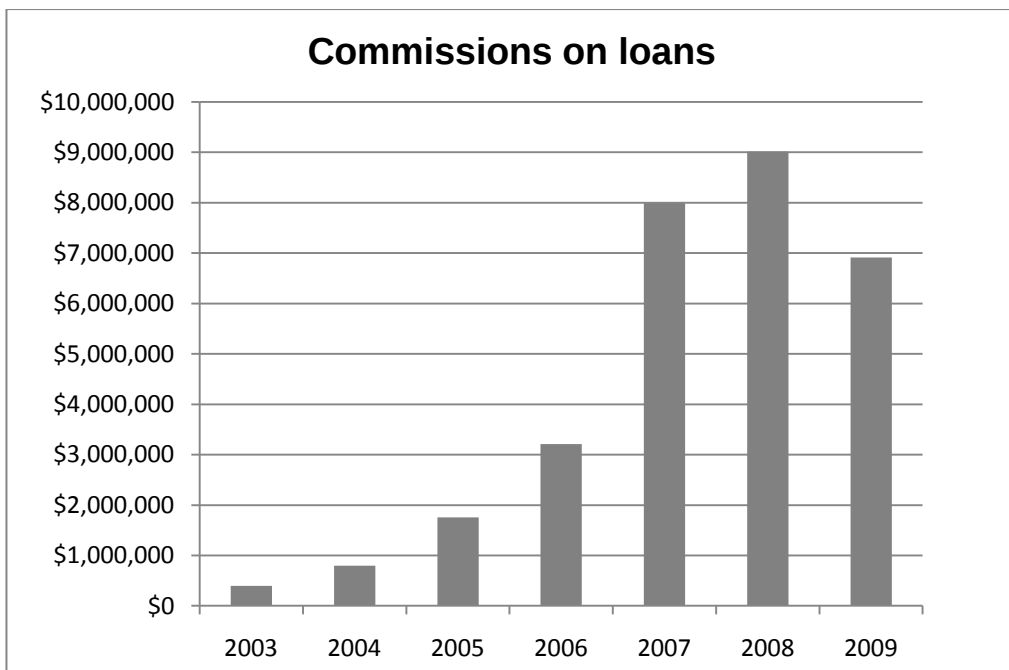
When expressing this data on a graph it is clear to see the growth experienced in this sector of the Cash Converters business model. Below we can see the growth in the total amount of money lent to high-cost short term lending consumers from 2003 to 2009.



In looking at the growth in loans versus the growth in individual customers we found data missing from 2003, 2004 and 2008 however were still able to capture a general trend upwards as illustrated below:



Most notably, we can see a steep rise in the level of commissions received from consumers to pay for these high-cost short term lending products over the past few years.



Based on the above data, Cash Converters has clearly experienced rapid and significant growth in its high-cost short term lending business, which in turn provides some indication of overall industry development. When allied with the previously noted proliferation of new lenders in the market, it is clear high-cost short term lending is robust enough to support numerous operators whilst still delivering large growth figures for major industry participants.

Cash Converters' faith in high-cost short term lending as a business model is reflected in their strategy to acquire franchisee stores and run them as company stores. This strategy was first revealed to shareholders in an announcement dated 3 September 2007 when Cash Converters announced it had entered into an agreement to purchase eight Victorian stores from the Hosking Financial Group, bringing the total of Australian corporate stores to nine.

At the time, Cash Converters stated:

*"This acquisition is a vital step towards the expansion of the corporate store network, a program which the company is now firmly committed to. This will be achieved by a combination of both new store openings and the acquisition of existing stores from franchisees... This acquisition is a strong vote of confidence by the Company in the future prospects of the Cash Converters business model."*¹²⁹

This vote of confidence was reiterated on 23 September 2008, when Cash Converters further announced it had acquired three more of its UK stores, all in Liverpool and had "...entered into contacts (sic) to acquire two stores in Western Australia..." scheduled to settle the following month. The statement goes on to say:

*"The Company intends to pursue this store acquisition program as aggressively as it can both in Australia and the United Kingdom."*¹³⁰

To the outside observer Cash Converters appears to have transformed itself from a chain of franchisee owned second hand goods stores, some of which happened to offer high-cost short term loans, into a chain of fringe and high-

¹²⁹ Cash Converters International, *Announcement: Acquisition of Eight Stores*, 3 September 2007.

¹³⁰ Cash Converters International: *Announcement: Store Acquisition*, 23 September 2008.

cost short term lenders, the majority of which still sell second hand goods - although not all.

In addition, Cash Converters stores are increasingly likely to be company owned, reflecting the company's confidence in this new business model.

A closer examination of Cash Converters' annual reports gives some insight into the strategy the company has pursued to grow its high-cost short term lending business and the importance it places on that aspect of its operations.

In their 2004 annual report, Cash Converters stated:

"It can be seen from these figures that the cash advance business is growing rapidly. Group commissions for the first half of this year were \$324,724 and for the second half they were \$474,084 a 46% increase.

*There are currently 58 stores providing cash advances, 32 in Queensland, 11 in Victoria, seven in South Australia and eight in Western Australia. We expect a further 25 stores to come on line during the next 12 months."*¹³¹

The annual report for 2005 contains a similar format, although by then, 84 stores were participating, with another 20 expected to come online. The annual report also anticipates further growth and indicates an advertising strategy to foster that growth:

*"As more stores come on stream the advertising budget for cash advance will grow which will see further business."*¹³²

The annual report for the following year gives some indication of Cash Converters' shift away from a retail store franchise business, to a fringe-lending business:

*"The large one off fees received by way of renewals from the Australian network and the licence fees received from the UK franchisees in past years has been replaced by growth in weekly fees, cash advance commission and cheque cashing fees."*¹³³

¹³¹ Cash Converters International, *Annual Report 2004*, p. 3.

¹³² Cash Converters International, *Annual Report 2005*, p. 4.

¹³³ Cash Converters International, *Annual Report 2006*, p. 2.

and:

“Strategically the Company has positioned itself to become a major player in the micro lending sector in Australia.”¹³⁴

This is further underlined by a new trend towards ‘finance only’ Cash Converters stores, including:

“...the first stand alone personal finance centre which was opened in Brisbane CBD in May 2005 which is proving to be very successful.”¹³⁵

The same report stated 97 of Cash Converters' 122 Australian stores were now participating in the high-cost short term lending business and further stores were *“...earmarked to come on stream in the next 12 months and with an increasing advertising budget we expect growth to continue.”¹³⁶*

Significantly, the 2006 report outlined the results of an intensive brand review of the Cash Converters brand in the Australian market.

Cash Converters reported:

“Our communication and advertising approach was revised in line with the brand strategy to signal change to the market, portraying a business that’s more open, more savvy, more modern and upbeat.

The revised brand identity demanded a fresh, contemporary look and feel to all franchised outlets in line with the newly established brand personality and values. The logo and store fascias, internal fit outs, in store signage, stationery and uniforms have all been updated to create a fresh new look. The plan is to have the majority of store exteriors and buys and loans rooms refitted nationally by late 2007, with retail and Personal Finance Centres completed by early 2008.”¹³⁷

The advertising strategy associated with this significant brand overhaul is described further in the report:

“Additional 30 to 15 second TV advertisements were produced to promote all core products and ensure coverage of key messages identified in the brand strategy. The TV ads adopted a distinctive style,

¹³⁴ Cash Converters International, *Annual Report 2006*, p. 3.

¹³⁵ Cash Converters International, *Annual Report 2006*, p. 19.

¹³⁶ Cash Converters International, *Annual Report 2006*, p. 3.

¹³⁷ Cash Converters International, *Annual Report 2006*, p. 4.

using stylised still photography, telling light-hearted stories about people getting on with their lives.

*Television remains the preferred media choice and the strategy 'to consolidate and dominate, in burst patterns' in order to maximise impact was adopted, along with a greater consideration of program 'environments' for the placement of ads to support the strategy.*¹³⁸

The 2006 report concludes with the statement:

*"We firmly believe the acquisition of MON-E and Safrock will be company transforming in nature. Both acquisitions are highly complementary and will significantly increase company profits."*¹³⁹

The following year, of Cash Converters' 137 Australian stores, 112 were now offering payday loans. The status of the company is reflected in its own statement in the 2007 financial report:

*"The business is rapidly evolving to take a leading position in the micro lending field and at the same time ensuring that it remains at the forefront of second hand goods retailing in Australia. The new look for the network is contemporary and delivers a retail space that strongly supports our financial service aims."*¹⁴⁰

In order to cope "...with the massive growth experienced in recent years and expected growth in the future..."¹⁴¹, in 2007 Cash Converters developed a new software system to "...allow MON-E to provide more relevant and timely reporting to franchisees and the Company."¹⁴²

The 2007 report on its payday lending division concludes with the statement:

"Further significant growth is expected next year as the Company launches its cash advance product into New South Wales through its existing eight store network and we see the balance of existing stores participate. There will also be continued growth experienced by the

¹³⁸ Cash Converters International, *Annual Report 2006*, p. 8.

¹³⁹ Cash Converters International, *Annual Report 2006*, p. 6.

¹⁴⁰ Cash Converters International, *Financial Report for the Year Ended 30 June 2007*, p. 3.

¹⁴¹ Cash Converters International, *Financial Report for the Year Ended 30 June 2007*, p. 4.

¹⁴² Cash Converters International, *Financial Report for the Year Ended 30 June 2007*, p. 4.

existing stores as their customer base increases with increased marketing and promotion.”¹⁴³

Earlier in the report, the company states “*Stand alone personal finance centres will also be opened in the Sydney CBD as part of the growth strategy.*”¹⁴⁴

It is worth noting that until 2008, Cash Converters had grown its high-cost short term lending business without operating in the most populous state in the country, a territory that presumably holds great growth potential.

Despite the generally upbeat tenor of Cash Converters’ annual reports, the 2007 financial report does contain some measured warning of possible “business turbulence” to come:

“The possibility of adverse change to Financial Services Legislation is an ever-present threat to our growing position in the micro lending market. Our objective is to ensure that any Legislation or regulation that affects our capacity to provide our preferred range of financial solutions profitably to consumers remains positively framed.”¹⁴⁵

Presumably in order to ensure such legislation is positively framed for the company, Cash Converters also report in their 2007 financial report that:

“We have recently appointed a Government liaison Manager [sic] to lead our approach to achieving a favourable result from current and future reviews. However as far as the company is concerned we will do whatever it takes to continue to provide to our many thousands of customers with the credit they require to ensure we maintain our market leadership position.”¹⁴⁶

In August 2007 Cash Converters issued a statement to shareholders, attaching a consultation package from the Queensland Department of Tourism, Fair Trading and Wine Industry Development, outlining proposed changes to the Consumer Credit Code.

¹⁴³ Cash Converters International, *Financial Report for the Year Ended 30 June 2007*, p. 4.

¹⁴⁴ Cash Converters International, *Financial Report for the Year Ended 30 June 2007*, p. 3.

¹⁴⁵ Cash Converters International, *Financial Report for the Year Ended 30 June 2007*, p. 3.

¹⁴⁶ Cash Converters International, *Financial Report for the Year Ended 30 June 2007*, p. 3.

In their statement, Cash Converters state:

*"It is clear from the draft proposals that there is no cap on interest rates and fees charged. Instead, what is proposed is greater disclosure on interest rates and charges and a new 'reasonableness' test for all micro-lending to consumers..."*¹⁴⁷

Despite the draft proposals, a 48% interest cap (inclusive of all fees and charges) was introduced in Queensland and came into effect on 31 July 2008.

Cash Converters' 2008 annual report makes reference to the Queensland interest rate cap, but outlines a clear strategy to counteract the legislative change with minimal interruption to normal business:

"In July the Queensland Government announced the introduction of a 48% interest cap, inclusive of fees and charges, effective from 31 July 2008. Whilst the announcement gave little time for the implementation of change it was not unexpected and MON-E was ready with an alternative web-based IT solution to help our franchisees service their customers using their traditional Pawnbrokers licence."

*The terms of the service agreement between Queensland franchisees and MON-E is on similar terms to their current agreement. It's early days but the indications are that the IT solution is robust and so far has been implemented by the majority of franchisees."*¹⁴⁸

This approach is further reiterated under a heading titled *The Future*:

"The bedding down of the new MON-E IT solution for Queensland will be a priority as we look to consolidate this replacement income stream from our Queensland network."

*As previously advised our profit guidance for the full year to June 2009 is \$12.0 million. This includes no revenue from the IT solution currently being trialled in Queensland. We look forward to updating shareholders with actual results throughout the course of the year."*¹⁴⁹

¹⁴⁷ Cash Converters International, *Statement to shareholders*, 27 August 2007.

¹⁴⁸ Cash Converters International, *Annual Report 2008*, p. 2.

¹⁴⁹ Cash Converters International, *Annual Report 2008*, p. 7.

In its financial report for the half-year ended 31 December 2008, Cash Converters reported:

“As previously reported the first half of the year has presented various challenges from a legislative perspective, which following the introduction in Queensland of an interest rate cap, saw our after tax profit guidance pared back to \$12.0 million.

*Pleasingly, this has now been upgraded to between a range of \$14.5 and \$15.0 million.”*¹⁵⁰

The financial statement goes on to state:

*“These challenges and uncertainties will remain in the short to medium term, as the Federal and State Governments work to transfer the State based consumer legislation across to a single, standard national regulation of consumer credit....As the leading industry participant in the micro-finance sector, Cash Converters is working closely with Government during this transition phase to ensure that legislative reform will enable our customers to enjoy continued access to credit at a fair cost, within an improved regulatory and supervisory regime.”*¹⁵¹

This theme is picked up from earlier in the same report, where Cash Converters also update the size of their customer base and seek to establish their special responsibility in the fringe lending field:

*“As a highly recognised brand in the micro-finance industry, with over 285,000 loyal customers nationally, Cash Converters recognises its industry leading position and its special responsibility to work alongside the Commonwealth and various State and Territory Governments to ensure a fair and balanced approach to legislative change for the micro-finance sector and one which protects the long term interests of our customers and shareholders.”*¹⁵²

As previously stated, the 2009 annual report did show a decline in earnings for Cash Converters from high-cost short term lending, the first such decline since

¹⁵⁰ Cash Converters International, *Report ting period: Half-year ended 31 December 2008*, p. 4

¹⁵¹ Cash Converters International, *Report ting period: Half-year ended 31 December 2008*, p. 4.

¹⁵² Cash Converters International, *Report ting period: Half-year ended 31 December 2008*, p. 2.

the company entered the market. Although primarily attributed to a new MON-E fee structure, it is difficult to believe the Queensland interest rate cap did not have something to do with this decline. Although average loan amounts rose from \$286 in 2008 to \$303 in 2009, the amount loaned out in principal dropped.¹⁵³

Given these developments, it is not surprising Cash Converters has taken a proactive approach to lobbying Government, presumably seeking to capture the policy debate by characterising their own high-cost short term lending business as a 'fair' business amongst other 'rogue' operators.

It should be evident from the above investigation that Cash Converters is more concerned with minimising disruption to their extremely profitable high-cost short term lending business, in which they have strategically staked their financial future, than they are with the 'long term interests' of their customers.

Cash Converters' conflict of interest when 'advising' Government on policy in the area is obvious and should not go unacknowledged.

3.3 Factors contributing to industry development

3.3.1 Marketing strategies, economic conditions and geography

The high-cost short term lending industry in Australia seems to have benefited from a general, explosive and well-documented growth of consumer credit during the 2002 to 2010 period. This has had both economic consequences (in the form of sharply increased household debt) and social consequences, most notably rising levels of mortgage stress and other indicators of financial hardship.

The Australian Bureau of Statistics document "*Australian Social Trends 4102.0 – Household Debt*" (2009), tracks growth in Australian household debt from 1990 and finds in the 18 year period to 2008 the "...amount of debt owed by Australian households rose almost six-fold".¹⁵⁴

Particularly significant in this growth figure is remarkable growth in credit card debt. Reserve Bank of Australia figures show the amount owed on credit cards in Australia rose from approximately \$20.7 billion in March 2002 to \$47.17

¹⁵³ Cash Converters International, *Annual Report 2009*, p. 4.

¹⁵⁴ Australian Bureau of Statistics, *Australian Social Trends 4102.0 – Household Debt*, p. 30.

billion in March 2010 – a 127.8% increase in eight years.¹⁵⁵ This growth in the use of credit cards is significant as credit cards are increasingly used by customers to meet the costs of day to day living (as opposed to ‘extra’ discretionary spending). This has been of concern to consumer advocates, with CHOICE spokesperson, Christopher Zinn, stating in a Queensland Sunday Mail article (printed on 17 August 2008) that use of credit cards for essential purchases was “...one of the most expensive ways, short of payday lenders, to borrow money”.¹⁵⁶

An increasing community reliance on credit and a growing comfort level with outstanding debt are positive developments for those seeking to sell financial services, including high-cost short term lenders. It is arguable that due to the general rise of a credit based economy, high-cost short term lenders have been able to position themselves as simply the newest product in a long line of finance options and blur the line between themselves and less expensive credit options. In this manner, high-cost short term lenders are able to ‘normalise’ what is still a relatively new industry to Australia and create the impression they are simply a natural extension of consumer credit and therefore have a ‘natural’ place in the economy.

An obvious way in which high-cost short term lenders have achieved this is by concealing the rate of interest charged on the principal loaned, generally by characterising interest as a ‘fee’, which is often not advertised and by adopting the language, decor, outward appearance and service style of mainstream financial service providers.

The 2002 Wilson report stated:

*“Visually payday lenders mimic mainstream financial service providers and this heightens feelings amongst consumers that they are active participants in a commercial economy.”*¹⁵⁷

This has clearly been a successful marketing approach for high-cost short term lenders and is now mirrored in the online industry, where high-cost short term lending websites typically take on the character, style and tone of banking or credit union websites.

¹⁵⁵ Reserve Bank of Australia, *C1 - Credit and Charge Card Statistics*.

¹⁵⁶ Hannah Martin, Queensland Sunday Mail, *Credit Card debt hits record \$44 bn*, 17 August 2008.

¹⁵⁷ Wilson, *Payday Lending in Victoria*, p. 76.

As for shop-fronts and as reported above, Cash Converters has recently undergone a 're-imaging' process involving (amongst other things) alterations to "the logo and store fascias, internal fit outs, in store signage, stationery and uniforms (which) have all been updated to create a fresh new look."¹⁵⁸

Cash Converters' entire payday lending service seems carefully framed to mimic mainstream credit providers and avoid association with fringe credit.

For example, Cash Converters now uses the term 'cash advance' (a term usually associated with credit cards) instead of the term it previously used: payday loan. Cash

Converters' loan centres are signed and advertised as 'Personal Finance Centres' and the company frequently describes itself as an industry leader in 'micro-finance' - studiously avoiding the phrase 'fringe lending'.

"Visually payday lenders mimic mainstream financial service providers and this heightens feelings amongst consumers that they are active participants in a commercial economy."

– Wilson Report

The terms 'micro-finance' or 'micro-credit' are broad terms that have been applied to a broad range of credit types. Often, though, the terms are taken to describe lending activities in developing nations, whereby low-income clients are lent small sums of money to enter into a productive practice or 'micro-business'.¹⁵⁹ Interest rates charged are usually very small - and such loans are easily distinguished from high-cost short term loans on the basis of both cost and the purpose for which the money is lent. What is commonly understood to be 'micro-finance' exclusively funds ongoing productive activity, whereas high-cost short term loans almost invariably fund consumption, often for recurrent purposes.

Using the term 'micro-finance' to describe high-cost short term lending obfuscates the real nature of the business being conducted and appropriates a socially positive term for application to an historically negative practice. Cash Converters are by no means alone in presenting their lending business in this

¹⁵⁸ Cash Converters International, *Annual Report 2006*, p. 4.

¹⁵⁹ See Grameen Bank website - *What is Microcredit?* (28/6/2010) :

(http://www.grameen-info.org/index.php?option=com_content&task=view&id=28&Itemid=108)

Grameen Bank is the world's largest micro-credit provider, having made over \$6 billion in micro-credit loans since its inception in 1983.

positive social manner but their example is useful given their previously noted position in the industry.

“...high-cost short term lenders generally establish themselves in less affluent suburbs, presumably so as to be easily accessible to large numbers of clientele experiencing financial hardship.”

Beyond mimicking mainstream financial service providers, high-cost short term lenders generally establish themselves in less affluent suburbs, presumably so as to be easily accessible to large numbers of clientele experiencing financial hardship. This is a critical strategy for lenders (as outlined in Chapter 2) as borrowers frequently make their consumer decision based on which lender is closest and requires the least effort to go to.¹⁶⁰

Once signed on with a particular high-cost short term lender, a borrower is likely to return to the same lender, as the process for further loans is even simpler than the process for an initial loan. Factors such as cost (which would usually be regarded as the main basis for a consumer choice) do not figure as highly for consumers of high-cost short term loans as do factors such as location, ease and convenience.

Indeed, high-cost short term lenders generally promote speed, ease and convenience as their crucial ‘point of difference’ and these factors probably have played a significant part in the industry’s growth. Just as credit cards have flourished on the basis of ‘convenience’, the easy availability of high-cost short term credit and the capacity to acquire it, even in the face of a poor credit history, makes the product an attractive option to low income clients.

“Factors such as cost...do not figure as highly for consumers of high-cost short term loans as do factors such as location, ease and convenience.”

¹⁶⁰ The Consumer Action survey found that 54.2% of respondents chose their lender primarily because they were nearby, or convenient.

Apart from filling a perceived 'void' in family finances, high-cost short term loans, like any form of credit, offer the attractive prospect of immediate gratification in return for a deferred cost, which can be rationalised and psychologically downplayed. Anecdotal evidence from the Open Mind qualitative survey suggests the ease and convenience of high-cost short term lending has led some customers into using the loans to pay for living expenses, rather than going through the more onerous (and sometimes perceived as degrading) process of requesting assistance from family and friends or arranging hardship variation payments.¹⁶¹

This also suggests speed, ease and convenience have arguably enabled high-cost short term lenders to create a certain degree of supply driven demand. Just as with credit cards the very availability of the loans may lead some clients to use them when in their absence they would resort to more sustainable practices such as arranging for hardship variation payments, accessing Centrelink loans or turning to welfare services for support.

Beyond providing a quick and easy loans service with limited administration and no credit checks, high-cost short term lenders are active in sustaining and growing their consumer base, encouraging their customers to borrow further and to introduce their family and friends to the product.

"Beyond providing a quick and easy loans service with limited administration and no credit checks, high-cost short term lenders are active in sustaining and growing their consumer base, encouraging their customers to borrow further and to introduce their family and friends to the product."

Again, from the Open Mind research project:

"Cash Converters constantly send me mail for months and months. They said we have credit waiting for you, you just have to come and sign and I've been to the bank to stop Cash Converters getting into my

¹⁶¹ Open Mind Research Group, *Exploring pay day loans*, p. 28. "I'm a bit too stubborn to ask family and friends...I'd prefer to do things on my own...and I don't want people to know my business." [male, northern suburbs, Melbourne]

bank account. I fell into a trap that I was constantly borrowing from them.” (single mother, Geelong)¹⁶²

*“Once you become a customer of theirs (AMX)...they start sending you birthday cards...and letters saying ‘we haven’t seen you for a couple of months...we’re still here if you need us’ kinda thing.”
(male, northern suburbs, Melbourne).¹⁶³*

*“I received a letter saying ‘you know if you send anyone along to us we’ll send you \$100’...”
(male, south-east suburbs, Melbourne).¹⁶⁴*

Although there is no question borrowers use payday loans to meet essential needs, it is unlikely the industry would be as successful were it not for the key features of speed, ease and convenience and the use of increasingly forceful marketing techniques.

Adopting the trappings of mainstream financial service providers, blurring the line between selling credit and posing as a ‘financial management tool’ (or even as a friendly financial advisor, such as Cash Doctors) seem to have been particularly effective marketing strategies for high-cost short term lenders.

***“These strategies tend to create the
impression that high-cost short term
lending occupies a necessary and natural
position in the consumer credit market.
Whether this impression reflects the reality,
is another matter”***

These strategies tend to create the impression that high-cost short term lending occupies a necessary and natural position in the consumer credit market. Whether this impression reflects the reality, is another matter.

¹⁶² Open Mind Research Group, *Exploring pay day loans*, p. 23.

¹⁶³ Open Mind Research Group, *Exploring pay day loans*, p. 23.

¹⁶⁴ Open Mind Research Group, *Exploring pay day loans*, p. 23.

Chapter 4 Payday Lending - The American Experience

4.1 Introduction

High-cost short term loans are universally described as 'payday loans' in the United States of America and are clearly understood to denote a narrow product type. This is distinct from Australia where although the term 'payday loan' is often used, it is not always perfectly understood (and is often inaccurately applied to longer term high-cost loans and even pawn-broking transactions). Despite this confusion, the 'payday loan' nomenclature is adopted throughout this chapter as appropriate to apply in the American context.

An examination of the American payday lending industry is instructive for Australian policy makers, as the longer history of the American industry provides some basis on which to project potential growth of the Australian industry (at least on a per capita basis). American payday lending in its modern form first emerged in Kansas City in the late 1980s, a full decade before the industry entered Australia.¹⁶⁵

While there are of course differences between the American and Australian environments, the broad economic, social and cultural similarities between the two countries do provide some basis to suggest the comparatively fledgling Australian payday lending industry may develop along somewhat similar lines to its more established American counterpart if given the time to do so. Further, the operation of the industry, the demographics of the market it serves and the impact it has on that market are also likely to be similar.

Apart from providing a useful tool for predicting likely industry development, an Australian – American comparison is also useful for analysing policy trends and the effectiveness of various regulatory approaches. Due to the advanced state of the industry in America, the policy debate surrounding payday lending is highly developed and provides useful case studies for application to an Australian context.

¹⁶⁵ Uriah King and Leslie Parrish, *Springing the Debt Trap: Rate caps are the only proven payday lending reform*, Center for Responsible Lending, 2007. p. 6.

The existence of differing policy positions across various American states is particularly useful, as it provides an opportunity to assess the differing efficacy of various legislative approaches. Further, an examination of payday lending policy in the United States gives an indication of general policy trends, potentially enabling Australia to conduct a more informed policy debate drawing on the American experience.

With those objectives in mind, this chapter addresses the following questions:

- How has the payday lending industry developed in America and to what extent has it grown?
- How has the policy debate progressed in America and what steps have been taken? How effective have they been?
- What is the current policy trend regarding payday lending in the United States?

4.2 How has the payday lending industry developed in America and to what extent has it grown?

Payday lending in America dates to the late nineteenth century, when lenders termed ‘wage buyers’ or ‘salary lenders’ would loan on the basis of future wages.¹⁶⁶ At the time, lenders argued they were not subject to existing credit laws as the transactions were said to constitute a sale (or fee for service) and not a loan.¹⁶⁷

To deal with wage-buying, anti-usury legislation was enacted across various American States throughout the early and mid 1900s, imposing comprehensive consumer credit interest rate caps of between 24% and 42% APR at an average of 36%.¹⁶⁸ It is notable that unlike early Australian attempts, fees and charges were included for the purposes of calculating the APR. Many of these laws remain in force and continue to apply to consumer credit today. At the time, they had their desired effect and ended the practice of wage buying.

¹⁶⁶ Uriah King and Leslie Parrish, *Springing the Debt Trap: Rate caps are only proven payday lending reform*, Center for Responsible Lending, December 13 2007, p. 5.

¹⁶⁷ King and Parrish, *Springing the Debt Trap*, p. 6.

¹⁶⁸ King and Parrish, *Springing the Debt Trap*, p. 6. It should be noted that these express APR figures.

The modern incarnation of American payday lending began in Kansas City in the late 1980s.¹⁶⁹ In a similar vein to wage buyers one hundred years earlier, payday lenders contested the application of consumer credit laws to their product and were initially able to operate in a legal 'grey' area. Over time, however, payday lenders gradually won specific legal exemptions for their industry.

Payday lending is now authorised by state laws or regulations in 34 American states.¹⁷⁰ In some states where such exemptions have not been granted, payday lenders were until recently able to circumvent state based legislation by partnering with federally-insured banks, thereby 'exporting' more lenient credit laws (or payday lending exemptions) from the bank's home jurisdiction. This business model was described colloquially as 'rent-a-bank'.¹⁷¹

"...more payday lending establishments than there are McDonald's and Starbucks locations combined."

The industry has grown at a rapid rate. In the early 1990s, there were less than 200 payday lending stores across America.¹⁷² By 2007, there were 25,000.¹⁷³ To give a sense of perspective, this has been described as:

"...more payday lending establishments than there are McDonald's and Starbucks locations combined".¹⁷⁴

The growth in loan volumes has been equally rapid. In 2000, \$10 billion was loaned in payday loans across America, a figure which grew to \$25 billion by 2003¹⁷⁵ and again to more than \$28 billion by 2006.¹⁷⁶

¹⁶⁹ King and Parrish, *Springing the Debt Trap*, p. 6.

¹⁷⁰ Consumer Federation of America – Payday Loan Consumer Information - <http://www.paydayloaninfo.org/legal.asp>, (8/7/2010)

¹⁷¹ Uriah King, Leslie Parrish and Ozlem Tanik, *Financial Quicksand: Payday lending sinks borrowers in debt with \$4.2 billion in predatory fees every year*, Center for Responsible Lending, 2006, p. 4.

¹⁷² Daniel Brook, *Usury country: Welcome to the birthplace of payday lending*, Harpers magazine, April 2009, p. 2.

¹⁷³ Charisse Ma Lebron, *Payday Lenders Evade Regulations*, California Reinvestment Coalition, 2007, p. 1.

¹⁷⁴ Ma Lebron, *Payday Lenders Evade Regulations*, p. 1.

¹⁷⁵ Keith Ernst, John Farris, Uriah King, *Quantifying the Economic Cost of Predatory Payday Lending*, Center for Responsible Lending, December 18 2003, p. 2.

Industry analysts vary in their estimation of the industry's current size, generally ranging from \$35 billion to \$48 billion.¹⁷⁷ Payday lenders are thought to issue loans to approximately 15 million American households every year.

"The growth in loan volumes has been equally rapid. In 2000, \$10 billion was loaned in payday loans across America, a figure which grew to \$25 billion by 2003 and again to more than \$28 billion by 2006."

In terms of loan revenue it is estimated American payday lenders generate approximately \$5.5 billion annually in loan fees.¹⁷⁸ It should be noted this estimate does not include the online industry which, as is the case in Australia, is comparatively small but growing. It is estimated the 2008 loan volume for online payday lending in America was approximately \$7.1 billion.¹⁷⁹

Unlike the Australian industry, the American payday lending industry is not dominated by one large industry participant - although Advance America Cash Advance Inc. (**Advance America**), the largest payday lender in America, is still a significant entity.

In their 2007 annual report, Advance America reported total revenue of \$709.6 million and by the end of 2007 the company had 2,832 stores across the US, Canada and the UK.¹⁸⁰ This revenue figure represented a 5.5% increase on the previous year but has declined in the two years since - to \$676.4 million in 2008 and \$647.7 million in 2009. Store numbers have also declined somewhat, to 2,587. Possible reasons for this decline are discussed later in the chapter.

Like Cash Converters in Australia, Advance America is a publicly listed company required to publish financial data which is useful when seeking to track industry development as a whole.

¹⁷⁶ King, Parrish and Tanik, *Financial Quicksand*, p. 2.

¹⁷⁷ Consumer Federation of America – Payday Loan Consumer Information - <http://www.paydayloaninfo.org/facts.cfm>; Brook, *Usury country*, p. 2.

¹⁷⁸ Consumer Federation of America – Payday Loan Consumer Information - <http://www.paydayloaninfo.org/facts.cfm>

¹⁷⁹ Consumer Federation of America – Payday Loan Consumer Information - <http://www.paydayloaninfo.org/facts.cfm>

¹⁸⁰ Advance America Annual Report 2006-2007, p. 3.

Consumer advocates contend, and evidence would tend to suggest, the success of payday lending in America has been driven largely by repeat borrowing.

In November 2006 the Centre for Responsible Lending reported nearly 90% of payday loans were made to customers who took five or more payday loans per year.¹⁸¹ The same study found approximately 62% of loans were made to borrowers who took twelve or more loans per year - implying the majority of revenue generated by the American payday lending industry was made from borrowers who experience payday loans as at least a monthly expense.¹⁸²

Corroborating such figures, the Consumer Federation of America reported in November 2005 the typical payday loan consumer takes out 9 to 13 payday loans annually and often holds more than one payday loan simultaneously (obtained from multiple lenders).¹⁸³

Further, Advance America consistently reports a ratio of approximately eight 'cash advances' originated for every customer served. Even this is likely to be an underestimate - the customer number reported is for customers of all the company's credit products - not just their payday loans.¹⁸⁴ Such figures have given rise to the characterisation of payday loans as 'debt traps'.

Debt traps are products that create ongoing debt spirals which borrowers find difficult or impossible to escape and which ultimately cost them hundreds of dollars a year. Far from assisting such borrowers, debt traps tend to drive them into further hardship. As one American commentator has put it:

*"With payday lending, the 'debt trap' is not a figure of speech: the loan is actually structured as a trap."*¹⁸⁵

¹⁸¹ King, Parrish, Tanik, *Financial Quicksand*, p. 6

¹⁸² King, Parrish, Tanik, *Financial Quicksand*, p. 6.

¹⁸³ Ma Lebron, *Payday Lenders Evade Regulations*, p. 4. Ma Lebron refers to the CFA fact sheet in the 2007 California Reinvestment Coalition publication. Consumer Action has been unable to directly obtain the 2005 fact sheet.

¹⁸⁴ For example, see Advance America *Annual Report 2009*, p. 11. Customers served in 2009 for all credit products: 1,316,000. Cash advances originated: 10,860,000. This creates a ratio of 8.25 loans per customer. The figures are similar for 2007 and 2008. (Ratio for 2007 is 7.86. Ratio for 2008 is 8.28).

¹⁸⁵ Brook, *Usury country*, p. 3.

The same commentator, Daniel Brook, describes American payday loan customers as typically in their early thirties, making approximately thirty thousand dollars per year and without savings.¹⁸⁶

An American payday lending expert, Judy Powers, is quoted by Brook in his April 2009 Harpers magazine article "*Usury Country: Welcome to the birthplace of payday lending*".

Powers succinctly describes the economic conditions that have grown this demographic in America:

*"Nationwide the savings rate now is like zero percent. And it's because expenses have just gone up and up and up, wages have not kept pace and people don't have anything extra to put away."*¹⁸⁷

Payday loan customers have been described by the Community Financial Services Association (a leading American payday lending lobby group) as "*the heart of America's middle class*."¹⁸⁸

Whilst this may be an exaggeration, it is true that a significant underclass exists below those who use payday loans in America. Twenty eight million Americans do not have a bank account and therefore cannot access the product and millions more are ineligible through unemployment or because they are paid through the 'black economy' (i.e. cash in hand).¹⁸⁹ Without a bank account into which to make the deposit, or the capacity to show proof of income, a customer cannot access a payday loan. This is because repayment of the loans relies on taking a 'first-stake' in the customer's income through a direct debit arrangement established on the customer's bank account and processed on the day their income is deposited – this is discussed further in Chapter 5.

In Australia, the situation is different. A far greater proportion of the population hold bank accounts (a 2008 ANZ survey of financial literacy found 97% of respondents held an account)¹⁹⁰ and even if unemployed, the Australian welfare system provides a regular income sufficient to obtain a payday loan.

¹⁸⁶ Brook, *Usury country*, p. 6.

¹⁸⁷ Brook, *Usury country*, p. 6.

¹⁸⁸ Brook, *Usury country*, p. 5-6.

¹⁸⁹ Brook, *Usury country*, p. 6.

¹⁹⁰ The Social Research Centre, *ANZ Survey of Financial Literacy in Australia*, ANZ Bank, October 2008, p. 37.

The true core market for payday loans in America has been described by consumer advocates as the 'working poor' - a growing proportion of the American population that are employed (or at least partially employed) - yet are unable to meet basic expenses. The US Department of Labor - US Bureau of Labor Statistics compiles statistics on the number of working poor in America and defines the working poor as:

*"...individuals who spent at least 27 weeks in the labor force (working or looking for work) but whose incomes still fell below the official poverty level."*¹⁹¹

In 2007, the number of such individuals was 7.5 million people, accounting for approximately 5% of the working population of America ('the working poor rate'). Distilling this figure further, the Bureau states:

*"In 2007, 4.2 million families were living below the poverty level, despite having at least one member in the labor force for half this year or more."*¹⁹²

"Not surprisingly, the working poor constitute a crucial market for the American payday lending industry. Such customers exhibit the primary attributes of the payday loan consumer – a recurrent yet insufficient income."

Not surprisingly, the working poor constitute a crucial market for the American payday lending industry. Such customers exhibit the primary attributes of the payday loan consumer – a recurrent yet insufficient income.

In order to access the working poor, payday loan storefronts in America are generally located in economically depressed areas and disproportionately serve low-income ethnic minorities.¹⁹³

¹⁹¹ U.S. Department of Labor, U.S. Bureau of Labor Statistics, *Report 1012: A Profile of the Working Poor*, 2007, March 2009, p. 1.

¹⁹² U.S. Department of Labor, *A Profile of the Working Poor*, 2007, p. 2.

¹⁹³ Steven M. Graves, *Landscapes of Predation, Landscapes of Neglect: A Location analysis of payday lenders and banks*, *The Professional Geographer*, 55(3) 2003, p. 311.

Contrary to industry claims, there appears to be little to no evidence payday loans have assisted the American working poor in attaining a higher level of financial stability. Indeed, significant research exists to suggest access to payday loans worsens the situation of borrowers, increasing the likelihood a borrower will lose their bank account, be forced to file for bankruptcy or become 'delinquent' in repaying their credit card.¹⁹⁴

Despite the industry's strength and record of consistent growth, there are signs the payday lending industry in America may have contracted in recent times.

Advance America, for example, reported on 29 April 2009 that their total revenues for the quarter ended 31 March 2009 had decreased 5.5% when compared with the same period the previous year – in dollar terms this is a \$9.1 million drop in revenue - from \$165.5 million to \$156.4 million.¹⁹⁵

The report states in part:

*"These comparisons include the results of operations in Arkansas and New Mexico, states which the Company exited in 2008, as well as operations in New Hampshire, a state which the Company ceased making advances in January 2009."*¹⁹⁶

In order to understand why Advance America has ceased to operate in Arkansas, New Mexico and New Hampshire and why payday lending may be beginning to contract in America after a period of such extensive growth, it is necessary to examine recent events in the American policy debate.

4.3 How has the payday lending policy debate progressed in America?

Consumer advocacy groups across America generally define payday lending as an exploitative or 'predatory' lending practice and have been vocal in their opposition since its emergence in the 1980s. As the industry has grown, this

¹⁹⁴ Jean Ann Fox, *Research Findings Illustrate the High-Risk of High-Cost Short Term Loans for Consumers*, Consumer Federation of America Fact Sheet, February 18 2009 .

See: [http://www.consumerfed.org/elements/www.consumerfed.org/File/CFA_Fringe_Loan_Product_Harm_Research\(1\).pdf](http://www.consumerfed.org/elements/www.consumerfed.org/File/CFA_Fringe_Loan_Product_Harm_Research(1).pdf) (8/7/2010)

¹⁹⁵ Advance America , *Advance America Earnings Per Share Increase 19.0% During First Quarter*, April 29 2009 .

¹⁹⁶ Advance America , *Advance America Earnings Per Share Increase 19.0% During First Quarter*, April 29 2009.

opposition has intensified and payday lending policy now represents a significant battleground issue for American consumer advocates.

This policy debate has seen some significant developments over the last five years and there are signs the general spread of payday lending in America, largely aided by state legislature authorisation throughout the 1980s and 1990s, may be abating. A chronological summary of key developments is set out below:

4.3.1 2004 - Georgia

In 2004, the state of Georgia acted against the payday lending industry, by bolstering long standing laws that had failed to contain it. The Georgian experience is set out below.

Georgia strengthens traditional anti-usury legislation capping interest on small loans at 16%

The *Georgia Industrial Loan Act* (1955) regulates loans of less than \$3000 and applies a small loans comprehensive interest rate cap of 16%.¹⁹⁷

Despite this cap, payday lending flourished in Georgia throughout the 1990s and into the early 2000s. This growth was largely achieved through use of the 'rent-a-bank' business model (see section 4.2 above).

In 2004 the Georgia General Assembly significantly amended the *Georgia Industrial Loan Act* (1955), instituting amendments collectively referred to as the *Payday Lending Act* of 2004.

The *Payday Lending Act* came into effect in May 2004 and addressed the 'rent-a-bank' loophole - as well as strengthening the penalties applying to those who violated interest rate cap limits on small loans. The increased penalties included fines of up to \$25,000 per offence and potential prison sentences of up to 25 years.¹⁹⁸

¹⁹⁷ Consumer Federation of America – Payday Loan Consumer Information - <http://www.paydayloaninfo.org/stateinfo/GA.asp> (19/5/2010)

¹⁹⁸ Georgia Government - Department of Banking and Finance: http://dbf.georgia.gov/00/article/0,2086,43414745_46389324_70709483,00.html (19/5/2010)

This legislation effectively prohibited high-cost payday lending in Georgia. The Georgian Department of Banking and Finance now states on its online payday lending factsheet "...payday lending in its most common form is illegal in Georgia."¹⁹⁹

According to industry analysts, in the wake of the *Payday Lending Act* Advance America closed 89 Georgian payday lending stores. Collectively, the stores had generated \$19.9 million in revenue for the company the previous year.²⁰⁰

In 2006, the *Payday Lending Act* was unsuccessfully challenged in the US Federal Court.²⁰¹ The provisions remain in force.

4.3.2 2005 - Federal Deposit Insurance Corporation guidance

Georgia was one of many states in which the payday lenders had partnered with federally-insured banks in order to circumvent state laws. In 2005 this 'rent-a-bank' loophole was targeted by the responsible agency.

Federal Deposit Insurance Corporation addresses 'rent-a-bank' loophole

In February 2005, the Federal Deposit Insurance Corporation (FDIC)²⁰² issued guidelines to banks under its jurisdiction preventing them from participating in payday lending practices that could be seen to convert short term loans into high-cost long term debt.

The guidance was "...necessitated by the high risk nature of payday lending and the substantial growth of this product."²⁰³ Although the guidance does not have the force of legislation it does carry some authority – including the power to instruct institutions to cease payday lending when examiners find "...serious deficiencies exist..."²⁰⁴

¹⁹⁹ Georgia Government - Department of Banking and Finance:
http://dbf.georgia.gov/00/article/0,2086,43414745_46389324_70709483,00.html (19/5/2010)

²⁰⁰ Payday Loan Industry Watch: [pliwatch.org](http://www.pliwatch.org)., *Payday lenders hope to return to Georgia*, March 18 2007 - http://www.pliwatch.org/news_article_070318C.html (18/5/2010)

²⁰¹ King, Parrish, Tanik, *Financial Quicksand*, p. 5.

²⁰² A US government corporation and banking insurer created by the Glass-Steagall Act.

²⁰³ Federal Deposit Insurance Corporation, *FIL-14-2005: Guidelines for Payday Lending*, 25 February 2005, p. 1.

²⁰⁴ Federal Deposit Insurance Corporation, *FIL-14-2005: Guidelines for Payday Lending*, 25 February 2005, p. 1.

The most significant feature of the guidelines was a concerted and explicit attempt to address the issue of repeat borrowing.

Amongst other requirements (such as cooling off periods, a maximum number of loans per year and no more than one payday loan per borrower be outstanding at any one time) the guidelines stated:

*"When a customer has used payday loans more than three months in the past 12 months, institutions should offer the customer, or refer the customer to, an alternative longer-term credit product that more appropriately suits the customer's needs."*²⁰⁵

These guidelines, in addition to follow-up guidance issued the following year, were specifically designed to negate the 'rent-a-bank' model and were reflective of the public views of the FDIC's Director, Thomas J. Curry.

In a speech on 30 September 2004 Mr Curry stated:

*"In closing, I want to underscore the potentially abusive impact of chronic payday loan borrowing on debt laden individuals and their families. ... I doubt anyone believes that payday lending is a suitable long-term consumer credit product. It is an issue that cries out for a better solution. My personal hope is that bankers can harness their proven creativity and deep community commitment to find 'a better way'."*²⁰⁶

²⁰⁵ Federal Deposit Insurance Corporation, *FIL-14-2005: Guidelines for Payday Lending*, 25 February 2005, p. 5.

²⁰⁶ Remarks of FDIC Director Thomas J. Curry, Women in Housing and Finance, September 30 2004, p.3.

4.3.3 2006 - North Carolina, Military Lending Act.

In 2006 North Carolina successfully halted payday lending after reaching an agreement with major payday lending chains.

North Carolina enforces 36% interest rate cap

On 1 March 2006, the state of North Carolina reached an agreement with three major payday lenders to cease payday lending in that state.

North Carolina state law had a comprehensive cap on small loan interest rates prohibiting those in excess of 36% APR since 2001 (when the state had allowed its legal authorisation of payday lending to lapse), yet lending had continued unabated under the 'rent-a-bank' model.

The agreement, made between the state of North Carolina and Check Into Cash, Check 'n Go and First American Cash Advance (who collectively operated 152 North Carolina outlets), required the lenders to stop making new loans, collect only the principal on outstanding loans and donate \$700,000 to non-profit credit counselling offices and other financial literacy groups.²⁰⁷

In December 2005 the North Carolina state banking commissioner found Advance America had been breaking state lending laws.

Advance America closed 117 North Carolina offices and then unsuccessfully appealed the finding.

The North Carolina Attorney General, Roy Cooper, stated in a press release on 1 March 2006:

*"We've fought payday lending at every turn and now we're putting this industry out of business here in North Carolina....These payday lenders thought they'd found a way around North Carolina law. Now we're showing them a way out of our state."*²⁰⁸

²⁰⁷ Payday Loan Industry Watch: pliwatch.org., *Three NC payday lenders agree to close, nearly drying up industry*, 1 March 2006 - http://www.pliwatch.org/news_article_060301A.html

²⁰⁸ North Carolina Department of Justice, *Payday Lending on the way out in NC*, March 1 2006. <http://ncdoj.gov/News-and-Alerts/News-Releases-and-Advisories/Press-Releases/Payday-lending-on-the-way-out-in-NC.aspx>

Also in 2006, the US Congress passed legislation to impose a comprehensive 36% interest rate cap on payday loans to US military personnel. This is discussed below:

Military Lending Act caps interest on loans to military personnel at 36%

In October 2006 the United States Congress passed the *John Warner National Defense Authorization Act*, which was further bolstered by Department of Defense regulations. Collectively known as the *Military Lending Act* this legislation was, in part, introduced to restrict payday lending to American military personnel.²⁰⁹

The *Military Lending Act* took effect on 1 October 2007 and comprehensively capped interest rates at 36% for all payday, auto-title²¹⁰ and refund anticipation loans²¹¹ to military personnel for any loan with a term of 91 days or less.

The passing of this Act came shortly after publication of a United States Defence Department report entitled “*Report on Predatory Lending Practices Directed at Members of the Armed Forces and Their Dependents*” (**Report on Predatory Lending**).

Published on 9 August 2006, the Report on Predatory Lending identified predatory lending as a significant organisational problem for the US military. The Report on Predatory Lending stated:

*“Predatory lending practices are prevalent and target military personnel, either through proximity and prevalence around military installations, or through the use of affinity marketing techniques, particularly on-line.”*²¹²

²⁰⁹ In September 2005, the Centre for Responsible Lending reported that active-duty military personnel were three times more likely than civilians to borrow from payday lenders and that 20% of active-duty US military personnel had been payday borrowers in 2004. Ozlem Tanik, *Payday Lenders target the Military*, Center for Responsible Lending Issue paper No. 11, September 29 2005, p. 1.

²¹⁰ A form of loan in which the borrower provides their car as collateral.

²¹¹ A form of short term loan given in anticipation of a borrower's expected income tax return.

²¹² United States Department of Defense, *Report on Predatory Lending Practices Directed at Members of the Armed Forces and Their Dependents*, August 9 2006, p. 4.

The report further stated:

*“Military families have characteristics that can make them a market of choice for predatory lenders. Forty-eight percent of enlisted Service members are less than 25 years old, typically without a lot of experience in managing finances and without a cushion of savings to help them through emergencies.”*²¹³

It also found:

*“...one in five active-duty Service members were payday borrowers and...predatory payday lending costs military families over \$80 million in abusive fees every year.”*²¹⁴

Of interest in the context of this report, the Report on Predatory Lending also identified online payday lending as a significant issue:

*“An online search for ‘military loans’ gets over thirty-eight million hits on Google, while ‘military payday loan’ fills over three million pages. Sponsored links on search pages connect potential military borrowers to numerous online lenders as well as websites that appear to be educational but are laden with ads for high cost loans.”*²¹⁵

A major consideration for the Department of Defense was the impact payday lending had on the capacity for military personnel to obtain security clearances, which are required for the assignment of American personnel to active duty.

Over the 2000-2005 period, revoked or denied security clearances for US Sailors and Marines on the basis of financial difficulties rose by around 1500%.²¹⁶ This was considered to have a detrimental impact on America’s war effort in Iraq. The Report on Predatory Lending concluded in part:

²¹³ US Department of Defense, *Report on Predatory Lending Practices*, p. 10.

²¹⁴ US Department of Defense, *Report on Predatory Lending Practices*, p. 12.

²¹⁵ US Department of Defense, *Report on Predatory Lending Practices*, p. 15-16.

²¹⁶ Amy Klumper, *Double Whammy: Payday loan victims face security clearance problems*, Seapower Magazine - Official publication of the Navy League of the United States, Vol. 49 No. 6 June 2006, p. 12. This figure is a percentage figure drawn from the numbers reported in the article. In 2000: 124 in 2005: 1,999. A total of 5,482 over the six year period.
http://www.navyleague.org/sea_power/jun06-12.php (19/5/2010)

*"Predatory lending undermines military readiness, harms the morale of troops and their families and adds to the cost of fielding an all volunteer fighting force. The report outlines the prevalence around military installations of payday lenders and the overt marketing of some installment (sic) and Internet lenders. The products they provide are of primary concern."*²¹⁷

"Over the 2000-2005 period, revoked or denied security clearances for US Sailors and Marines on the basis of financial difficulties rose by around 1500%. This was considered to have a detrimental impact on America's war effort in Iraq."

"Predatory lending undermines military readiness, harms the morale of troops and their families and adds to the cost of fielding an all volunteer fighting force."

The issue was put in even starker terms by Captain Mark D Patton, US Navy Commanding Officer at Point Loma naval base, California. Appendix 5 of the Report on Predatory Lending provides a reproduction of the transcript for Captain Patton's 23 May 2006 appearance at a hearing of the California State Senate Joint Assembly Sunset Review/Consumer Protection Committee.

At the hearing, Captain Patton stated:

*"...there has been an explosive increase in the number of predatory establishments that encourage deferred deposit transactions with single balloon payments and easy - even encouraged - loan flipping policies. This is a direct threat to our military readiness. There are nearly four Payday Lenders for every McDonalds in California."*²¹⁸

²¹⁷ US Department of Defense, *Report on Predatory Lending Practices*, p. 53.

²¹⁸ Captain Mark D. Patton, *Statement before the California State Senate Joint assembly Sunset Review/Consumer Protection*, 23 May 2006 . Reproduced - US Department of Defense, *Report on Predatory Lending Practices*, p. 86.

“This is a direct threat to our military readiness. There are nearly four Payday Lenders for every McDonald’s in California.”

Captain Patton went on to state *“We MUST protect our protectors”* and:

*“We do not need the so-called services of predators outside our gates who are little more than legalized loan sharks.”*²¹⁹

And finally, he stated:

*“There is no Enemy that our Navy is more passionate about defeating than one who targets our own sailors. We will do everything WE possibly can to turn this trend around and defeat unscrupulous practices that prey on our sailors. But these efforts demand tremendous resources; both in manpower and available funds. These are resources that we cannot afford to waste in a time of War.”*²²⁰

“We do not need the so-called services of predators outside our gates who are little more than legalized loan sharks.”

4.3.4 2007- Oregon, New Mexico

North Carolina was not the only US state tackling payday lending in 2006. The Oregon legislature debated and passed payday lending regulation that year, which came into effect in 2007. This is described below:

²¹⁹ Captain Mark D. Patton, *Statement before the California State Senate Joint assembly Sunset Review/Consumer Protection*, 23 May 2006 . Reproduced - US Department of Defense, *Report on Predatory Lending Practices*, p. 86, p. 88.

²²⁰ Captain Mark D. Patton, *Statement before the California State Senate Joint assembly Sunset Review/Consumer Protection*, 23 May 2006 . Reproduced - US Department of Defense, *Report on Predatory Lending Practices*, p. 88.

Oregon imposes a 36% interest rate cap

On 20 April 2006 the Oregon Legislature passed a number of amendments to the *Oregon Consumer Finance Act* to establish a specific regulatory regime applicable to payday lenders.

The regulations prohibited loans of less than 31 days altogether and limited the interest chargeable on a payday loan to 36% per annum, plus a one-off origination fee for a new loan (specifically excluding renewals or 'roll-overs') of \$10 for each \$100 borrowed - up to a maximum of \$30.²²¹

The cumulative, practical impact of these regulations is that for a payday loan of \$300 with a repayment period of 31 days in Oregon, the maximum cost is equivalent to 154% APR.

The regulations also prohibited lenders from allowing borrowers to take out more than one loan at a time, imposed a seven day cooling off period between loans and restricted the permitted number of loan roll-overs (or 'renewals') to two.²²²

Prior to the amendments, Oregon had experienced rampant growth in payday lending. The Oregon Department of Consumer & Business Services, Division of Finance and Corporate Securities reports from 2001 to 31 December 2005, the number of Oregon payday lending stores practically doubled - from 184 to 360 - and the principal loaned in payday loans grew from \$63.8 million in 1999 to \$250 million by 2004.²²³

The Centre for Responsible Lending found by 2005 that number had grown to over \$278 million, generating over \$56.3 million in fees.²²⁴ Oregon's payday lending industry was therefore medium sized by American standards, roughly commensurate with the state's population of approximately 3.8 million.²²⁵

²²¹ *Oregon Consumer Finance Act*, 725.622.

²²² *Oregon Consumer Finance Act*, 725.622.

²²³ Department of Consumer & Business Services, Division of Finance and Corporate Securities, *Payday loans in Oregon* - http://dcfs.oregon.gov/cf/fact_shett.html (20/5/2010)

²²⁴ King, Parrish, Tanik, *Financial Quicksand*, p. 17.

²²⁵ U.S Census Bureau, 2009 estimate. <http://quickfacts.census.gov/qfd/states/41000.html>. (20 May 2010)

The law came into effect on 1 July 2007 and a year later the Community Financial Services Association of America (a payday lending industry lobby group) reported 75% of Oregon's payday lenders had shut down with the remaining 70 stores offering other products in order to continue trading.²²⁶

The Centre for Responsible Lending estimated in December 2007 that the amendments will save Oregon borrowers up to \$65 million in loan fees.²²⁷

In signing the amendment into law, Oregon Governor Ted Kulongoski was quoted in an official press release:

*"The sad reality is that many borrowers cannot repay the loan in two weeks. And because of the exorbitant interest rate, they quickly find themselves mired in debt. Because they live and work at the low end of the pay scale, these borrowers must often choose between buying food and paying the loan fees. And that's wrong."*²²⁸

and:

*"No working resident of Oregon should suffer the hopelessness that comes from step debt that is the result of unregulated payday loans."*²²⁹

New payday lending regulations also came into effect in the state of New Mexico in 2007. However, unlike in Oregon (and the other examples above), the New Mexico lawmakers chose not to limit the interest rate allowable for loans. Instead, New Mexico chose a fee based cap - which means that the interest charged can still be very high, depending on the repayment term of the loan.

²²⁶ Community Financial Services Association, *Restrictive rate caps result in a ban of payday advance loans*, 25 February 2009, p. 1.

²²⁷ King and Parrish, *Springing the Debt Trap*, p. 19.

²²⁸ Oregon Department of Consumer & Business Services, Division of Finance and Corporate Securities, News Release: Governor Kulongoski signs payday regulation into law, Senate Bill 1105 caps interest rates and adjusts terms of loans, 26 April 2006.
http://dfcs.oregon.gov/cf/governors_newsrelease.pdf (20 May 2010)

²²⁹ Oregon Department of Consumer & Business Services, Division of Finance and Corporate Securities, News Release: Governor Kulongoski signs payday regulation into law, Senate Bill 1105 caps interest rates and adjusts terms of loans, 26 April 2006.
http://dfcs.oregon.gov/cf/governors_newsrelease.pdf (20 May 2010)

New Mexico caps fees and interest on payday loans at \$16.00 for every \$100 borrowed

On 1 November 2007 new laws took effect in New Mexico to regulate the state's payday lending industry. The provisions capped charges at \$16.00 for every \$100 borrowed (a \$15.50 charge, plus a 50 cent verification fee) and limited loan terms to between 14 and 35 days.²³⁰

Under this system, the minimum interest charge applicable to a New Mexico payday loan (using a 35 day repayment period) is equivalent to 166.8% APR. For a loan term of 14 days, the figure is 417.14% APR.

Under the legislation, a borrower who is unable to repay their loan must be offered a 130 day repayment plan with no additional fees or interest.²³¹

The law also aims to prevent loan rollovers, or 'loan flipping', by requiring the borrower to wait ten days after having paid off one payday loan before they can obtain a further loan.²³²

This regulation is supported by a state-wide payday loan database which is maintained by the New Mexico Regulation and Licensing Department. The database is funded by 50 cents from the charge for each loan.²³³

Finally, the law prohibits a lender from loaning an amount in excess of 25 percent of the individual's gross monthly income.²³⁴

Consumer advocates have criticised the New Mexico legislation for not appropriately addressing the fundamental issues of payday loans - namely the cost of the credit and the practice of requiring repayment in a single payment.²³⁵ The laws are likened to similar payday lending 'reforms'

²³⁰ The laws are contained within the *New Mexico Statutes Annotated* (NMSA) 1978, 58-15-32 to 38 and essentially constituted amendments to the *New Mexico Small Loans Act* of 1955. (Cap: NMSA 58-15-33. Loan period: NMSA 58-15-32.)

²³¹ NMSA 58-15-35.

²³² NMSA 58-15-36.

²³³ NMSA 58-15-33, NMSA 58-15-37.

²³⁴ NMSA 58-15-32.

²³⁵ The typical American payday loan is generally required to be repaid in a single payment. This is not necessarily the case in Australia, although it is reasonably rare for a loan to be paid off over more than two pay periods. Of course, even if a loan is paid off in two payments over the course of a month, the interest on the loan does not change - it is determined by the repayment amount and the over-all term of the loan.

undertaken in Florida, Michigan, Oklahoma and Washington which are deemed ineffective by consumer advocates.²³⁶

Further, there are claims payday lenders in New Mexico have evaded regulations by changing their products to high-cost instalment loans²³⁷ which are not caught by the legislation.²³⁸

The New Mexico Senate passed the bill on 16 March 2007 in a 37-5 vote which was described at the time as a compromise deal. Senator James Taylor, a Democrat from Albuquerque, stated:

*"We're not trying to close down this industry because we have identified the fact that there is a huge need for this industry. But, we've also identified that there is no need for these companies to be pillaging and raping consumers."*²³⁹

As a consequence of the compromise deal, the Consumer Federation of America still lists New Mexico as a state that authorises payday lending. This is because the New Mexico regulation still allows a cost of 417.14% APR for a two week loan of \$100.²⁴⁰

This view is bolstered by the Centre for Responsible Lending, which has found cooling off periods, payment plans, loans data-bases and income level related borrowing limits have been largely ineffective in preventing repeat borrowing.²⁴¹ Conversely, the same report found the relatively simple measure of a comprehensive 36% interest rate cap has been highly effective whenever and wherever enacted (such as in Oregon, North Carolina and through the *Military Lending Act*).

²³⁶ Leslie Parrish, *High-Cost Payday Lending Traps Arizona Borrowers*, Center for Responsible Lending, September 16 2008, p. 7 -8.

²³⁷ As opposed to single repayment loans, which is the usual model for American payday lending and is the type of loan the laws were drafted to address. By revamping the product as installment loans, lenders can often extend the loan period beyond the loan period defined for a short-term loan. This has been seen in Australia, when lenders in New South Wales extended loans terms to 63 days, in order to avoid legislation covering short term loans - defined as having loan terms of 62 days or less.

²³⁸ Consumer Federation of America – Payday Loan Consumer Information - <http://www.paydayloaninfo.org/facts.asp> (20 May 2010)

²³⁹ Payday Loan Industry Watch: [pliwatch.org](http://www.pliwatch.org)., *House, Senate lawmakers agree on payday loan restrictions*, 16 March 2007 - http://www.pliwatch.org/news_article_070316B.html. (20 May 2010)

²⁴⁰ Consumer Federation of America – Payday Loan Consumer Information - <http://www.paydayloaninfo.org/stateinfo/NM.asp> (20 May 2010)

²⁴¹ King and Parrish, *Springing the Debt Trap*.

Anecdotal evidence seems to suggest New Mexico's laws have had some effect, although this is inconclusive and may only relate to national lending chains which are less able to modify their practices (and product range) to evade specific state legislation. Certainly, Advance America withdrew their minor presence in New Mexico by closing nine stores.

The company stated in a 23 September 2008 media release:

*"This decision to close these Centers is the result of recent regulatory and legislative actions that prevent the Company from continuing to operate in an economically viable manner..."*²⁴²

Despite competing views, it is unclear to what extent the reforms have worked in New Mexico as the most recently available data predates the reform.

Prior to the reform, in 2005 the Centre for Responsible Lending reported New Mexico had a small to mid-sized payday lending industry by American standards. That year, payday lenders loaned out over \$139.5 million in principal and generated over \$30 million in payday lending fees.²⁴³ It is worth noting New Mexico has a relatively small population by US standards, of 2,009,671²⁴⁴. For the purposes of comparison, that is around 160,000 less than Western Australia²⁴⁵.

Until new data is reported it is not possible to determine whether the 2007 payday lending reforms have had a significant effect.

4.3.5 2008 - District of Columbia, Ohio, Arkansas

In January 2008, new payday lending rules came into effect in the District of Columbia. As in other jurisdictions applying comprehensive interest rate caps, the laws effectively prohibit the sale of payday loans in the District.

²⁴² Advance America, *Announces the Closing of 39 Centres*, 23 September 2008.

²⁴³ King, Parrish, Tanik, *Financial Quicksand*, p. 17

²⁴⁴ U.S Census Bureau, 2009 estimate. <http://quickfacts.census.gov/qfd/states/35000.html> (20 May 2010)

²⁴⁵ Australian Bureau of Statistics, 30 June 2008 estimate: 2.17 million. <http://www.abs.gov.au/ausstats/abs@.nsf/Products/3235.0~2008~Main+Features~Western+Australia?OpenDocument#PARALINK0> (20 May 2010)

District of Columbia imposes a 24% interest rate cap

On 18 September 2007 the District of Columbia (D.C.) passed the *Payday Loan Consumer Protection Act* (2007) by a 12 to 1 majority. The *Payday Loan Consumer Protection Act* amended the *Check Casher's Act* (1998), thereby ending D.C.'s previous authorisation of payday lending and specifically rendering the practice subject to the District's general 24% consumer credit interest rate cap.²⁴⁶

Under the legislation, payday lenders may continue to operate, but only if they obtain a Money Lenders licence from the D.C. Department of Insurance, Securities and Banking ("DISB") and operate under the cap.

The commissioner of the DISB, Commissioner Thomas E. Hampton stated:

*"This is a consumer protection measure intended to prevent the perpetual cycle of debt from entrapping some of our most vulnerable residents. DISB supports efforts to mitigate lending practices that are not in the consumer's long-term best interests."*²⁴⁷

In co-sponsoring the Bill, Council Member Mary M. Cheh was quoted by The Washington Post:

*"Less than 1 percent of borrowers are able to pay it back or pay it back in two weeks. They don't provide short-term loans. They create long-term debt and that's the whole point."*²⁴⁸

Of the 48 payday lending stores in the District, Ms Cheh stated:

*"If they can't follow the model and live within the cap, then they should go out of business."*²⁴⁹

²⁴⁶ District of Columbia, Department of Insurance, Securities and Banking <http://newsroom.dc.gov/show.aspx/agency/disr/section/26/release/12328/year/2007> (21 May 2010)

²⁴⁷ District of Columbia, Department of Insurance, Securities and Banking <http://newsroom.dc.gov/show.aspx/agency/disr/section/26/release/12328/year/2007> (21 May 2010)

²⁴⁸ Nikita Stewart, *Bill to cap payday loan interest passes*, The Washington Post, 19 September 2007 <http://www.washingtonpost.com/wp-dyn/content/article/2007/09/18/AR2007091801943.html> (21 May 2010)

The Act took effect on 9 January 2008.

In June 2008 Ohio passed payday lending regulation which was affirmed by the public in a state-wide referendum later that year. It appears this regulation has had some impact, but lender efforts to circumvent the new rules have also been quite successful.

Ohio imposes 28% interest rate cap

In 2005 Ohio was the seventh largest payday loan market in America, generating over \$232.5 million in loan fees from \$1.63 billion in principal loaned across 1375 payday loan stores.²⁵⁰

This figure grew to 1638 payday loan stores by 2007 but has been reported by some sources to have dropped to 960 by May 2009²⁵¹ with further closures expected.

On 28 October 2009, Advance America reported a dramatic drop in revenue from its Ohio stores, from \$16.6 million to \$3.8 million.²⁵²

The winding back of payday lending in Ohio began with the passing of amendments to Ohio's *Short Term Loan Act* which came into effect on 2 June 2008. The amendments implemented a 28% APR cap for short term loans, in addition to a minimum loan term of 31 days and a maximum loan limit of \$500.²⁵³

²⁴⁹ Nikita Stewart, *Bill to cap payday loan interest passes*, The Washington Post, 19 September 2007, <http://www.washingtonpost.com/wp-dyn/content/article/2007/09/18/AR2007091801943.html> (21 May 2010)

²⁵⁰ King, Parrish, Tanik, *Financial Quicksand*, p. 17.

²⁵¹ Alexander Coolidge, *Payday lenders drying up - New Ohio law sends them packing*, May 18 2009, <http://news.cincinnati.com/apps/pbcs.dll/article?AID=/20090518/BIZ01?905180344/payday> (10 June 2009)

²⁵² *Advance America Cash Advance Reports Diluted Earnings per share of \$0.20 for the Third Quarter* <http://www.advanceamerica.net/about-us/media-details/233>

²⁵³ *Ohio Short Term Loan Act*. Interest cap: 1321.40 (A). Loan period: 1321.39 (B). Maximum loan amount: 1321.39 (C)

On 4 November of the same year, the *Short Term Loan Act* was the subject of a state-wide referendum, Ballot Initiative 5, held to affirm the Act. Between the Ohio ballot and a similar ballot in Arizona (where regulations authorising payday lending expired on 1 July 2010), Advance America spent \$8.1 million campaigning against anti-payday lending laws.²⁵⁴ Despite this expenditure, Ballot Initiative 5 was approved by a 63% majority.

Advance America reported the ballot result in a media release entitled “*Nearly Two Million Ohioans Stand Up for Payday Advances*”.²⁵⁵ The outcome was described as a result which:

“...will unfortunately deny responsible consumers the right to choose a sensible, reliable and regulated credit option to meet short term financial needs.”²⁵⁶

Despite the passing of the laws in June 2008 and the affirmation by referendum five months later, payday lenders continued to operate in Ohio. In most cases, lenders did so by obtaining lending licences under alternative Ohio legislation (namely, the *Small Loans Act* or the *Mortgage Loan Act*).

In March 2009, Ohio’s Housing Research and Advocacy Center found the vast majority of Ohio’s payday lenders were:

“...virtually ignoring the new Short-Term Loan Act enacted by the Ohio legislature in 2008: as of February 2009, there were only 19 active licences statewide under this law.”²⁵⁷

By contrast, the Center found 632 licences had been issued under the *Small Loan Act* since May 2008, 653 under the *Mortgage Loan Act*. In addition, 125 payday lenders had obtained licences under the state’s *Pawnbroker Act*.²⁵⁸

On balance, and based on 2007 figures, it was found 78 of 86 Ohio counties had experienced a decrease in the number of payday lending stores since the

²⁵⁴ Advance America, *Advance America Announces Results for 2008*, 19 February 2009.

²⁵⁵ Advance America, *Nearly Two Million Ohioans Stand Up for Payday Advances*, 5 November 2008.

²⁵⁶ Advance America, *Nearly Two Million Ohioans Stand Up for Payday Advances*, 5 November 2008.

²⁵⁷ Jeffrey D. Dillman, Samantha Hoover, Carrie Pleasants, *The new face of payday lending in Ohio*, Housing Research and Advocacy Center, p.3.

²⁵⁸ Dillman, Hoover, Pleasants, *The new face of payday lending*, p.1.

passing of the 2008 legislation, whereas two had actually experienced an increase and six had experienced no change.²⁵⁹

The flouting of the intended ban on payday lending in Ohio provoked further consumer advocacy. A New York Times article, published on 16 April 2009, quoted a spokesperson for the Center for Responsible Lending, Mr Uriah King:

*"It is not unusual for lenders to find ways to avoid new state regulations. Georgia, New Hampshire, North Carolina, Oregon and Pennsylvania had to pass a second round of legislation or aggressively enforce regulations after their initial reform efforts. Payday lenders are very aggressive about circumventing the law. It takes the real will of the regulators to ensure that the will of the legislatures are met."*²⁶⁰

The same article reported that Matt Lundy, a Democrat Representative and chairman of the consumer affairs and economic protection committee in the Ohio House, was preparing a bill to '*plug the loopholes*'.

That legislation, entitled the *Issue 5 Payday Lending Enforcement Act*, was introduced to the Ohio legislature on 4 June 2009. The Act imposes the existing 28% interest rate cap on all loans under \$1000 with a repayment term of 90 days or less - and prohibits the charging of a fee to cash a loan cheque.²⁶¹

Further, the legislation empowers the state Attorney General to prosecute lenders who evade the regulation.²⁶²

Mr Mundy has stated:

*"We have a clear mandate from the voters to make sure that their will is enforced. They wanted the payday lenders reined in."*²⁶³

²⁵⁹ Dillman, Hoover, Pleasants, *The new face of payday lending*, p.4.

²⁶⁰ Bob Driehaus, *Lenders Thwart Ohio Law Intended to Limit High Interest on Payday Loans*, New York Times, 16 April 2009.

²⁶¹ H.B. No. 209 sec. 1321.13.

²⁶² H.B. No. 209 sec. 1321.61.

²⁶³ Driehaus, *Lenders Thwart Ohio Law*, New York Times, 16 April 2009.

The Bill has been assigned to the Financial Institutions, Real Estate and Securities Committee for consideration.²⁶⁴

The payday lending policy debate in Arkansas also culminated in 2008, resulting in the affirmation of a state based Constitutional prohibition against usury. The prohibition had much greater success in countering payday lending. This is set out below:

Arkansas reinforces state-based Constitutional usury limit of 17%

Throughout the 1990s the Arkansas Attorney General's office successfully launched several legal actions against payday lenders for breaching a usury limit of 17% APR, imposed by Article 19, Section 13 of the Arkansas Constitution.²⁶⁵

In response, the payday lending industry lobbied for and won legislation to exempt them from the state Constitution. That legislation (the *Check Cashers Act*) was passed in 1999.²⁶⁶

The *Check Cashers Act* purported to legalise payday lending in Arkansas and provided a regulatory regime to be overseen by the Arkansas State Board of Collection Agencies.

The *Check Cashers Act* determined sums advanced as payday loans '*shall not be deemed to be a loan*' and fees charged by payday lenders were not '*deemed to be interest*'.²⁶⁷

On 24 March 2000 and in response to the *Check Cashers Act* and similar legislation in other states, the US Federal Reserve Board of Governors issued

²⁶⁴ Ohio Legislative Service Commission, House Bill Status Report of Legislation 128th General Assembly <http://lsc.state.oh.us/coderev/hou128.nsf/House+Bill+Number/0209?OpenDocument> (20 May 2010)

²⁶⁵ H.C. Klein, *Payday Loans in Arkansas*, AARP/Arkansas, http://www.stoppaydaypredators.org/pdfs2/payday_loans.pdf. Article 19, Section 13 (b) states:

"Consumer Loans and Credit Sales: All contracts for consumer loans and credit sales having a greater rate of interest than seventeen percent (17%) per annum shall be void as to principal and interest and the General Assembly shall prohibit the same by law."

²⁶⁶ H.C. Klein, *Payday Loans in Arkansas*, AARP/Arkansas, http://www.stoppaydaypredators.org/pdfs2/payday_loans.pdf

²⁶⁷ *Check Casher's Act* (Act 1216 of 1999 - Arkansas Code Annotated 23-52-101 to 117)

a rule²⁶⁸ stating 'regardless of how the fee is characterised for state law purposes' it would be regarded as interest and must be disclosed as such in accordance with Federal legal consumer disclosure requirements.

This rule came into effect on 1 October 2000. Various Arkansas representatives attempted to repeal or amend the *Check Cashers Act* through the Arkansas General Assembly but were unsuccessful.²⁶⁹

At the same time, consumers and consumer groups continued to launch legal actions against payday lenders, alleging lenders were violating the usury provisions of the Arkansas Constitution.

The consumer group Arkansans Against Abusive Payday Lending (AAAPL) found in a 2004 sample study that 44.44% of Arkansas payday lenders had been sued by Arkansas law firms. In addition, 33.33% were operating outside of the regulatory framework established by the *Check Cashers Act* and 22.22% were evading Arkansas state law by adopting the 'rent-a-bank' model.²⁷⁰ Further, 20.83% were evading state law by utilising out of state finance companies (effectively, a 'rent-a-finance company' arrangement). The study also found Fort Smith, Arkansas had the highest per capita number of payday lending stores of the cities in the study whilst also experiencing the lowest median household income.²⁷¹

In 2007 Arkansas elected a new state Attorney General with a strong interest in consumer law and payday lending.

On 18 March 2008 the Attorney General's office issued correspondence to 156 payday lenders demanding they immediately cease operation and void all outstanding loans.²⁷² The correspondence stated a failure to do so would result in legal action by the Attorney General's office as had occurred throughout the 1990s.

²⁶⁸ Federal Reserve System, 12 CFR Part 226, Regulation Z, Docket No. R-1050. *Truth in Lending*.

²⁶⁹ H.C. Klein, *Payday Loans in Arkansas*, AARP/Arkansas, http://www.stoppaydaypredators.org/pdfs2/payday_loans.pdf

²⁷⁰ *Payday Lenders in Arkansas: The Regulated and the Unregulated*, Arkansans Against Abusive Payday Lending, August 2004. p. 2.

²⁷¹ *Payday Lenders in Arkansas: The Regulated and the Unregulated*, Arkansans Against Abusive Payday Lending, August 2004. p. 2 - 3.

²⁷² Dustin McDaniel, Arkansas Attorney General, Wednesday 19 March 2008 - http://www.ag.arkansas.gov/newsroom/index.php?do:newsDetail=1&news_id=156. (21 May 2010)

In November 2008, the Arkansas Supreme Court found in a unanimous 6-0 ruling that the *Check Cashers Act* “clearly and unmistakably” authorised “usurious interest rates” which violated the Arkansas Constitution and declared the Act void.²⁷³ In the judgement, Associate Justice Paul E. Danielson expressed the court’s view on the issue of payday lending fees:

*“Because that fee is in reality an amount owed to a lender in return for the use of borrowed money, we must conclude that the fees authorized clearly constitute interest.”*²⁷⁴

Payday lenders had already been leaving Arkansas due to Attorney General McDaniel's correspondence and by August 2009 the industry had completely left the state.²⁷⁵

The Consumer Federation of America now lists Arkansas as one of sixteen American states that explicitly prohibits high-cost payday lending.²⁷⁶

Arkansas is the only American state to do so by a virtue of a Constitutional provision.

4.3.6 2009 - New Hampshire, South Carolina

The state of New Hampshire also passed a comprehensive interest rate cap in 2008 which came into force in early 2009.

Advance America made a legal attempt to be exempted from the new regulation but this was rejected.

New Hampshire imposes 36% interest rate cap

On 14 February 2008 the New Hampshire Senate passed legislation to apply a 36% comprehensive interest rate cap to payday loans.²⁷⁷ The payday

²⁷³ *McGhee v Arkansas Board of Collection Agencies*, Supreme Court of Arkansas No. 08-164. p.13.

²⁷⁴ *McGhee v Arkansas Board of Collection Agencies*, Supreme Court of Arkansas No. 08-164.p.11.

²⁷⁵ *Payday lending is history in Arkansas*, August 11 2009, Arkansans Against Abusive Payday lending, http://www.stoppaydaypredators.org/pdfs/payday_lending_is_history.pdf (21 May 2010).

²⁷⁶ Consumer Federation of America – Payday Loan Consumer Information - <http://www.paydayloaninfo.org/legal.asp>.

²⁷⁷ Advance America, *New Hampshire state senate voted to pass 36% Rate cap on payday loans*, 14 February 2008. <http://www.advanceamerica.net/about-us/media-details/24> (21 May

lending industry in New Hampshire had grown since 2000, after the state removed its traditional 24% interest rate cap on small loans.²⁷⁸

The Centre for Responsible Lending found in 2005 that New Hampshire had 51 payday lending stores, lending an average loan amount of \$366 per loan.²⁷⁹ The \$38 million loaned out in principle generated \$6 million in loan fees, making the industry quite small by American standards, particularly given the state's population of approximately 1.3 million.²⁸⁰

The new law came into effect on 1 January 2009.

In a decision dated 6 January 2009, the New Hampshire Banking Department rejected a request by Advance America for a declaratory ruling that their "Credit Line" product should be regarded as a small loan, not a payday loan and should not be subject to the 36% cap. This finding was made on the basis the interest charged for the product constituted an unfair trade practice and was also deceptive. Accordingly, the Department was not required to determine the definitional issue of whether the loan was a small loan or a payday loan.

The finding stated in part:

"Having considered the Company's December 9, 2008 request and the supplement material attached hereto, I find that the Credit Line Product does not comply with New Hampshire law and that it may not be offered in New Hampshire or to New Hampshire consumers after the date of this Letter. I so find because an APR of 365% or more on small loan constitutes an unfair trade practice...and is therefore unlawful. Further, the Credit Line Product contract is vague in regards to key terms and conditions and is thus deceptive. The determination of

2010) . (New Hampshire Statutes - Chapter 399-A: Regulation of Small Loans, Title Loans and Payday Loans. 399-A:13 Provisions Applicable to Payday Loan Lenders.)

²⁷⁸ National Consumer Law Center, - America's Consumer Law Experts Protecting Vulnerable Consumers and Promoting Marketplace Justice - *Predatory Small Loans , a form of loan-sharking , the problem, legislative strategies, a model act* - http://www.consumerlaw.org/issues/payday_loans/pay_menu.shtml. (21 May 2010)

²⁷⁹ King, Parrish, Tanik, *Financial Quicksand*, p. 17.

²⁸⁰ US Census Bureau, 2009 estimate. <http://quickfacts.census.gov/qfd/states/33000.html> (21 May 2010)

*unfairness and deception renders the Company's argument regarding the type of loan - small loan vs. Payday - moot.*²⁸¹

On 9 February 2009 Advance America issued a press release stating it would be closing its 24 New Hampshire payday lending stores, following passage of the above legislation and the above decision by the Department which *"...effectively prohibits the offering of the cash advance product in that state."*²⁸²

While Advance America was attempting to find a way around the New Hampshire payday lending laws in 2009, by contrast it was supporting proposed new payday lending regulation in South Carolina. As the following case study illustrates, this apparent contradiction can be explained by the fact the South Carolina regulation differed significantly from the New Hampshire regulation. Like in New Mexico in 2007, South Carolina proposed to regulate various aspects of payday lending but avoid an effective limit on the cost of the loans.

Attempted payday lending reform in South Carolina

On 16 June 2009, the South Carolina Senate over-rode a State Governor's veto to pass the *South Carolina Deferred Presentment Services Act* (2009) by a vote of 39 to 3.²⁸³

The *South Carolina Deferred Presentment Services Act* was a mild reform, imposing a requirement that a lender charge no more than 15% of the face value of the payday loan in interest and charges.²⁸⁴ In addition, the Act limited customers to a maximum loan limit of \$500 and prohibited lending to customers with outstanding loans.²⁸⁵

²⁸¹ Peter C. Hildeth, Banking Commissioner New Hampshire Banking Department, Decision: *Advance America Cash Advance Centers of New Hampshire Inc. - Request for no-action determination/declaratoryruling*, 6 January 2009, p. 1.

²⁸² Advance America, *Advance America announces settlement in Georgia and closing of 24 centers in New Hampshire*, 9 February 2009.

²⁸³ South Carolina Legislature Online: http://www.scstatehouse.gov/sess118_2009-2010/bills/3301.htm (21 May 2010)

²⁸⁴ South Carolina Code of Laws 34-39-180(E)

²⁸⁵ South Carolina Code of Laws 34-39-180(B), 34-39-270 A(1).

In vetoing the bill on 26 May 2009, Governor Mark Sanford had expressed his view that South Carolinians should be free to make their own financial decisions and was quoted in a South Carolina based internet news service stating:

*"...it is my hope that in time they see my consistency in pushing for limited government and maximized individual freedom."*²⁸⁶

Advance America's public affairs director, Jamie Fulmer, expressed the company's disappointment in the Governor's veto:

*"Advance America understands Governor Sanford's belief that too much government interference in private sector enterprise can lead to overly restrictive regulation. But we are disappointed that he chose to veto (the payday lending bill) which would have provided consumers who choose to use the cash advance product in South Carolina with comprehensive reforms and protections."*²⁸⁷

Advance America's support for the *South Carolina Deferred Presentment Services Act* seems indicative of the fact the reform was never likely to significantly limit South Carolina's payday lending industry. The Consumer Federation of America points out a payday lender in South Carolina is still permitted to charge 391% APR for a two-week loan of \$250, even after the reform.²⁸⁸

On 2005 figures, South Carolina's payday lending industry generated over \$206 million in payday loan fees through 1066 stores.²⁸⁹ This meant South Carolina had the 8th largest payday lending industry in America despite only being ranked 24th by population (approximately 4.5 million people).²⁹⁰

South Carolina also happens to be Advance America's home state - the company has its headquarters in the South Carolina city of Spartanburg.

²⁸⁶ Roddie Burris, *Sanford vetoes payday lending bill*, The State.com, 3 June 2009 <http://www.thestate.com/local/story/811902.html> (15 June 2009)

²⁸⁷ Roddie Burris, *Sanford vetoes payday lending bill*, The State.com, 3 June 2009 <http://www.thestate.com/local/story/811902.html> (15 June 2009)

²⁸⁸ Consumer Federation of America – Payday Loan Consumer Information - <http://www.paydayloaninfo.org/legal.asp>

²⁸⁹ King, Parrish, Tanik, *Financial Quicksand*, p. 17.

²⁹⁰ US Census Bureau, 2009 estimate. <http://quickfacts.census.gov/qfd/states/45000.html>

4.3.7 2010 - Arizona

Finally, on 1 July 2010, a decade long authorisation of payday lending in Arizona came to an end and the state's traditional 36% comprehensive interest rate cap on loans below \$1000 was reinstated. This is described below:

Arizona re-instates traditional interest rate cap of 36%

On 1 July 2000, Arizona enacted laws which exempted payday loans from the state's 36% APR interest rate cap, which had traditionally been applicable to loans of \$1000 or less.²⁹¹

The exemption did not permit the charging of unlimited fees for payday loans but instead imposed a maximum charge on loans of \$500 or less. This cap was set at \$17.65 per \$100 borrowed, equivalent to 459% APR for a two week loan or 214.7% for a 30 day loan.

Payday lending flourished in Arizona under this exemption and by August 2008 over 700 payday lending stores were operating across the state. Collectively, the industry was estimated to be loaning out approximately \$841 million in principal for payday loans and generating approximately \$149 million in fees.²⁹²

The exemption was scheduled to sunset on 1 July 2010, at which time the original 36% cap would again apply to all loans of less than \$1000.

In an attempt to avoid this sunset clause, the Arizona payday lending industry launched a 'citizen initiated' referendum, termed Arizona Proposition 200, or the *Payday Loan Reform Act*. The ballot campaign was heavily backed by industry, which spent \$8.7 million on the campaign, through the state-based payday lending industry body - the Arizona Community Financial Services Association.²⁹³ The ballot on the *Payday Loan Reform Act* was held in

²⁹¹ This provision, which is now back in effect, can be found in Arizona Revised Statutes 6-632 A.(1)

²⁹² Parrish, *High-Cost Payday Lending Traps Arizona Borrowers*, p. 2.

²⁹³ Matthew Benson, *Big Money, not citizens, driving initiatives*, The Arizona Republic, July 30 2008. See: <http://www.azcentral.com/arizonarepublic/news/articles/2008/07/30/20080730initiatives0730.html> (9/7/2010)

November 2005 - the same month as the similar Ballot 5 Initiative in Ohio (see above).

The *Payday Loan Reform Act* sought to remove the sunset clause applicable to the exemption on payday loans and impose a regulatory regime that would secure the ongoing viability of the industry.

The *Payday Loan Reform Act* regulatory regime included:

- A slight reduction in the \$17.65 cap, to \$15 for every \$100 borrowed, (equivalent to 391% APR for a two week payday loan);
- A maximum loan term of 35 days;
- A limit of one payday loan per borrower at any given time, plus a 24 hour cooling off period;
- Capacity for direct debit processing to ensure payment of loans;
- A repayment plan scheme;
- A borrower database to track active repayment plans
- Product disclosure in Spanish or English, at the borrower's request.

Consumer advocates contested the *Payday Loan Reform Act*, arguing it did not represent effective reform and would permit harmful payday lending in Arizona beyond 1 July 2010 and indefinitely into the future. In particular, advocates cited other states which had implemented similar reforms, only to find they did not curb payday lending. Those states included Florida, Michigan, Oklahoma and Washington.²⁹⁴

The *Payday Loan Reform Act* was rejected in the November ballot by a 59.5% majority and as a consequence, a 36% interest rate cap came into effect in Arizona on 1 July 2010.

A week later, Advance America announced it would cease operations in Arizona, concluding that due to the sunset clause cash advances were no longer permitted and "*...an economically viable alternative product or service does not currently exist.*"

²⁹⁴ Parrish, *High-Cost Payday Lending Traps Arizona Borrowers*, p. 7.

The company announced it would close its 47 Arizona stores, which had generated \$3.7 million in revenue and \$1.5 million in gross profit in the first three months of the year, to 31 March 2010.

The Consumer Federation of America now lists Arizona as a state which prohibits payday lending.

4.3.8 Other American states that prohibit or restrict payday lending

Other American states that prohibit payday lending (not discussed above) are listed below:

- New York
- New Jersey
- Pennsylvania
- West Virginia
- Maryland
- Vermont
- Connecticut
- Massachusetts
- Maine

In each case, the state has simply maintained its historical opposition to usury and failed to permit the practice to operate during the general period of industry expansion experienced throughout the 1990s.²⁹⁵

When taken together, it is fair to say much of the north-east corner of the United States actively enforces interest rate caps to prevent high-cost payday lending - this is particularly so if Ohio and the District of Columbia are added to the list.

4.4 Summary: The current policy trend in the United States

The period from 2004 - 2009 saw a modest but significant winding back of high-cost payday lending in America.

²⁹⁵ Consumer Federation of America – Payday Loan Consumer Information - <http://www.paydayloaninfo.org/legal.asp>

“In no state or district where payday lending has been prohibited has there been popular political pressure for it to be restored.”

This trend continued, with an exemption for payday lenders having sunset in Arizona on 1 July 2010, rendering payday loans subject to that state's 36% small loans interest rate cap. Arizona has thus become the sixteenth American state to expressly cap interest in payday lending, along with the District of Columbia.

The American experience of payday lending tends to indicate reform is only effective when the legislative intent is not to modify the practice, but to strictly limit cost through the implementation of a comprehensive interest rate cap.

In almost every reforming state, the legislative intent to prohibit exploitative lending practices has been strongly resisted by a payday lending industry that is highly creative in evading state based legislation. Amongst other examples, the tenacity of the payday lending industry is demonstrated by:

- The need in Ohio to bolster the 2008 *Short Term Loan Act* by introducing the *Issue 5 Payday Lending Enforcement Act* a year later, which itself gives efficacy to an anti-payday lending mandate gained by virtue of a state-wide referendum. At the time of writing this second Act had yet to be passed despite being introduced a year earlier and;
- The need in Arkansas for a 2008 Supreme Court ruling to enforce the state's Constitutional provision against usury as well as a US Federal Board of Governors rule clearly countering the state's *Check Cashers Act* since October 2000 and;
- The need for the New Hampshire Banking Department to issue a declaratory ruling against Advance America, who was seeking to have its payday loan product deemed as something other than a payday loan.

In no state or district where payday lending has been prohibited has there been popular political pressure for it to be restored.

In those states where the issue has been tested in the electorate (namely the 2008 ballots in Ohio and Arizona), the public have affirmed broad support for an interest rate cap - despite intensive lobbying by industry.

Despite this clear trend, the winding back of payday lending in America should not be over-stated. Payday lending is still authorised in a vast majority of American states and of those states where it has been rolled back, only Ohio can be said to have had an industry of truly national significance.

Of the top six states, three of them easily dwarf Ohio's \$232 million industry (on 2005 figures).²⁹⁶ In the same year, Louisiana generated approximately \$345 million in fee revenue and Missouri approximately \$351 million. In California, the nation's largest payday lending industry loaned out almost \$2.5 billion in principal, through 2445 stores, generating \$405 million in payday loan fees. These numbers are particularly impressive when one considers the average loan amount in California was only \$253. Further, it should not be forgotten that those figures are based on a 2005 survey (the latest available comprehensive data) and are likely to have grown significantly since then.

The requirement to achieve payday lending reform on a state by state basis has made reform difficult, as the debate generally devolves into a lobbying contest between industry and those who favour a cap. The varying outcomes across different states are reminiscent (although obviously far more various) of the 'patch-work quilt' of regulation that has traditionally existed across Australian state jurisdictions (see Chapter 5).

As in Australia, there are indications payday lending regulation in America may be moving into the Federal sphere of politics. This presents the possibility that universally strong restrictions may be applied, or, conversely, that recently implemented state-based protections may be lost.

On 24 January 2008, the *Wall Street Journal* published an opinion piece entitled "*Beyond Payday Loans*". The piece was co-authored by the current Governor of California, Arnold Schwarzenegger and the former president of the United States, Bill Clinton. The piece commences:

"The American dream is founded on the belief that people who work hard and play by the rules will be able to earn a good living, raise a family in comfort and retire with dignity.

²⁹⁶ King, Parrish, Tanik, *Financial Quicksand*, p. 17

But that dream is harder to achieve for millions of Americans because they spend too much of their hard-earned money on fees to cash their paychecks or pay off high-priced loans meant to carry them over until they get paid at work.”²⁹⁷

The article essentially calls for a nationwide reduction in the use of fringe credit, particularly payday loans, on the basis that to do so is not only good for individuals but also has significant macroeconomic benefits:

“Imagine the economic and social benefits of putting more than \$8 billion in the hands of low- and middle-income Americans. That is the amount millions of people now spend each year at check-cashing outlets, payday lenders and pawnshops on basic financial services that most Americans receive for free – or very little cost – at their local bank or credit union.”

The piece focuses on enabling vulnerable and ‘unbanked’ Americans to enter the economic mainstream and implores “...leaders across the country in the public, private and nonprofits sectors to join this effort.”

In particular, the piece calls on banks and credit unions to expand their efforts to provide low-cost alternatives to payday loans, stating:

“They already have the storefronts to compete for this business: More than 90% of nonbank alternatives are located within one mile of a bank or credit union branch.”

In concluding their article, Schwarzenegger and Clinton state: “By working together, we can improve the lives of millions of people, boost our economy and strengthen our communities”.²⁹⁸

Less than a month later, the *Wall Street Journal* published a further article entitled “High-Interest Lenders Tap Elderly, Disabled.” The article focused specifically on payday loans and called attention to a growing trend for payday lenders to target borrowers on social security benefits:

²⁹⁷ William J. Clinton and Arnold Schwarzenegger, *Beyond Payday Loans*, The Wall Street Journal, 24 January 2008.

²⁹⁸ Clinton, Schwarzenegger, *Beyond Payday Loans*.

“Such lenders are increasingly targeting recipients of Social Security and other governmental benefits, including disability and veteran’s benefits. ‘These people always get paid, rain or shine,’ says William Harrod, a former manager of payday loan stores in suburban Virginia and Washington, D.C.. Government beneficiaries ‘will always have money, every 30 Days’.”²⁹⁹

The article further cited evidence that payday lenders were targeting welfare recipients:

“There are no publicly available statistics on the proportion of payday loans that are backed by Social Security and other government benefits. But dozens of legal-aid lawyers, senior service groups and credit counsellors across the country say they are seeing more and more clients on Social Security struggling with multiple payday loans.”

And;

“An analysis of data from the U.S. Department of Housing and Urban Development shows many payday lenders are clustered around government-subsidized housing for seniors and the disabled.”

Without calling for any reform or solution, the article served to further highlight the broad social and economic detriment resulting from payday lending in America and its particular impact on the financially disadvantaged.

As part of Barack Obama’s successful Obama ’08 presidential election campaign, an eight page policy document entitled “*Barack Obama’s Plan to Strengthen the Economy for Working Families*” was made publicly available on the Obama campaign web-site.³⁰⁰ The document sets out five main policy goals, collectively grouped under the heading “*Barack Obama’s Economic Growth Agenda*”.

Of the five headings, which include objectives such as protecting homeownership, strengthening retirement security and providing middle class tax

²⁹⁹ Ellen E. Schultz and Theo Francis, *High-Interest Lenders Tap Elderly, Disabled*, The Wall Street Journal, 12 February 2008.

³⁰⁰ *Barack Obama’s plan to strengthen the economy for working families*, Barack Obama.com. <http://www.barackobama.com/pdf/issues/economy/EconomicPolicyFullPlan.pdf> (21 May 2010)

relief, the fourth heading is: *Address Predatory Lending Practices and Reform Bankruptcy Laws*.

A further sub-heading states – “*Cap Outlandish Interest Rates on Payday Loans and Improve Disclosure*”.

The document states:

*“In the wake of reports that some service members were paying 800 percent interest on payday loans, the U.S. Congress took bipartisan action to limit interest rates charged to service members to 36 percent. Barack Obama believes that we must extend this protection to all Americans, because predatory lending continues to be a major problem for low and middle income families alike.”*³⁰¹

In essence, the above statement calls for the capping of interest on all payday loans in America - which would effectively end the American high-cost payday lending industry.

It is an indicator of the significant socio-economic impact of high-cost payday lending in America that the issue could receive such profile, in the midst of a presidential election campaign.

Since assuming office on 20 January 2009, Barack Obama has not yet moved to fulfil his promise on payday lending. There are signs, however, his administration is concerned at the scale of fringe lending in America and is prepared to address the issue.

In an early indication, the President's 2010 budget requests included a 127% increase in funding to Community Development Financial Institutions (CDFI's).³⁰² Admittedly modest in the context of the broader economy, the increase would nevertheless lift CDFI funding from \$107 million in 2009 to \$243.6 million in 2010. CDFI's have been described as:

³⁰¹ *Barack Obama's plan to strengthen the economy for working families*, p. 6.

<http://www.barackobama.com/pdf/issues/economy/EconomicPolicyFullPlan.pdf> (21 May 2010)

³⁰² Community Development Financial Institutions Fund, United States Department of Treasury, *President's Budget Requests \$243.6 million for the CDFI fund*, 7 May 2009, http://www.cdfifund.gov/news_events/CDFI-2009-27-Presidents-2010-Budget-Request.asp (21 May 2010)

*"Community based specialized financial institutions that serve low-income people or work in economically distressed communities, often working in market niches that may be underserved by traditional financial institutions."*³⁰³

Of those CDFI's that are banks or credit unions, approximately 50% offer low-cost alternatives to payday loans.³⁰⁴ Such institutions essentially provide a government subsidised product that acts in direct competition with payday lending.

In further signs the payday lending policy debate is shifting to the Federal arena, the U.S. Congress has already seen the introduction of two payday lending bills. The nature of each bill, however, warrants further investigation.

On 26 February 2009, Luis Vincente Gutierrez, a Democratic Representative from Illinois, introduced the *Payday Lending Reform Act* of 2009. The bill proposed to cap payday lending, in those states where it is currently permitted, to the equivalent of 391% APR for a two week loan (expressed as a cap of 15 cents for every dollar loaned),³⁰⁵ the bill would also ban rollovers.³⁰⁶ The proposed legislation would reduce the industry's profitability, but would not prevent harmful repeat borrowing - and as a consequence, it has not been welcomed by either the industry³⁰⁷ or its critics.³⁰⁸

On 1 April 2009, Joe Baca, a Democrat from California, introduced the *Consumer Lending Education and Reform Act (C.L.E.A.R Act)*.

³⁰³ US Department of Treasury Press Room, *Testimony of Kimberley A. Reed, Director Community Development Financial Institutions Fund Before the House Appropriations Committee, Subcommittee on Financial Services*, 1 March 2007.p. 1. <http://www.treas.gov/press/releases/hp286.htm> (3 June 2009)

³⁰⁴ US Department of Treasury Press Room, *Testimony of Kimberley A. Reed, Director Community Development Financial Institutions Fund Before the House Appropriations Committee, Subcommittee on Financial Services*, 1 March 2007.p. 4. <http://www.treas.gov/press/releases/hp286.htm> (3 June 2009).

³⁰⁵ H.R. 1214: *Payday Lending Reform Act of 2009*, p. 10 lines 9-12.

³⁰⁶ H.R. 1214: *Payday Lending Reform Act of 2009*, p. 11 line 4.

³⁰⁷ For example, Michael Flores, CEO of Bretton Woods, Inc. a management consulting firm specialising in financial services, (and representing clients including payday lenders) testified before the Subcommittee on Financial Institutions and Consumer Credit on April 2, 2009, stating at p. 5: *"To sum up, I believe there is a need for all options to be made available in a regulated environment to satisfy the short-term credit market, a multi-billion, important market. I hope this Committee will find a legislative balance that increases, not diminishes competition in this market."*

³⁰⁸ For example, Jean Ann Fox, Director of Financial Services, Consumer Federation of America, testified before the Subcommittee on Financial Institutions and Consumer Credit on April 2, 2009, stating at p. 3: *"This legislation authorizes a predatory loan model that is the norm for state payday loan regimes and fails to provide substantial new protections in the states where payday lenders now operate under safe harbor carve-outs from state usury or small loan laws."*

The C.L.E.A.R Act proposes the same 391% APR interest rate cap for “brick and mortar stores” but allows higher rates for online lenders (an additional 5% of the principal loaned).³⁰⁹ The rationale for this difference is not made clear in the bill. Further, the C.L.E.A.R Act allows some roll-overs and – perhaps most significantly – takes the step of pre-empting all state laws on payday lending, removing state-based restrictions on payday lending wherever they currently exist and regulating the industry on a national basis.³¹⁰

The Baca bill is likely to garner industry support over the Guterrez bill, despite the fact QC Holdings (a nationwide US payday lending company) was Guterrez’s top corporate campaign contributor and donated \$13,300 towards his 2007-2008 campaign committee.³¹¹

Both bills are currently in the committee phase of the legislative process and may never be considered for general debate.³¹² It does appear, however, after years of state by state reform, the payday lending policy debate in America may be shifting to the national arena.

If the U.S. experience has demonstrated nothing else, it is that the only reform that successfully curbs payday lending is a comprehensive interest rate cap. Such a law requires significant political will, both to enact and subsequently enforce and is likely to be vehemently opposed by industry lobbyists.

America’s experience of payday lending is highly pertinent to the Australian context and the particular stage at which the Australian payday lending now finds itself. This is discussed further in the following chapter.

³⁰⁹ *H.R. 1846: C.L.E.A.R Act of 2009*, p. 5 lines 18-24. *H.R. 1846*, p. 6 lines 1 -4.

³¹⁰ *H.R. 1846: C.L.E.A.R Act of 2009*, p6 lines 5-16. *H.R.1846* p12 lines 16-24 & p13 lines 1 -15.

³¹¹ Opensecrets.org - Center for Responsive Politics -<http://www.opensecrets.org/politicians/summary.php?cid=N00004874&cycle=2008> (21 May 2010)

³¹² *H.R. 1214: Payday Lending Reform Act of 2009* - referred to House Committee on Financial Services - see: <http://www.govtrack.us/congress/bill.xpd?bill=h111-1214> (21 May 2010) *H.R. 1846: C.L.E.A.R Act of 2009* - referred to House Committee on Financial Services - see: <http://www.govtrack.us/congress/bill.xpd?bill=h111-1846> (21 May 2010)

Chapter 5 The Australian Policy Debate

5.1 Introduction

In Australia, legislative responsibility for the regulation of consumer credit has traditionally sat with State and Territory governments - an arrangement which has led to significant variation between jurisdictions. Since 1996 the Uniform Consumer Credit Code (**UCCC**) has sought to address the issue of inconsistency, an approach which has been somewhat successful, though not entirely.³¹³

In July 2008 the Council of Australian Governments (**COAG**) signalled a new approach by agreeing to transfer regulatory responsibility for consumer credit from the States and Territories to the Commonwealth - thereby setting in train the conditions for a single national consumer credit law, the first time in Australia's history that such a framework has existed.

Announced as a two stage process in October 2008, the stated intent of this significant reform is to:

“...boost consumer protection, cut red tape for business and ...modernise Australia's key financial services with the provisions of single national regulation and oversight.”³¹⁴

Phase One of the National Consumer Credit Protection Reform Package (the **Reform Package**) was introduced into the Australian parliament on 25 June 2009.

Phase One did not and was not intended to, address matters specifically related to high-cost short term lending. Instead, phase one focussed on writing the UCCC into national law (with some amendments), creating a new Australian Securities and Investments Commission (**ASIC**)-administered national licensing regime for credit providers and implementing mandatory

³¹³ The UCCC is enacted in Queensland legislation and applied by other states via legislation adopting the UCCC as in force in Queensland. It has been in force since 1 November 1996. See section 5.2.1 for more details.

³¹⁴ *National Consumer Credit: Single, standard, national regulation of consume credit for Australia*, Australian Government, p.1.

responsible lending requirements - along with other consumer protection measures.

These laws were passed as the *National Consumer Credit Protection Act 2009* (**National Credit Act**) in November 2009 and will generally apply to all credit providers and brokers who deal with consumers, including high-cost short term lenders.

New regulatory elements in the phase one legislation may have an impact on high-cost short term lending. For example, the legislation requires lenders to obtain a licence and join an ASIC-approved external dispute resolution scheme. In addition, the new responsible lending requirements require lenders to make an assessment that the loan product they are offering a customer is '*not unsuitable*' for that customer.

Whilst responsible lending obligations may have some limited impact on the high-cost short term lending industry, Phase Two of the Reform Package could have more profound significance.

The Federal Government has indicated Phase Two of the Reform Package will include:

*"Enhancements to specific conduct obligations to stem unfavourable lending practices, such as a review of credit card limit extension offers, **an examination of State approaches to interest rate caps**; and other fringe lending issues as they arise."*³¹⁵ (emphasis added)

This reference to '*...an examination of State approaches to interest rate caps...*' reflects the fact that, as is the case in America, Australian high-cost short term lending regulation varies significantly from state to state and depends largely on the application and enforcement of an interest rate cap or comprehensive interest rate cap.

Whether or not to apply a national interest rate cap is likely to be one of the more contentious aspects of Phase Two of the reform debate and places significant pressure on the Federal Government to take a clear policy position on the issue of high-cost short term lending.

³¹⁵ *National Consumer Credit*, Australian Government, p. 1.

If a national cap is not adopted then significant and, in some cases, long-standing state-based consumer protections will be lost. Conversely, the adoption of an effective national interest rate cap will significantly reduce the profitability of high-cost short term lending to the extent the industry may no longer be viable in Australia in its current form.

Given its potential impact, the interest rate cap debate will dominate the high-cost short term lending policy debate in Australia.

The following chapter assesses the relative merits of policy arguments both for and against the implementation of a national interest rate cap to address high-cost short term lending and examines how the debate has evolved so far and how it is likely to continue in the coming months.

In order to undertake this assessment, the chapter addresses the following questions:

- What is the current legislative approach to high-cost short term lending across various Australian state and territory jurisdictions? How effective have they been?
- What are the arguments against the implementation of a national interest rate cap?
- What are the arguments for the implementation of a national interest rate cap?
- Given the above discussion, what reasonable policy options are there for Government and how may they be best applied?

5.2 What is the current legislative approach to high-cost short term lending?

5.2.1 The Uniform Consumer Credit Code (UCCC)

The UCCC came into legal effect in most Australian States and Territories on 1 November 1996, with the adoption of Queensland based template legislation.

The agreement to adopt the UCCC was made by the State and Territory Governments in 1993 under the Australian Uniform Credit Laws Agreement 1993.³¹⁶

This agreement provided that the States and Territories would establish a co-operative scheme for uniform regulation of consumer credit. Amendments to the legislation could only be made with the agreement of a two third majority of the Ministerial Council for Uniform Credit Laws (which was established under the auspices of the Ministerial Council on Consumer Affairs).

However, under the agreement, certain matters were reserved for individual States and Territories providing for variation on matters not covered by the UCCC regime. These 'non-uniform matters' included licensing and/or registration of credit providers and 'the fixing of maximum interest rates payable under consumer credit contracts' (in other words: interest rate caps).

Apart from these non-uniform matters the UCCC did operate as a largely national code from its inception, with the exception of Tasmania and Western Australia, which both chose to retain a degree of legislative independence. For most States and Territories, any Queensland amendment automatically applied, with the proviso that no amendment could be passed by the Queensland parliament without first having been approved by a two third majority of the Ministerial Council. Despite the benefits of a uniform approach, it is arguable this system made the UCCC difficult to amend and unresponsive to changing circumstances.

The difficulty of achieving truly national regulation through the template system led to the 2008 COAG decision to transfer regulatory responsibility for consumer credit to the Commonwealth and the subsequent drafting of the legislation implementing Phase One of the Reform Package which wrote the UCCC into Federal law.

In so far as it related to high-cost short term lending, the UCCC had only limited relevance and did not create consistent national conditions for the industry.

³¹⁶The Consumer Credit Code Website, www.creditcode.gov.au
http://www.creditcode.gov.au/display.asp?file=/content/original_credit_code.htm

Initially, the UCCC did not apply to high-cost short term loans at all, as loans with a repayment period of 62 days or less were specifically excluded from the Code.

This exemption was removed on 10 December 2001, following a 2000 report by the Queensland Office of Fair Trading which specifically addressed high-cost short term lending (then a very young industry in Australia, just over a year old). Although the report recommended the UCCC should apply to high-cost short term lenders, it stopped short of advocating an interest rate cap³¹⁷.

Since the amendment, the short term loan provisions of the UCCC have applied to any loan of 62 days or less, for \$50 or more, where the annual interest rate exceeds 24% or the fees charged for the loan exceed 5%.³¹⁸

Accordingly, from December 2001 high-cost short term lenders have been subject to the disclosure requirements of the UCCC and borrowers have had legal access to UCCC avenues for challenging unjust or unconscionable contracts.

Unfortunately, such protections are largely ineffective in the context of high-cost short term loans, as the practical value of issuing court action over a short term loan (and the likelihood of an income constrained consumer doing so), is extremely low. The cost of taking legal action is also likely to be disproportionate to the amount in dispute.

At best, the amendment can be said to have required higher standards of product disclosure by high-cost short term lenders, although this can only really be regarded as a minor protection.

As was discussed in Chapter 2, the typical circumstances of a high-cost short term loan consumer mean no amount of disclosure is likely to discourage the purchase of high-cost credit, such is the perceived need for the product. Accordingly, the 2001 amendment to the UCCC appears to have had little to no impact on high-cost short term lending in Australia.

Therefore, if high-cost short term lending has been limited in various jurisdictions then this can only be attributed to state based legislation imposing

³¹⁷ *Payday Lending - A Report to the Minister of Fair Trading*, Queensland Office of Fair Trading, 2000.

³¹⁸ UCCC s. 7(1).

interest rate caps, specifically designed to address high-cost lending. These caps have operated independently from or in tandem with the UCCC and have existed in various forms since 1941. Such approaches have differed significantly from state to state.

As a means of informing the current debate (and highlighting that the issues are by no means new) the history of state based credit regulation is outlined briefly below.

5.2.2 New South Wales

In 1941 both New South Wales and Victoria introduced legislation specifically designed to prohibit usurious consumer credit. As is discussed below, Victoria chose to introduce an interest rate cap, whereas New South Wales did not. Instead, lawmakers in New South Wales enacted the *Moneylenders and Infant Loans Act*, which allowed courts to amend credit contracts if they could be shown to be harsh or unconscionable. The cost of a loan, both in terms of interest and fees charged, was considered central to considerations of harshness and unconscionability.³¹⁹

In 1981 the *Moneylenders and Infant Loans Act* was superseded by the *Credit Act*, which was further amended in 1984. Despite consultation with Victoria over the potential implementation of a 50 percent interest rate cap, the 1984 amendments did not introduce a cap.³²⁰ Instead, the *Credit Act* granted power to the Commercial Tribunal of NSW to introduce a maximum interest rate should it wish to do so. The Tribunal chose not to.³²¹

In 1991 the NSW government commissioned the Tribunal to carry out an investigation into the cost of consumer credit in NSW.

As a result of the investigation, in 1992 the Tribunal recommended a 48% cap should be introduced.³²² Despite an intervening change of government, this initiative survived and when the *Credit Act* was amended in 1993 a cap was introduced into NSW for the first time.

³¹⁹ Ian Manning and Alice de Jonge, *Regulating the cost of credit*, Consumer Affairs Victoria Research Paper No.6 March 2006, p. 17.

³²⁰ Manning and de Jonge, *Regulating the cost of credit*, p. 18.

³²¹ Manning and de Jonge, *Regulating the cost of credit*, p. 18.

³²² Manning and de Jonge, *Regulating the cost of credit*, p. 18.

The amendment did not impose the previously proposed 48% cap, but instead opted for a variable rate system, based on four times the Supreme Court interest rate with an extra 7% (or \$35 - whichever was the greater) allowable for loans under \$2000.³²³ At the time of enactment this formula equated to a 49% interest rate cap for high-cost short term loans.³²⁴ The intent of the legislation was to capture all fees and charges, but the wording was not sufficiently rigorous to do so.³²⁵

In 1996 NSW adopted the UCCC by enacting the *Consumer Credit (New South Wales) Act 1995*. In addition to adopting the Code, NSW bolstered its regulatory regime by retaining an interest rate cap, which was implemented by state based regulation. The regulation essentially mirrored the Victorian cap of 48%.³²⁶

When the UCCC was expanded in 2001 to include short term loans, NSW tightened its regulation to prevent legal evasion of the cap by the charging of fees as an alternative to interest. Although this measure was reasonably effective, some lenders evaded the law by issuing loans of 63 days duration (so as to avoid the 62 day definition of a 'short term loan') and this led to further extension of the cap.

This further legislation, titled the *Consumer Credit (New South Wales) Amendment (Maximum Annual Percentage Rate) Act 2005*, was assented to on 17 November 2005 and commenced operation on 1st March 2006. The amendments provided that the comprehensive cap applied to all consumer loans, regardless of their loan period.³²⁷

Finally, on 1 July 2010 further amendments came into effect in New South Wales, this time to counter-act a sham brokerage fee arrangement (or, "loop-hole") being used by the high-cost short term lending industry to further evade the state's interest rate cap.³²⁸

³²³ Manning and de Jonge, *Regulating the cost of credit*, p. 18.

³²⁴ Manning and de Jonge, *Regulating the cost of credit*, p. 18..

³²⁵ Manning and de Jonge, *Regulating the cost of credit*, p. 18.

³²⁶ Manning and de Jonge, *Regulating the cost of credit*, p. 18.

³²⁷ *Consumer Credit (New South Wales) Amendment (Maximum Annual Percentage Rate) Act 2005* Schedule 1, s. 11.

³²⁸ John Rolfe, Meet the lenders Charging 780 per cent, *The Daily Telegraph*, June 4 2010 <http://www.news.com.au/money/money-matters/meet-the-lenders-charging-780-per-cent/story-e6frfmd9-1225875224705> (13/7/2010)

5.2.3 Victoria

In 1941 Victoria introduced an interest rate cap of 48%, a figure which was derived from 1927 amendments to the UK *Moneylenders Act*. The intent of the cap was to prevent unconscionable practices in lending. The 48% figure had been identified in England as the point above which a lender would bear the onus to establish a loan was not unconscionable.³²⁹

The 48% cap has remained in Victoria since that time and throughout subsequent developments - such as the development of the UCCC.

In its current guise, the cap is enforced through the *Consumer Credit (Victoria) Act 1995*.³³⁰ The Victorian laws also void any mortgage (security taken over property) relating to a consumer credit contract with an interest rate over 30%.³³¹

Despite the existence of the cap, high-cost short term lending has flourished in Victoria since the late 90s. This growth is universally regarded to be due to the fact the cap (unlike the current NSW cap) does not explicitly include fees and charges.

A cap that fails to include fees and charges is effectively no cap at all, as lenders simply off-set interest rate limitations with fees. Crucially, the cost to the consumer is no different than if a higher rate of interest were being charged.

Further, the fees are disclosed as dollar amounts and not as an APR figure, which makes cost comparisons with other forms of credit difficult.

5.2.4 Queensland

Queensland is generally regarded as the state in which high-cost short term lending first originated in Australia.³³² Certainly, until very recently, Queensland clearly represented the largest payday lending market in Australia.

³²⁹ Manning and de Jonge, *Regulating the cost of credit*, p. 17.

³³⁰ *Consumer Credit (Victoria) Act 1995* s 39.

³³¹ *Consumer Credit (Victoria) Act 1995* s 40.

³³² Wilson, *Payday Lending in Victoria*, p.34.

To provide some perspective on the state's importance to the industry, in 2005 Cash Converters reported to have 37 Queensland stores offering high-cost short term loans - 13 more than in Victoria, the company's next most profitable state. By 2009, this figure had reportedly grown to 45³³³. Overall, Queensland was deemed to have 166 high-cost short term lenders by 2009.³³⁴

This prominence may be due to the historical lack of any price limit on consumer credit (as opposed to the regimes that existed in Victoria and NSW from 1941) combined with Australia's third largest population base.

Possibly due to the flourishing nature of the industry, the high-cost short term lending policy debate in Queensland has, at least in recent times, been more active than in other Australian jurisdictions.

Concern over the impact of high cost credit led Queensland's Attorney General and Minister for Justice, Kerry Shine, to release draft legislation in October 2007. The draft legislation, the *Consumer Credit (Queensland) Amendment Bill 2008*, proposed a comprehensive 48% interest rate cap, similar to the NSW regime. The draft legislation was opened for public comment with submissions closing on 15 February 2008. The consultation over this legislation was hotly contested by advocates both for and against the implementation of a cap.

The *Courier-Mail* (Queensland's only state-wide daily newspaper and the fourth largest newspaper in Australia) took a clear editorial stance in support of a cap.

Cash Converters, the largest high-cost lender in Queensland, adopted an active marginal seats campaign, lobbying 33 Queensland MP's whose electoral margins were smaller than 11,000.³³⁵ In addition, the company conducted a YouTube campaign depicting customers supporting payday lending and published a full-page ad in Queensland's Sunday newspaper, the

³³³ Patrick Lion, *State Attorney-General swoops on dodgy payday lenders*, The Courier Mail, 6 January 2009.

³³⁴ Patrick Lion, *State Attorney-General swoops on dodgy payday lenders*, The Courier Mail, 6 January 2009.

³³⁵ Derek Tipper, *Payday lenders won't wear interest cap*, ABC Far North Queensland, 19 October 2007. <http://www.abc.net.au/local/stories/2007/10/19/2063904.htm> (22 May 2010)

Sunday Mail, imploring the Government to re-consider the implementation of a cap.³³⁶

Of course, all lobbying was supported by numerous official submissions to Attorney-General Shine, as part of a broad consultative process that generated significant interest.

Despite the efforts of industry lobbyists, on 31 July 2008 a comprehensive 48% interest rate cap, inclusive of fees and charges, came into effect. The cap was implemented by state based regulation pursuant to section 14 of the *Consumer Credit (Queensland) Act 1994*.

Although it is still too early to determine the full impact of the cap, anecdotal evidence suggests it has had a significant impact on payday lending in Queensland.

This impact has not been straightforward, however, as many lenders quickly devised strategies to avoid the cap or simply continued to operate in defiance of it. For example, as was reported in Chapter 3, Cash Converters attempted to evade the cap utilising its pawnbrokers licence for the purpose of small loan lending by requiring the customer to hand over token "collateral" in a sham pawn-broking transaction. This product was sold as the "VIP Advantage Loan".³³⁷

On 6 January 2009, the *Courier Mail* reported approximately a third of Queensland's fringe lenders were under investigation by the Queensland Office of Fair Trading for breaching the cap.³³⁸

Specifically, the article reported Attorney-General Shine would require all Cash Converters stores to sign enforceable undertakings to desist from offering the "VIP Advantage Loan" and any store that refused to sign the deed would be liable for prosecution. The article further reported one lender (not a Cash

³³⁶ Derek Tipper, *Payday lenders won't wear interest cap*, ABC Far North Queensland, 19 October 2007. <http://www.abc.net.au/local/stories/2007/10/19/2063904.htm> (22 May 2010)

³³⁷ Patrick Lion, *Sky-high loan rates exposed as lenders skirt new law*, The Courier Mail, 17 August 2008. <http://www.couriermail.com.au/news/queensland/bligh-looks-at-lending-loophole/story-e6freoof-111117208453> (22 May 2010)

³³⁸ Patrick Lion, *State Attorney-General swoops on dodgy payday lenders*, The Courier Mail, 6 January 2009.

Converters outlet) had been found to be charging interest 10 percent above the cap and had been required to repay \$41,546 to customers.³³⁹

On 16 June 2009, the Courier Mail further reported that Queensland high-cost short term lenders would be required to pay back \$978,861 in illegal interest to almost 1700 customers, at an average of about \$575 per customer.

The largest single offender was Sunshine Loan centres, an online Gold Coast based lender, which was required to pay back \$684,977 in addition to being fined \$35,000.

Another online lender, Cash Today, was fined \$20,000 and required to repay \$14,788.

In all, 57 lenders were issued with breach notices and 14 were given warnings.³⁴⁰

Fair Trading Minister Peter Lawlor was quoted in the article as stating:

*"Inspectors will continue to monitor the industry closely and won't hesitate to prosecute rogue traders who persist in ripping off their customers. There is no excuse for further infringements."*³⁴¹

Reflecting the need for effective enforcement of any interest rate cap legislation, Legal Aid Queensland civil justice director Elizabeth Shearer was also quoted in the article:

*"(It) highlights how important it is to have good laws in place and good public officers enforcing them to protect vulnerable people from the unfair practices used by some fringe credit providers."*³⁴²

The Courier Mail followed up the article with editorial comment, stating:

"Queensland's notorious payday lenders have been caught out....It is good that the Government has worked to ensure a decent outcome for

³³⁹ Patrick Lion, *State Attorney-General swoops on dodgy payday lenders*, The Courier Mail, 6 January 2009.

³⁴⁰ Patrick Lion, *Ripped-off borrowers get their cash back*, The Courier Mail, 16 June 2009.

³⁴¹ Patrick Lion, *Ripped-off borrowers get their cash back*, The Courier Mail, 16 June 2009.

³⁴² Patrick Lion, *Ripped-off borrowers get their cash back*, The Courier Mail, 16 June 2009.

these customers, whose plight was revealed by a series of reports in The Courier-Mail about the seedier aspects of the payday lending industry."³⁴³

Developments within Queensland over the last twelve months hold significant interest for those engaged in the high-cost short term lending debate in Australia. The importance of the effective implementation and enforcement of a genuine interest rate cap in Australia's largest high-cost lending market cannot be over-stated and provides an ideal test case to assess the impact of a cap and to determine its appropriateness for nation-wide application.

5.2.5 South Australia

The UCCC took effect in South Australia on 1 November 1996 through the auspices of the *Consumer Credit (South Australia) Act 1995*. Other than through this legislation, South Australia does not specifically address high-cost short term lending, nor has it ever adopted an interest rate cap.

But there has been debate in South Australia surrounding high-cost lending.

In October 2006, the South Australian Office of Consumer and Business Affairs (**OCBA**) released a discussion paper, titled "*Payday lending in South Australia - options to increase consumer protection*" and called for submissions with a closing date of 6 November 2006.

It is arguable the OCBA was forced into this position by the actions of the shadow Minister for Consumer Affairs, Liberal MP Liz Penfold, who campaigned vocally for the introduction of an interest rate cap based on the NSW model.

Following the consultation period, Ms Penfold did indeed introduce legislation modelled on the NSW legislation that had come into effect in March that year. The *Consumer Credit (South Australia) (Maximum Annual Percentage Rate) Amendment Bill 2006* received its First Reading on 15 November 2006, but did not win support of the Parliament and was not passed.

Despite this failure, the issue has remained contentious in South Australia.

³⁴³ Courier Mail Editorial, *Victory for victims*, The Courier Mail, 16 June 2009.

On 18 February 2009 Dennis Hood, the leader of the South Australian branch of Family First, introduced the *Consumer Credit (South Australia) (Pay Day Lending) Amendment Bill 2009* - another attempt to introduce a comprehensive 48% interest rate cap. Again the Bill failed to win support, possibly due to imminent national reform, which would have rendered any legislation short-lived.

Despite this lack of legislative action, the OCBA continues to voice its concern about the ill-effects of payday lending.

At the time of writing, on a web-page headed "*What is payday lending?*",³⁴⁴ the OCBA website states:

"Problems with payday lending

There are widespread community concerns about payday lending. In-depth research summarised the problems as follows:

- *Payday lenders may charge high rates with effective interest charges as high as 1300% per annum.*
- *Payday lenders' clients are generally low-income consumers.*
- *The rolling over of payday loans leads to a rapidly growing debt that consumers may find difficult to repay.*
- *Lenders who require direct debit as a form of payment guarantee have priority access to the income of consumers, leaving them exposed to other financial difficulties."*

Under a further heading titled "*Related Information*" the web-page goes on to provide further links respectively titled: "*Payday lending isn't the answer to your financial needs*"³⁴⁵ and "*Alternative sources of financial assistance*"³⁴⁶.

The first link contains a detailed examination of the dynamics of payday lending with particular reference to the high cost of payday loan credit and the

³⁴⁴ South Australian Office of Consumer and Business Affairs:
http://www.ocba.sa.gov.au/consumeradvice/matters/paydaylending/what_is_payday.html (22 May 2010)

³⁴⁵ South Australian Office of Consumer and Business Affairs:
http://www.ocba.sa.gov.au/consumeradvice/matters/paydaylending/payday_not_ans.html (22 May 2010)

³⁴⁶ South Australian Office of Consumer and Business Affairs:
http://www.ocba.sa.gov.au/consumeradvice/matters/paydaylending/alt_sourcesml.html (22 May 2010)

potential for consumers to be caught in a debt trap. The page concludes with the statement:

"Horror stories aren't they!! Don't let it happen to you."

The second link contains contact details for various financial counselling, charity and alternative low-cost finance organisations.

5.2.6 Western Australia

As alluded to above, Western Australia did not adopt the UCCC in 1996, but instead opted for "alternative but consistent" legislation via the *Consumer Credit (Western Australia) Act 1996*.

This approach established similar consumer credit laws to those which existed in other states but did not tie WA to the national regime nor commit the state to future amendments to the UCCC. This represented a significant, although short-lived, divergence from the template approach favoured by most other states.

In 2003 WA amended the *Consumer Credit (Western Australia) Act 1996* to adopt the template system, a change which took effect on 9 July 2003. This was only a partial concession however, as the WA legislation still requires amendments to the UCCC to be passed by both houses of the Western Australian state parliament and published in the State Gazette before they can take legal effect in Western Australia.

This system also exists in Tasmania, the only other UCCC state to require local approval before UCCC amendments can take effect.

Western Australia has never had a maximum interest rate although the *Consumer Credit (Western Australia) Act 1996*, as with some other state Acts adopting the UCCC, does explicitly provide for the potential implementation of a maximum interest rate through regulation.

Section 12 of the *Consumer Credit (Western Australia) Act 1996* states in part:

“12. Maximum annual percentage rate

(1) A regulation under this part may prescribe a maximum annual percentage rate for a credit contract or class of credit contract, within the meaning of the Consumer Credit (Western Australia) Code.

...

(1a) In the case of a short term credit contract, the regulations may require interest charges and all credit fees and charges under the contract to be included for the purpose of calculating the maximum annual percentage rate under the contract for the purposes of subsection (1). "

Despite this provision, Western Australia has never had a concerted interest rate cap debate.

Instead, Western Australia has a unique credit licensing system, whereby non-bank credit providers must obtain a Credit Providers Licence under the state's *Credit (Administration) Act 1984*.

Although a notable feature of Western Australia's consumer credit landscape, a licensing regime in the absence of an interest rate cap does not prevent lenders offering usurious credit - it simply requires them to obtain a licence before they do so. Nevertheless, the licensing regime in Western Australia is often presented by opponents of interest rate capping as an effective means of preventing exploitative credit.

In its Response to the Federal Government's Green Paper on Financial Services and Credit Reform (July 2008), Cash Converters makes the statement:

“The Western Australian Government does not support capping and has adopted a stringent licensing regime, allowing them to exclude rogue traders from participating through a process of regular review. They understand that annualised capping distorts the market for short term loans and will drive traders from the industry denying consumer's choice.”³⁴⁷

³⁴⁷ Cash Converters, *Position Paper - Response to the Federal Government's Green Paper on Financial Services and Credit Reform*, July 2008 p. 9.

In 2005, Cash Converters reported it had 13 stores in Western Australia offering high-cost short term loans, a figure which appears to have grown to 19 by 2010.³⁴⁸ Despite Western Australia's relatively small population base, the State represents a significant market for the company - second only in importance to Victoria (at least since the introduction of an interest rate cap in Queensland).

It should also be noted Cash Converters was originally established in Perth in 1984 and continues to be a Western Australian based company.

5.2.7 Tasmania

Like Western Australia, Tasmania does not automatically apply amendments to the UCCC, but instead conducts a parliamentary vote before accepting any changes. The UCCC is applied in Tasmania through the *Consumer Credit (Tasmania) Act 1996*.

High-cost short term loans in Tasmania are currently regulated solely by the short term loan provisions of the UCCC, which is to say they are subject to only very minor regulation. This has not always been the case.

In 2000, while the Queensland Office of Fair Trading was conducting its report into fringe lending, the Tasmanian Government passed the *Payday Lenders Moratorium Act 2000 (Moratorium Act)*. The Moratorium Act came into effect on 26 April 2001 and imposed a moratorium on high-cost short term lending in Tasmania until 1 December 2002. The Act implemented an interest rate cap of 60% in addition to a prohibition on fees exceeding 10% of the total credit provided.³⁴⁹

As mentioned earlier, the short term loans provisions of the UCCC took effect on 10 December 2001. The passing of those amendments by the Tasmanian parliament cleared the way for the Moratorium Act to sunset on 1 December 2002, as had been envisaged from its commencement. Tasmania's interest rate cap then fell away and Tasmanian payday lending has been subject solely to the much weaker provisions of the UCCC ever since.

³⁴⁸ Cash Converters website: http://cashconverters.com.au/store_locator.html (22 May 2010)

³⁴⁹ Camilla Hughes, *Pay day lending in Tasmania*, Social Action and Research Centre, Anglicare Tasmania, January 2009, p. 18.

5.2.8 Northern Territory

The Northern Territory adopted the UCCC through the *Consumer Credit (Northern Territory) Act 1995*, an Act which does provide for the potential implementation of a maximum annual percentage interest rate although the provision has never been utilised.³⁵⁰

Given the small and relatively disparate population of the Northern Territory (about 225,900 in total with approximately 124,800 residing in Darwin)³⁵¹ it is unlikely the Territory will ever represent a major market for high-cost short term lenders. Probably due to this fact, the interest rate cap debate has not been particularly active in Territory politics. Nevertheless, high-cost short term lending does exist in the Territory.

Cash Converters, for example, operates two Northern Territory stores. In addition, online lenders actively and specifically promote their services to Territory residents through their business websites. Cash Doctors provides a good example of this - see:

<http://www.cashdoctors.com.au/locations/darwin.php>.

5.2.9 Australian Capital Territory

The Australian Capital Territory applies the UCCC through s4 of the *Consumer Credit Act 1995* (ACT) and has in recent times mirrored New South Wales' approach to consumer credit regulation.

In September 2006 the ACT amended its Consumer Credit Code to implement a comprehensive 48% interest rate cap, along the lines of that which had come into effect in NSW on 1 March the same year. The amending legislation, entitled the *Justice and Community Safety Legislation Amendment Act 2006* (ACT), took effect on 28 September 2006 and introduced a comprehensive calculation to ensure the ACT's 48% cap included all interest, fees and charges associated with a loan.

³⁵⁰ *Consumer Credit (Northern Territory) Act 1995* s. 11

³⁵¹ Australian Bureau of Statistics, *3218.0 - Regional Population Growth Australia 2008-2009*. June 2009 estimates.
<http://www.abs.gov.au/ausstats/abs@.nsf/Latestproducts/3218.0Main%20Features102008-09?opendocument&tabname=Summary&prodno=3218.0&issue=2008-09&num=&view=#PARALINK5> (22 May 2010)

5.2.10 National consumer credit reform

The UCCC was replaced by the National Credit Code under the National Credit Act on 1 July 2010.

There are some new regulatory provisions in the Act – most prominently, licensing, including a requirement to belong to an ASIC-approved external dispute resolution scheme, and responsible lending obligations.

It is unclear to what extent they will have an effect on high-cost short term lending. Like the 'old' UCCC, these measures rely on legal action being taken to test the provisions in each individual instance. As with the 'old' UCCC laws, the practical value in issuing court action over a small short term loan and the likelihood of an income constrained consumer doing so, is extremely low and the cost of taking legal action is likely to be disproportionate to the amount under dispute.

This leaves the regulator, ASIC, with the main role in taking legal action under the new rules. Unlike in Qld where the regulator has taken action as described above, the new national laws will be harder to enforce because they do not require simply demonstrating whether the loan cost exceeds the cap, but whether lenders have breached less clear-cut concepts such as acting reasonably or fairly and whether the loan is 'not unsuitable' for the borrower.

5.2.11 Summary

Currently, the ACT, NSW and Queensland all have comprehensive interest rate caps. These comprehensive caps are not long standing and although NSW has attempted to impose a comprehensive cap since 1993, it has required a few legislative attempts to do so. Queensland, in particular, has only managed to secure its cap very recently (July 2008). Victoria has had an interest rate cap since 1941, but because it fails to include fees and charges, it is largely symbolic.

The remaining jurisdictions - South Australia, Western Australia, Tasmania and the Northern Territory - have no cap at all, although Tasmania did impose a 60% cap for a brief period (26 April 2001 - 1 December 2002). Taken in its totality, it is clear the recent legislative trend in Australia has been in favour of comprehensive interest rate caps. Available evidence tends to suggest a comprehensive cap, combined with active enforcement, is effective in curbing

exploitative lending - although ongoing vigilance is necessary to counter avoidance behaviour.

Within the coming months, the Federal Government will be required to decide either for or against the implementation of a national interest rate cap - and in so doing, the Government will be required to determine the immediate future of high-cost short term lending.

In the meantime, state-based protections will remain.

What follows is an assessment of the arguments frequently made for and against the implementation of comprehensive interest rate caps.

This assessment includes an examination of the veracity of such arguments and provides an analysis of how they have been promulgated in the Australian context - who has made them, how they have been made and who they serve.

It is instructive that arguments against interest rate caps are almost universally made by proponents with a financial interest in payday lending - either directly as a business practice or as a consultant hired by a high-cost lender to research the industry.

It would be a mistake to accept such arguments at face value. At the very least, the strong element of self-interest demands those arguments be subjected to significant scrutiny and testing.

5.3 The arguments against an interest rate cap

In July 2008 Cash Converters provided its response to the Federal Government's Green Paper on Financial Services and Credit Reform, which had called for industry comment on the proposed Federal regulation of financial services and credit.

Cash Converters' position was that Federal oversight of all consumer credit was desirable, primarily because it would ensure “...*the short term loan industry in Australia is appropriately regulated.*”³⁵²

Cash Converters expressed particular concern that “*The current trend amongst State-based legislation is to introduce annualised caps on interest, fees and charges...*” and went on to state that if national regulation of

³⁵² Cash Converters, *Position Paper*, July 2008, p. 5.

consumer credit did not extend to the short term loan industry, then “...States such as Queensland and NSW will continue to introduce independent legislation and capping, threatening the viability of the industry.”³⁵³

The opportunity to respond to the Green Paper was used by Cash Converters to outline a number of arguments against interest rate caps. As a result, the document provides a useful summary of the arguments typically made by proponents of high-cost short term lending. It is those arguments which are discussed below.

In support of its arguments, Cash Converters drew heavily on the work of *Policis*, a UK based private research firm it commissioned to conduct a study of the Australian high-cost short term lending market and the impact of interest rate caps.

Through its reports, *Policis* has come to occupy a prominent space in the Australian high-cost short term lending debate. This echoes the role the organisation played in the UK in 2004-2005, when the firm was commissioned by the UK Department of Trade and Industry (**DTI**) to conduct research into the potential implementation of a cap in the UK.

Policis' role in that debate has been publicly questioned by consumer groups both in the UK and Germany and Consumer Action has serious concerns about the objectivity, transparency and methodology of the reports the firm has produced for Cash Converters.

The dearth of alternative objective academic research into the Australian high-cost short term lending market means the *Policis* reports may exert more influence than they warrant and unduly sway policy makers against interest rate caps.

Neither the arguments put forward by *Policis*, nor its role in the broader policy debate, should be accepted without rigorous critical analysis.

What follows is an examination of the arguments made by Cash Converters, *Policis* and others in favour of high-cost short term lending (and therefore, against interest rate caps) followed by an analysis of *Policis'* role in the broader debate and the objective merit of their reports.

³⁵³ Cash Converters, *Position Paper*, July 2008, p. 5.

5.3.1 The role of short term credit – “Fundamental Need”

The basis of most arguments in favour of high-cost short term loans is that the loans and their provision serve a ‘need’ or market in the community for short term credit.

This is expressed by Cash Converters in its submission:

“Any proposed changes must recognise that there is a need in the community for short term loans”³⁵⁴

And by *Policis* in its report: *“The dynamics of low income credit use: A research study of low income households in Australia”*:

“Demand for credit among those on low incomes is shaped by an irreducible need to borrow, most pronounced among young families.”³⁵⁵

This argument is often bolstered by figures illustrating the extent of high-cost short term lending, married with a characterisation of the product as a natural and essential feature of Australia's consumer credit landscape:

“Australia wide, Cash Converters has 138 outlets and employs more than 2,000 staff. Each year, we provide approximately \$230 million in small dollar, short term loans.”³⁵⁶

and:

“Short term lending is an important component of Australia's credit industry. In the period 1 June 2007 to 31 May 2008, Cash Converters provided approximately \$19 million in Cash Advance loans in South Australia and \$48 million in Queensland. These figures clearly indicate how widely our micro lending service is used. And we are only one lender in the industry.”³⁵⁷

According to this argument, the use of high-cost short term loans to meet basic expenses is evidence of their necessity. *Policis* puts this as a series of

³⁵⁴ Cash Converters, *Position Paper*, July 2008, p. 3.

³⁵⁵ Anna Ellison and Robert Forster, *The dynamics of low income credit use - A research study of low income households in Australia*, *Policis*, p.8.

³⁵⁶ Cash Converters, *Position Paper*, July 2008, p. 3.

³⁵⁷ Cash Converters, *Position Paper*, July 2008, p. 6.

dot points in the Executive Summary of *"The dynamics of low income credit use"*:

"Credit is used by low income households primarily for essentials and to ensure the effective functioning of household finances.

Small sum credit in the form of cash advances on credit cards and payday loans appears to play a key role in the finances of those on low incomes.

More likely to be used for cash emergencies and meeting unanticipated expenses than other credit types."

Finally, the 'essential' nature of high-cost loans is emphasised by the assertion that many consumers who use the product have little or no access to alternative credit products: *"29% of payday users do not have a credit alternative"*.³⁵⁸

The argument of "irreducible need" can be critiqued on a number of grounds.

First - the argument tends to characterise consumer demand for additional funds as an *"irreducible need"* for high-cost short term loans. Indeed, the converse can be argued - for a consumer on a low-income, access to a product that increases indebtedness or further reduces available income (due to loan servicing costs) could be characterised as harmful.

Demand for a product does not in itself define the product as a public good, or prove a fundamental need. If it did, the same could be said of any discretionary good, including overtly harmful products such as alcohol, nicotine and fast food. The fact that hamburgers sell well and there is clearly a public demand for hamburgers, does not in itself illustrate that hamburgers are necessary or inherently good. Nor does it illustrate that certain sections of the population would starve to death should hamburgers be outlawed tomorrow. Equally, it does not follow that because a market exists, it should be enabled. Markets are regulated in all sorts of ways, ranging from some restriction on sale and access (e.g. tobacco, alcohol etc), to prohibition (e.g. human organs, unsafe products).

³⁵⁸ Cash Converters, *Position Paper*, July 2008, p. 11.

It may be argued the rapid growth of high-cost short term lending is itself evidence for the fact the product is necessary. It is true the growth of Australian high-cost short term lending has been spectacular, but this does not necessarily mean the product is serving an inherent need - only that it has been very popular and has been successfully marketed to a high demand demographic.

It may even be argued that a growing demand for high-cost short term loans is an indicator of financial distress, and that in a healthy economy such demand would be low.

The secondary assertion that high-cost short term loans are a necessary feature of the consumer credit market is undermined by the short history of the industry in Australia - which for some of that time has existed on only a very small scale. Further, high-cost short term credit does not exist in major developed western economies such as France and Germany, both of which impose low interest rate caps and have done so for decades - a situation common to much of mainland Europe.

When a global view of this lending is taken it is clear high-cost short term lending, at least in so far as it pertains to developed economies,³⁵⁹ is a largely Anglo-American practice.

The industry only has a significant presence in the US, the UK, Canada, Australia and New Zealand. These countries do not exhibit lesser levels of household debt, financial hardship and income inequality than other developed western economies.³⁶⁰ It does not hold, therefore, that high-cost

³⁵⁹ In terms of poorer nations, South Africa had a significant payday lending industry between 31 December 1992 and 1 June 2007 during which time it exempted short term loans from the South African *Usury Act* (1968), before re-instating interest capping due to concerns over the detrimental impact of high-cost lending and explosive industry growth. By 1999 there were reportedly 3,500 payday lending branches in South Africa. Jonathan Campbell, *The Cost of Credit in the Micro-Finance Industry in South Africa*, Master of Laws Thesis, Rhodes University, December 2006, p. 67.

³⁶⁰ For household debt see:

OECD Economic Outlook No. 80 Special Chapter: *Has the rise in debt made households more vulnerable?*, 2006, p. 173. OECD figures for household debt as a percentage of GDP indicate that in 2005, New Zealand, Australia, the USA and the UK exhibited ratios between 90% and 105%. By contrast, Italy, France and Germany ranged from 40% to 70% respectively. <http://www.oecd.org/dataoecd/40/31/39698857.pdf>.

For income inequality see:

Timothy Smeeding, *Luxembourg Income Study Working Paper Series Working Paper No. 320 Globalization, Inequality and the Rich Countries of the G-20: Evidence from the Luxembourg Income Study (LIS)*, Luxembourg Income Study (LIS), July 2002, p. 11 - 12. "Inequality is still lowest in Scandinavia, then Central Europe, Southern Europe, and Asia with the English

short term loans are an essential feature of any consumer credit market, nor that they improve the situation of those at the lower end of the income spectrum.

That some consumers who use high-cost short term loans have no alternative credit option and use the loans to cover both recurrent basic costs and emergency expenses, indicates some consumers are often not exercising a consumer 'choice' in the traditional sense - but are instead acting out of a degree of financial desperation.

The lack of competitive pressure on interest rates and fees and charges in the high-cost short term lending industry does tend to show the loans are not always perceived as discretionary by those who use them - but that is not the same as saying they are necessary. It simply says the customer base is in financial distress and a proportion of high-cost short term lending may potentially be described as "involuntary consumption".

This in turn establishes nothing more than the fact financial distress exists in the community - which is an uncontroversial point. Clearly, financial need is not the same thing as a need more specifically for high-cost short term loans. They are simply one response to that need, which is not the same as saying that they are the only solution - or any solution at all.

Like all credit products used for consumption, the appeal of high-cost short term loans is immediate benefit with the detriment of repayment deferred. For consumers in financial hardship, that detriment can be significant and ongoing. It is hard to believe such a product should rightly be regarded as a 'necessary good'. It may even be argued the growing demand for high-cost short term loans is simply an indicator of financial distress, and that a healthy economy would exhibit low demand.

5.3.2 The substitution argument – “The mythical rise in illegal lending”

Proponents of high-cost short term lending often claim prohibition of this lending will lead to a rapid rise in an informal illegal money lending market, effectively a black market populated by 'loan sharks'.

speaking countries (except for Canada) having the highest inequality, and the United States the highest among these, and then followed at last by Russia and Mexico."

The implication an illegal market will logically emerge to fill the space previously occupied by the legal lending industry is flawed, yet it has remained a cornerstone argument in favour of high-cost short term lending. In its submission, Cash Converters makes the following statement:

*"In markets where access to credit is reduced or eliminated for those who need it most, research shows that a credit vacuum leads to... the rapid rise of an illegal lending industry."*³⁶¹

This argument is repeated later in the submission, asserting that an interest rate cap will have unintended consequences, "...scooping up all responsible lenders in the proposed 'solution' to the problem and encouraging the growth of an illegal lending industry."³⁶²

The illegal lending argument has been raised before in interest rate cap debates and often to significant effect. In August 2004, when announcing its decision not to impose an interest rate cap, the DTI in the UK cited the potential risk of a burgeoning illegal lending industry as a major factor in its decision. As reported by the BBC online on 26 August 2004,

*"People in countries where rates are capped are in fact more likely to have financial problems and borrow from illegal loan sharks, the DTI said"*³⁶³

This statement in turn reflected the contents of a July 2004 *Policis* report commissioned by the DTI, entitled, "*The effect of interest rate controls in other countries*".³⁶⁴ The report asserted consumers in France and Germany were far more likely to turn to illegal lenders than consumers in the UK due to a lack of viable credit options owing to interest rate caps and other regulatory factors. The report states:

"Clearly, it is impossible to obtain accurate figures on the extent of illegal lending. However, the consumer surveys indicate there appears

³⁶¹ Cash Converters, *Position Paper*, July 2008, p. 10.

³⁶² Cash Converters, *Position Paper*, July 2008, p. 11.

³⁶³ BBC News - Business. *DTI says no to interest rate cap*, 26 August 2004. <http://news.bbc.co.uk/2/hi/business/3601122.stm> (22 May 2010)

³⁶⁴ *Policis, The effect of interest rate controls in other countries*, Department of Trade and Industry, July 2004.

to be significantly more illegal lending to such consumers both in France and Germany than in the UK.”³⁶⁵

The report goes on to state:

“In the UK 3% of those on low incomes who are credit impaired are prepared to admit that either they or someone living in their household have used an unlicensed lender. This compares with 7% in France and 8% in Germany. Among those on low incomes who have been refused a loan, this rises to 4% in the UK, 12% in France and 10% in Germany.”³⁶⁶

Despite the relatively low incidence of illegal lending in the UK, *Policis* was further commissioned by the DTI to undertake a study entitled *"Illegal lending in the UK"*. This further report was published in February 2006. In this report the notion that illegal lending was lower in the UK and the lack of an interest rate cap was a major explanation for this, was further promoted. The Executive Summary states in part:

“Previous research indicates that the incidence of illegal lending in Germany is two and a half times higher than in the UK and that in France is three times higher than in the UK.

In the UK, the supply vacuum - and thus the opportunities for illegal lenders - appears not only to be smaller than in neighbouring European markets but to occur in different parts of the socio-economic spectrum.

In advanced credit markets which have tighter regulatory environments (France, Germany and Japan) illegal lenders target middle income, credit impaired borrowers, who in the UK are served by sub-prime lenders.”³⁶⁷

It is necessary to examine the *Policis* reports because they seem to form the only empirical basis for Cash Converters' assertion that *“...research shows that a credit vacuum leads to the rapid rise of an illegal lending industry.”³⁶⁸*

³⁶⁵ *Policis, The effect of interest rate controls*, July 2004, p. 40.

³⁶⁶ *Policis, The effect of interest rate controls*, July 2004, p. 40.

³⁶⁷ *Policis/Personal Finance Research Centre (PFRC), Illegal lending in the UK - Research report*, Department of Trade and industry, November 2006, p. 6.

³⁶⁸ *Cash Converters, Position Paper*, July 2008, p. 10.

The 2004 *Policis* report results were based on a survey of 2717 consumers in France, Germany and the UK who were surveyed with a series of unreleased questions by *Policis* in addition to face to face interviews undertaken in home through October and November 2003.³⁶⁹

The *Policis* report states German and French consumers are more likely to go to an 'unlicensed lender' which is presented as evidence illegal lending is more common in those countries. The fact illegal lending is more common in turn is taken to support the assumption the illegal lending is made by loan sharks. Accordingly, a report which purported to indicate more lenders in Germany and France borrow from 'unlicensed lenders' appears to have become the cornerstone document for implying those countries are awash with 'loan sharks' whilst the UK, owing to the lack of an interest rate cap, is not.

The reliability of the 2004 data presented by *Policis* has been publicly questioned by Debt on Our Doorstep: A Network for Fair Finance in the UK; and in Germany by Professor Udo Reifner, head of the Institute for Financial Services (IFF), a non-profit research body based in Hamburg.

In a 2005 briefing on the UK Consumer Credit Bill, Debt on our Doorstep wrote:

"In respect of the degree to which illegal lending occurs in the countries studied by Policis we should also be wary of the evidence on offer. The Policis report relied on market research with 2717 consumers in France, Germany and the U.K. The questions asked in the survey have not been released despite a request made by Debt on our Doorstep for a blank copy of the survey used....Debt on our Doorstep is concerned that the survey may have failed to distinguish between informal lending (from friends and family for example) and illegal lenders of the type we commonly associate with violence and intimidation.

....

"Equally, as the work being undertaken by the DTI in the U.K.in respect to illegal money-lending is now starting to show, there is a wide range of illegal lending covering people who are not licensed but act to all intents and purposes as legitimate lenders...The data available in the Policis report does not give any indication as to the different types of illegal lending that is taking place in the three European

³⁶⁹ *Policis, The effect of interest rate controls*, July 2004, p. 4 - 5.

countries....and does not inform our understanding as to how this relates to whether or not a ceiling is in place or the level of that ceiling.”³⁷⁰

At the request of Debt on our Doorstep, Professor Reifner also reviewed the *Policis* report. He heavily criticised the report for its lack of reference data:

“There is constant SOEP panel research in Germany which could have been evaluated as well as the recent publication of the disputed SCHUFA data on 60 million Germans’ credit behaviour. We have little trust in the indication that a special survey has been done in Germany and France....No references or methodological information is given.”³⁷¹

The *Policis* report does provide some disclaimer regarding the German results - acknowledging they may be skewed by an informal sector of the German consumer credit market, a group which could not reasonably be described as ‘loan sharks’:

“This may reflect the activity of some sections of the thriving and colourful broking sector in Germany, which has become effectively the de facto sub- prime sector. Credit intermediaries are indeed currently the subject of a forthcoming regulatory clampdown...”³⁷²

At most, the *Policis* data shows borrowers in Germany and France use unlicensed lenders more than borrowers in the UK. Given the much tighter regulatory controls in Germany and France surrounding consumer credit, it is quite possible more informal lending occurs. When one considers this may include borrowing from friends, family, or through the ‘colourful broking sector’ in Germany, the implication loan shark behaviour is higher in continental Europe than in the UK becomes increasingly tenuous.

Despite this, the *Policis* data appears to have been relied on by the UK DTI to effectively state that interest rate caps in Europe lead to loan sharks and by Cash Converters to imply an interest rate cap in Australia will do the same.

³⁷⁰ Debt on our Doorstep: A network for fair finance, *Briefing on Consumer Credit Bill - Briefing 1: Interest rate ceilings*, 22 June 2005, paras 2.16 - 2.17.

³⁷¹ Ifi - institute for financial services, *Comments on the DTI study - "The effect of interest rate controls in other countries"* (Germany, France and the US), 12 October 2004, p.8.

³⁷² *Policis, The effect of interest rate controls*, July 2004, p. 41.

As far as Consumer Action can ascertain, no other 'conclusive' evidence of a link between interest rate caps and loan sharks has been offered in the Australian high-cost short term lending debate. Given the number of American states which now impose an interest rate cap, it seems strange no other evidence has emerged if the link is as clear as high-cost short term lenders seem to suggest.

Beyond lacking clear empirical evidence for a rise in loan sharking, the substitution argument is also logically flawed.

The potential existence of a black market is not in itself a credible argument against legislating to restrict supply of an undesirable product. Any rise in illegal lending, if in fact it were to occur, would be likely to be far smaller in scale than the current legal high-cost short term lending industry. If the product is deemed to be undesirable, then even if loan sharking were to increase, it would be likely to negatively affect far fewer people than the current legal industry.

In jurisdictions where caps do currently exist, both here and abroad, no evidence has been presented to suggest loan sharking is of such magnitude it is considered to be a significant social problem. Further, there is no evidence to suggest illegal lending was problematic in Australia prior to the entry of high-cost short term lending in the late 90s.³⁷³ Any decision to impose a cap therefore, would have to take into account the scale of the potential increase in illegal activity, weighed against the net benefit of prohibiting a practice that arguably has a harmful impact on hundreds of thousands of consumers.

5.3.3 Increased demand on social welfare – "Cost to Government"

High-cost short term lenders consistently seek to present high-cost credit as a welfare enhancing product. Under this argument, high-cost lending is characterised as a private sector alternative to social welfare, supporting consumers in their hour of need and effectively relieving the state of a significant burden in the process. In this sense, high-cost lending is presented as an ideal social good - both beneficial for consumers and profitable for suppliers.

The Cash Converters submission states:

³⁷³ Manning and de Jonge, *Regulating the cost of credit*, p. 12.

*“State governments are yet to experience the ‘hidden’ social costs of a cap on interest, fees and charges. Once all of the loopholes are shut down and a cap is truly in effect, the social consequence stemming from the inability of thousands of people across Australia to access small sum credit, will lead to a dramatic rise in requests for help from social welfare.”*³⁷⁴

Policis presents a similar argument although couched in slightly different terms. According to *Policis*, the need for short term credit is so fundamental the product will remain necessary even if legislated against - which means the state will have to fill the ‘credit vacuum’.

In its Cash Converters commissioned report, *“The impact of interest rate ceilings: The evidence from international experience and the implications for regulation and consumer protection in the credit market in Australia”*, *Policis* states:

*“In the event that a rate ceiling is imposed, it would seem likely that there will be a significant need for alternative social lending. The experience of other countries who have pursued this route is that establishing a social lending operation is highly challenging, slow to establish and scale and, for most governments, prohibitively expensive.”*³⁷⁵

This ‘drain on welfare’ argument is flawed and has the potential to be alarmist and misleading.

Most obviously, the argument ignores that a high proportion of borrowers already receive welfare support - the reason for borrowing is often to supplement inadequate welfare income. In that sense, those borrowers are already a ‘drain on welfare’ - they are receiving what they are entitled to and are already accessing appropriate services. By purchasing high-cost short term loans, such borrowers then direct a proportion of their welfare income towards repaying those loans, often in a repetitive and ongoing manner. When this dynamic occurs, one could say that far from acting to prevent a ‘drain on

³⁷⁴ Cash Converters, *Position Paper*, July 2008, p. 5.

³⁷⁵ Anna Ellison and Robert Forster, *The impact of interest rate ceilings - The evidence from international experience and the implications for regulation and consumer protection in the credit market in Australia*, *Policis*, p. 7.

welfare', high-cost short term lending itself becomes part of the 'drain' diverting welfare income from its intended purpose.

Beyond this obvious contradiction, the 'drain on welfare' argument depends on the common industry view that high-cost lending aids those in financial hardship and allows consumers to overcome their mid to long term financial difficulties through the use of high-cost short term credit.

As has been demonstrated throughout this report, this is by no means a settled view.

High-cost lending has the capacity to worsen a consumer's situation by creating an ongoing debt spiral. The endpoint of that spiral is the consumer in a worse situation than they were before they commenced borrowing having added loan servicing and repayment costs to previous commitments. They are therefore more likely to seek welfare support, if they have not already done so.

On that basis, it may be argued high-cost lending does not prevent consumers from requiring welfare support but - at most - simply delays the point at which they are likely to do so. In some cases, it may actually lead those who did not require welfare support into a situation where they do. Further, the financial standing of some consumers may be so weakened by the time they do seek support, they may require more assistance to recover their position than they would have had they accessed services sooner.

The argument high-cost lending saves the public sector is therefore not only flawed, it is possible the practice actually costs the public sector in the long run.

It should also be noted this analysis does not even consider the non-financial costs of high-cost lending, such as the emotional distress experienced by those who find themselves caught in a debt spiral.

The inherent contradiction of 'assisting' low income consumers by selling them a high-cost credit product that must be repaid in a short period of time, forms the basis of the 'drain on welfare' argument and on that basis it should be regarded with scepticism.

5.3.4 Rise in indebtedness

The high-cost short term lending industry often contrasts its product favourably with alternative forms of consumer credit, particularly with the revolving credit provided by credit cards.

According to this argument, high-cost short term loans are less dangerous than revolving credit because loans are typically for smaller amounts and have a fixed short term repayment period. The contention is high-cost loans are more manageable than credit cards and do not result in long term indebtedness. If high-cost loans are prohibited by an interest rate cap, an increasing reliance on alternative forms (particularly revolving credit) is likely to lead to a significant rise in indebtedness.

In its submission, Cash Converters states:

*“Many consumers will be left unable to access credit or if they can, may be pushed into revolving lines of credit which can ultimately lead to greater levels of indebtedness.”*³⁷⁶

For its part, *Policis* states:

*“A rate ceiling would appear unlikely to prevent over-indebtedness. It is more likely to increase the indebtedness of low income borrowers and to simply shift more debt into revolving credit vehicles being repaid over extended terms.”*³⁷⁷

And in another *Policis* report, *“The dynamics of low income credit use - A research study of low income households in Australia”*:

*“Taking cash advances on revolving credit cards may expose vulnerable consumers to a series of risks to their well-being and financial security.”*³⁷⁸

Policis goes further in its assertion, to state:

³⁷⁶ Cash Converters, *Position Paper*, July 2008, p. 11.

³⁷⁷ Ellison and Forster, *The impact of interest rate ceilings*, *Policis*, p. 7.

³⁷⁸ Anna Ellison and Robert Forster, *The dynamics of low income credit use - A research study of low income households in Australia*, *Policis*, p. 4.

“Payday borrowers appear better able to manage mainstream credit:

- Payment irregularity on mainstream credit lower than other credit users*
- Miss fewer payments when do miss payments*
- Pay back credit card debt quicker than other card users.”³⁷⁹*

The ‘rise in indebtedness’ argument overlooks the apparent reality that for most consumers, high-cost loans do not act as a substitute form of credit but as an additional form, often obtained because the credit available through their credit card (or cards) has already been exhausted.³⁸⁰

It follows then that legislation against high-cost lending will not necessarily result in an increased take-up of revolving credit (such credit would have to be approved by mainstream lenders in any event) but may simply make servicing existing debt more difficult in the short term.

This, in turn, does not necessarily indicate a rise in indebtedness. Although high-cost borrowers may be able to meet their immediate credit card payments more easily, they still have to repay their high-cost loan or seek a ‘rollover’.

The repayment of high-cost short term loans operates differently to the repayment of more mainstream revolving credit products. Unlike revolving credit, high-cost borrowers do not have the option of meeting basic needs (such as food and rent) before repaying their high-cost loan. Instead, the high-cost short term lender takes a ‘first-stake’ in the consumer’s income. They do this by arranging for direct debit repayment instalments to come out of the consumer’s bank account on the days the consumer’s income (salary or social security) is due to be deposited.

Cash Converters describes this arrangement:

“The loan is essentially unsecured, with the customer’s regular income as the asset to secure the loan...On approval of the loan, the customer’s repayment schedule is input and the system arranges for direct debits to occur directly to the customer’s bank account at the

³⁷⁹ Ellison and Forster, *The dynamics of low income credit use*, Policis, p.3.

³⁸⁰ The 2008 Consumer Action Law Centre survey found that 62.7% of respondents had used a credit card within the previous twelve months.

*agreed dates, as per the signed agreements between the customer and the lender”.*³⁸¹

This locks the consumer into an immediate set repayment or series of repayments. This in turn increases the likelihood of further borrowing - although the 'debt' generated by a single high-cost loan is only brief in duration, high-cost loans generate an ongoing need for small amounts of credit. Rather than accumulating a large standing balance of debt, the consumer repays and re-borrows small amounts which are simply a different form of ongoing debt.³⁸²

In the meantime, the prospects of genuine debt reduction are limited. It stands to reason a consumer with a static income cannot effectively reduce a significant existing debt balance by borrowing at an even higher rate of interest - although this appears to be the assertion high-cost lenders are making.

It should be noted many consumers do express a preference for the simpler terms of a high-cost short term loan - a set repayment amount over a finite period is often perceived as 'safer' than the open ended and ongoing commitment of a credit card.³⁸³ This fear often reflects negative experiences with revolving credit, which in turn may reflect a limited degree of financial literacy in many cases.

Although the terms of credit cards are confusing to many consumers and can contribute to over-commitment, this does not necessarily mean they are more dangerous than high-cost loans. Indeed, the 'first stake' nature of a high-cost short term loan could be seen as an inherently 'dangerous' aspect of the product which is not present in credit cards.

At the same time, the high repayment rate of high-cost short term loans is often presented by lenders as evidence borrowers are good money managers. In its submission Cash Converters makes the statement that payday loans are

³⁸¹ Cash Converters International Limited, *Annual Report 2008*, p. 10.

³⁸² See also the discussion of the Cash Doctors online loan contract in section 3.2.3 of Chapter 3, which shows that the offer on its face is for a small amount loan, but the loan contract is actually a continuing contract with a large total amount of credit available to the borrower over a twelve month period.

³⁸³ Open Mind Research Group, *Exploring payday loans*, Consumer Action Law Centre, 21 November 2008. p. 18.

'...**used well** - 97% of loans are repaid in full.'³⁸⁴ This figure, of course, simply reflects the 'first stake' nature of the high-cost short term loan business model.

In its report, *Policis* makes the statement that '*A rate ceiling would appear unlikely to prevent over-indebtedness*'³⁸⁵ to imply the purpose for a cap would not be served by its implementation. This statement is uncontroversial but unfortunately misses the purpose of a cap. An interest rate cap will not prevent consumers from borrowing more than they can afford. An interest rate cap would, however, limit the interest lenders can charge on any particular transaction.

Levels of household debt in countries without high-cost short term lending (such as France and Germany) are significantly lower than in the US, UK or Australia - which exhibit some of the highest levels of household debt in the world.³⁸⁶ It follows that high-cost lending, then, is no panacea to indebtedness. The fact interest rate caps too, are no panacea, does not mean their implementation will result in yet higher household debt – if anything, they simply act to help cut off a cycle of increasing debt earlier.

5.3.5 Rise in defaults

High-cost lenders often assert a prohibition on high-cost short term lending will lead to higher default rates on other payments such as utilities and incurred penalty fees for overdrawn bank accounts, late credit card payments and the like. It is better, they argue, and ultimately cheaper to incur the discrete cost of a high-cost short term loan than it is to be subject to an array of alternative charges or fall behind on payments for essential services.

Cash Converters states in its submission and in reference to *Policis* research:

*"In markets where access to credit is reduced or eliminated for those who need it most, research shows that a credit vacuum leads to:...a rise in the level of default (including utilities),"*³⁸⁷

³⁸⁴ Cash Converters, *Position Paper*, July 2008, p. 3.

³⁸⁵ Ellison and Forster, *The impact of interest rate ceilings*, *Policis*, p. 7

³⁸⁶ OECD figures for household debt as a percentage of GDP indicate that in 2005, New Zealand, Australia, the USA and the UK exhibited ratios between 90% and 105%. By contrast, Italy, France and Germany ranged from 40% to 70% respectively. OECD Economic Outlook No. 80 Special Chapter: *Has the rise in debt made households more vulnerable?*, 2006, p. 173, <http://www.oecd.org/dataoecd/40/31/39698857.pdf> (16 July 2010).

³⁸⁷ Cash Converters, *Position Paper*, July 2008, p. 10.

Policis, in *"The dynamics of low income credit use"* states:

*"The qualitative research... suggested that some use of high cost cash credit... is undertaken to maintain commitments on mortgages and bills and to avoid default charges on loans and credit arrangements, reconnection fees on utilities and over-limit fees on overdrafts etc. Borrowers also used short term high cost loans to keep up payments on commitments specifically to avoid damage, or further damage, to credit records."*³⁸⁸

It is clear high-cost short term borrowers do use loans for such purposes. It is also fair to assume in the absence of high-cost short term lending some consumers will default on payments they otherwise would have met. They will not, however, be required to repay the high-cost loan and therefore will retain more of their income to service those and other needs when their next income period falls due.

The 'rise in defaults' argument also ignores that utility companies and mainstream financial service providers generally employ a range of hardship options to assist consumers in financial difficulty and these are available at little or no cost. These services are not always well promoted or widely used, yet they provide a far better option for avoiding default than does high-cost lending. They are often more difficult to access, can be administratively onerous and can be perceived as humiliating by the consumer. The convenience, speed and relative ease of high-cost lending can make it appear a more attractive option despite the obvious drawbacks.

The question for policy makers is whether it is preferable to encourage consumers to access hardship programs more effectively, accepting that some consumers may default on payments (yet retain a higher proportion of their income), than for borrowers to forfeit a higher proportion of their income in order to meet those immediate payments.

It seems clear the less income retained by the borrower, the higher the likelihood further shortfalls will occur in future and that further borrowing will be required to avoid default, resulting in a further loss of income.

³⁸⁸ Ellison and Forster, *The dynamics of low income credit use*, Policis, p.46.

While there is a clear trend to reduce or abolish late payment, overdraft and other penalty fees across financial services and possibly into utilities, there is also a clear trend for increasing high-cost short term loan sizes and repayment amounts. Taken together, it seems increasingly unlikely that consumers are making genuine 'savings' by borrowing high-cost short term loans to avoid default fees. This requires further investigation but if - as a rule of thumb - an average high-cost short term loan is approximately \$300, with a \$105 cost, then consumers would have to be incurring significant ongoing default costs for it to be more beneficial for them to borrow than to bear the cost of default. Particularly when, as discussed above, many service providers offer hardship options that already enable the consumer to avoid those costs, if they are aware of the option to do so.

5.3.6 An analysis of *Policis* reports commissioned by Cash Converters

In its July 2008 submission, Cash Converters referred at length to two international research reports prepared by the *Policis* organisation based on research commissioned by Cash Converters.

Those reports are;

- *The dynamics of low income credit use - A research study of low income households in Australia;*

and;

- *The impact of interest rate ceilings - The evidence from international experience and the implications for regulation and consumer protection in the credit market in Australia.*

In its submission, the company stated:

*"To provide context and data to the debate, Cash Converters commissioned Policis, in conjunction with Synovate Australia, to produce consumer research on the habits and use of credit by low income Australians."*³⁸⁹

³⁸⁹ Cash Converters, *Position Paper*, July 2008, p. 9.

As has already been noted, *Policis* has a history of producing research in favour of high-cost short term lending.

In particular, the company had a high profile role in the UK interest rate cap debate of 2004, producing the report on which the DTI appears to have based its reasoning not to implement a national cap.³⁹⁰ Again, as already stated, the merits of that report have since been strongly and publicly questioned by consumer advocates in both the UK and Germany (see **5.3.2**).

Policis describes itself as:

*"...an independent consultancy specialising in evidence based policy development, both in the UK and internationally. We bring high quality social and economic research and a wide-ranging understanding of the issues to strategic planning in the public sector and to the development of public policy."*³⁹¹

Consumer Action raises the role of *Policis* as the company appears to have produced more research specifically into the role of credit for low income Australians (and the potential impact of an interest rate cap) than any other organisation, public or private. As the *Policis* reports occupy a prominent space in the high-cost short term lending debate, they warrant close scrutiny.

In addition to the two reports above, *Policis* has also published "*Payday in Australia: A research study of the use and impact of payday lending in the domestic Australian Market*."³⁹²

As with the previous two reports, *Payday Australia* is undated as it appears on the *Policis* website so it is unclear whether the report pre- or post -dates the company's other Australian reports which were commissioned by Cash Converters.

Further, as is the case with the other two reports, *Payday Australia* makes no mention of a commissioning party in the body of the report itself. However, the

³⁹⁰ BBC News - Business. *DTI says no to interest rate cap*, 26 August 2004. <http://news.bbc.co.uk/2/hi/business/3601122.stm> (22 May 2010) citing: *Policis, The effect of interest rate controls in other countries*, Department of Trade and Industry, July 2004.

³⁹¹ *Policis* website - <http://www.policis.com/> (22 May 2010).

³⁹² Anna Ellison and Robert Forster, *Payday in Australia: A research study of the use and impact of payday lending in the domestic Australian market*, *Policis*.

research methodology would suggest *Payday Australia* is drawn from the same data as was used to compile “*The dynamics of low income credit use*” which is described by Cash Converters in its submission:

“As part of the research, 500 low income Australians, 400 low income users of credit and 320 low income users of payday lending were surveyed earlier this year.”³⁹³

This description closely resembles the research methodology information provided in both “*The dynamics of low income credit use*” and *Payday Australia*, which is reproduced below:

“Quantitative research with a nationally representative 500 sample of low income consumers and a little over 400 low income credit users...”³⁹⁴

and:

“Quantitative research with a random nationally representative sample of a little fewer than 320 low income users of payday loans...”³⁹⁵

On that basis, it appears the data used to support the conclusions in that report is the same data used to compile “*The dynamics of low income credit use*” which Cash Converters has stated derives from research commissioned by Cash Converters.

It also seems the third report was produced at about the same time as the other two reports. It should be stressed this information can only be presumed. Neither the reports themselves, nor the *Policis* website, give any clear indication of the commissioning party, the date of the reports, nor the relation of the reports to each other. All three reports are credited to the same authors.

The three reports uniformly reach the conclusion that interest rate caps are detrimental for consumers and that a well-regulated short term credit market is preferable to the imposition of an interest rate cap. These conclusions are supported by the variety of arguments presented above; namely that short term credit is a necessary good and its removal will result in more illegal

³⁹³ Cash Converters, *Position Paper*, July 2008, p. 9.

³⁹⁴ Ellison and Forster, *The dynamics of low income credit use*, *Policis*, p. 7.

³⁹⁵ Ellison and Forster, *Payday in Australia*, *Policis*, p. 10.

lending, a drain on social welfare, a growing reliance on other ('more harmful') forms of credit and a rise in payment defaults.

Consumer Action is concerned that the data provided by *Policis* is unclear and the reports do not provide raw numbers for their survey results, preferring instead to provide bar graphs with rough percentage figures. The methodology data itself talks in generalities ("...a little over 400..." and "...a little fewer than 320...") thus does not provide further clarification.³⁹⁶

Further, the reports routinely fail to consider, let alone critique, counter arguments to their pro high-cost short term lending stance or take into account alternative evidence to their own. For example, it is a staple claim of all reports that high-cost short term lending does not cause debt spirals, despite large amounts of easily obtainable evidence to the contrary - particularly from the USA.

The first two Australian-based *Policis* reports were reviewed by Consumer Action in 2008 in the course of composing a Draft Literature Review for the purposes of this Report. The Draft Literature Review makes the above points in considerably more detail and a copy is attached at *Appendix D* to this Report.

In June 2008, the Draft Literature Review was submitted to the Victorian Government's Small Amount Cash Lending Inquiry, as a supplement to Consumer Action's main submission. As is usual practice, a copy of the Draft Literature Review was then published on the Consumer Action website along with the main submission.

In February 2009, Consumer Action received a letter dated 16 February 2009 from Anna Ellison, Principal Consultant at *Policis*, strongly requesting the Draft Literature Review be removed from Consumer Action's website.

In the letter, *Policis* described the Draft Literature Review as "...entirely unfounded [and] clearly defamatory" and requested a written guarantee from Consumer Action that, amongst other things, the document be removed from the Consumer Action website and a revised document put in its place clearly stating previous statements made about *Policis* were unfounded. Further, the letter requested all Consumer Action staff be required not to repeat the

³⁹⁶ Ellison and Forster, *The dynamics of low income credit use*, *Policis*, p. 7.

allegations *Policis* claimed were 'defamatory' either verbally or in writing 'or through any other medium'. The letter also stated:

"The Policis research was intended to support evidence based policy making and inject some authoritative data into the debate in Australia."

Following considered review of the Draft Literature Review, Consumer Action was not able to comply with the requests made.

Consumer Action did reply to *Policis*, stating in part:

"Consumer Action has noted the points raised in your correspondence and must respectfully disagree with the opinions expressed therein."

Consumer Action maintains that both reports contain a lack of detail regarding the research methodology used to generate data and both reports fail to disclose the commissioning party (Cash Converters).

Accordingly, Consumer Action must respectfully decline your requests.

Once again, we thank you for your interest".

While *Policis* states its research is intended to '*...inject some authoritative data into the debate in Australia*', all of *Policis*' research into Australian payday lending and consumer credit generally, appears to have been commissioned by Cash Converters - the largest payday lender in Australia. The reports themselves do not disclose this fact.

The evidence put forward to substantiate the views contained in the reports is limited (for example, survey questions are not provided) and methodological information is scant in detail.

Finally, the reports echo an argument consistently made by *Policis* in the vast majority of its published reports. Far from being a wide-ranging research body with an interest in an array of public policy areas, *Policis*' work appears to be done exclusively in the field of consumer credit and generally relates to the issue of interest rate caps. Of the ten publications on *Policis*' website, eight consider the issue of interest rate caps in detail and come to the conclusion they are undesirable.

Ironically, the other two documents published on the site (a short fact sheet titled "*Affordable credit*" and a briefing titled "*Robbing Peter to Pay Paul*"), advocate the importance of affordable financial inclusion, particularly the provision of state funded interest free loans and other low-cost credit for the benefit of the poorest consumers. This is considered necessary, it is argued, because under current arrangements the poor pay more for credit and the strain of debt is damaging to families - especially children in poverty.

Although these reports do seem at odds with *Policis*' usual conclusions, they effectively start from the same basic proposition - that short term credit is necessary for consumers and must be made available. They simply reach different conclusions as to how it should be provided. The fact sheet was produced by the UK National Consumer Council apparently in collaboration with *Policis* and the briefing was released by *Save The Children* (UK).³⁹⁷

5.4 The argument for an interest rate cap

The argument for an interest rate cap is based on the premise that at a certain point credit becomes too expensive to benefit the consumer and becomes harmful. Put another way, credit is useful when it enables positive consumption at a sustainable price, but becomes counter-productive when the purchase price itself becomes a significant financial burden.

High-cost short term loans are harmful because, where used other than as a 'one-off', they worsen the consumer's financial position. The low incomes earned by the majority of borrowers, the application of a majority of borrowings to recurrent basic living expenses and the industry's own reference to its 'loyal' customers, all combine to create a picture of repeat borrowing which in turn could be termed an ongoing debt spiral.

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

³⁹⁷ *Policis* website - Publications: <http://www.policis.com/publications.htm> (22 May 2010).

The product is also harmful because it takes a 'first stake' in the consumer's income - impinging on their capacity to meet basic needs without further borrowing.

The price level at which this point occurs is a matter for debate but in Australia has traditionally been regarded as 48% APR.³⁹⁸

Whatever the exact price level, the central argument for introducing an interest rate cap is to protect vulnerable consumers from harm by preventing access to a harmful product.

In addition to the social benefit of preventing harm, an interest rate cap arguably has economic benefits. By freeing up limited capital, an interest rate cap enables consumers to spend more of their income on productive consumer spending and less on servicing repetitive short term debt. This is not to say an interest rate cap will end financial hardship or indebtedness - it obviously will not - but it will prevent the ongoing and deepening financial hardship of a growing number of consumers. When this occurs on a large scale it has negative implications for the broader economy quite apart from the personal distress experienced by the individual consumer. This has most clearly been demonstrated in the United States, where the industry has developed to a far greater extent than in Australia.

This report argues the implementation of an interest rate cap carries little risk, other than to the profitability of the high-cost short term lending industry. A cap would be relatively simple to implement and would be highly effective in achieving its desired purpose. It would have a targeted, measurable impact on a relatively small industry and from a public policy perspective, its benefits would far outweigh its costs. These points are discussed further below.

³⁹⁸ There is no magic to the 48% figure - it is simply an historical carry over from English legislation, devised in 1927, which determined that when lending above 48% APR, the onus lay on the lender to show that the loan was not unconscionable. Put another way, the legal presumption was that any loan above 48% was prima facie, an unconscionable loan. One could equally argue that 36% APR is the point at which credit becomes exploitative - based on the median interest rate cap across the United States, a result of state based anti-usury legislation introduced during the first half of the twentieth century. Similarly, one could argue that a rate somewhere in the mid to low 20% range is more appropriate - as has traditionally existed in France and Germany. Debates about usury and the use of an interest rate cap to prevent the practice, are certainly nothing new.

5.4.1 An interest rate cap would have a targeted, measurable impact and carries little risk

An interest rate cap is a targeted policy initiative that will have a limited, measurable impact.

Despite the protestations of industry and industry lobbyists, as discussed in section 5.3, high-cost short term lending is not a necessary feature of the consumer credit market and its prohibition will not usher in the range of dire consequences that proponents often claim. A cursory study of consumer credit markets in mainland Europe and many states of the United States shows consumer credit markets with interest rate caps do function effectively (often with much lower caps than the proposed 48%) and a prohibition on high-cost lending does not result in a commensurate growth in illegal lending, reliance on welfare, or a catastrophic rise in defaults.

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

The majority of high-cost lending companies are private companies, benefitting a small group of owners. Only one major payday lender, Cash Converters, is publicly owned. Traditionally, Cash Converters has generated its core business through the sale of second hand goods. In addition to its pawn-broking roots, Cash Converters also has a line of credit products that would not be impacted by an interest rate cap. The majority of those employed by high-cost short term lenders are administrative and financial services staff, whose skills are readily adaptable to alternative employers in the broader credit market or services sector generally.

The needs of the Australian consumer credit market are better served by products that do not exceed the proposed cap. As discussed in Chapters 2 and 3, high-cost short term lending currently attracts many consumers on the basis of speed and convenience despite its uncompetitive price. Without the option of high-cost short term lending it is likely consumers would either seek alternative means of alleviating financial stresses (see below) or seek credit elsewhere, where the process is more involved but the price of credit is cheaper and less likely to cause harm. Further, such credit products are subject to more competitive pressure than high-cost short term loans. A

unique feature of the high-cost short term lending industry is the lack of competitive price pressure between participants.

High-cost lending, therefore, is a small, uncompetitive industry that would be the 'loser' in the event of a national interest rate cap. The broader consumer credit market would remain unaffected and if anything, would benefit.

Consumers would also benefit. In the absence of high-cost short term lending, it is likely that at least the majority of consumers will resort to a wide range of alternative coping mechanisms to meet temporary shortfalls in income. Such mechanisms include informal lending through friends and family, the negotiation of hardship variation payments, utility concessions and relief grants, the purchase of credit from alternative credit providers and some recourse to charity and welfare services. Many of these measures require more time and effort on the part of the consumer than do high-cost short term loans.

The above approaches, as difficult as they may be, provide a preferable strategy for coping with financial hardship and recovering financial stability. Far from exposing consumers to financial and social exclusion, an interest rate cap will help financially disadvantaged consumers to achieve financial stability earlier, by avoiding repetitive and counter-productive high cost debt.

Interest rate caps, where they have been introduced, have been overwhelmingly welcomed by the majority of the population. It is notable that in the various jurisdictions in which interest rate caps have been introduced, both in Australia and elsewhere, there has not been a single case of popular support for its removal.

In those areas where such a cap has been removed, it has been solely at the behest of the high-cost short term lending industry. Simply put, the high-cost short term lending industry is the only vocal opponent of an interest rate cap.

Despite extensive review, there appears to be no evidence the implementation of an interest rate cap has ever resulted in electoral damage for any government in any jurisdiction, in any country, where it has been introduced.

5.4.2 The timing is appropriate for a national interest rate cap – and it could be achieved with minimal disruption and administrative ease

Phase two of the Reform Package presents a unique opportunity to implement a comprehensive national interest rate cap with limited administrative difficulty and minimal disruption.

Apart from the obvious legislative and administrative efficiencies a national consumer credit law provides, the implementation of a comprehensive national interest rate cap is aided by the fact a comprehensive cap already exists in New South Wales, Queensland and the ACT. Victoria also has a cap - although it is not comprehensive. In relation to other jurisdictions, an interest rate cap would simply be another component of already broad reform to be accommodated as part of the national consumer credit reforms.

Given the current legislative standing of interest rate caps across the country, to not introduce a cap would be equally as disruptive as introducing one.

It should be noted high-cost short term lending is still a relatively young industry in Australia. The American industry provides a good example of the capacity for the industry to grow and illustrates the harm it can cause if allowed to develop.

Accordingly, the national consumer credit reform process offers a mechanism that is not only efficient and administratively advantageous but which also comes at an opportune time both in the broader economic cycle and in the development of the industry in Australia.

5.4.3 An interest rate cap is the only effective approach to counter high-cost short term lending

Finally, it is emphasised that a comprehensive, well enforced interest rate cap is the only proven policy measure to counter the negative impact of high-cost short term lending. Accordingly, if it is accepted that high-cost short term lending is harmful and should be prohibited then it follows that an interest rate cap must be adopted.

As has been demonstrated throughout this report, efforts to prohibit high-cost short term lending have been frequently circumvented, undermined and

frustrated by industry practitioners both here and overseas, wherever those efforts have attempted to 'strike a balance' between lenders and borrowers.

It is common for industry to advocate for 'effective regulation' without impeding profitability. Of course, this does nothing to prevent harm caused by very high interest rates and charges and could be seen merely as an effective public relations exercise for lenders.

Measures that have been introduced to counter payday lending in various American jurisdictions, without the introduction of an interest rate cap, are:

- *Renewal bans/cooling off periods*
- *Limits on number of loans outstanding*
- *Extended payment plans*
- *Loan amount caps based on borrower's income*
- *Regulations that narrowly target payday loans*

In December 2007 the Center for Responsible Lending in the U.S released a study entitled "*Springing the Debt Trap: Rate caps are the only proven payday lending reform*".³⁹⁹ In that report, the Center examined each of the above measures and found they comprehensively failed to prevent repeat borrowing.

The conduct of lenders was often a major factor in this failure.

For example, payment plans were found to be ineffective because lenders would frequently price the first instalment of the payment plan above the cost of 'flipping' the loan - thereby ensuring there was a very low uptake. In the example given, the Center for Responsible Lending found that for a \$325 payday loan, a customer could choose between renewing (or 'flipping') the loan for \$52 or paying \$94 to commence a payment plan. Not surprisingly, the Center found that in the four states in which they were offered, payment plans formed between 0.42% and 1.33% of total payday loan transactions - i.e. their uptake was negligible despite their potential benefits for the consumer.⁴⁰⁰

³⁹⁹ Uriah King and Leslie Parrish, *Springing the Debt Trap: Rate caps are only proven payday reform*, Center for Responsible Lending, 13 December 2007.

⁴⁰⁰ King and Parrish, *Springing the Debt Trap*, p.14.

In the case of renewal bans, lenders would circumvent regulations by adopting a 'back to back' transaction model - where the customer 'pays off' the first loan before immediately taking out another. Whilst technically not 'renewing' the loan this does nothing to protect the consumer from repeat borrowing.⁴⁰¹

In the case of limits on outstanding loans, lenders would simply require borrowers to sign a statement that they had no other outstanding loans before lending to them.⁴⁰² This approach fails to acknowledge the circumstances of the typical high-cost short term loan consumer and the likelihood they may lie in their declaration. Yet the statements produced under this process served to 'discharge' lenders of their duty not to engage in irresponsible lending.⁴⁰³

In the case of limits based on a borrower's income, no effort would be made to ascertain the borrower's other financial commitments (i.e. their real ability to pay) and the decision to lend would instead be based solely on the customer's pre-tax income. Again, this does nothing to protect consumers from falling into a debt spiral. It should be noted that in Australia, Cash Converters often defends its high-cost short term lending business with the claim it does not generally lend a customer more than 15% of their monthly income.⁴⁰⁴ Without further knowledge of the customer's circumstances (for example, how many dependents they have, what their mortgage, car loan or credit card repayment commitments and other expenses are) this 'protection' is extremely limited. Whilst responsible lending obligations under the National Credit Act may now require additional questions to be asked by lenders, the incentive for consumers to do what is necessary to obtain funds remains.

In relation to regulations that sought to narrowly target payday loans without utilising a cap, the Center found lenders would simply adjust their loan model slightly so as to avoid falling into the definition of a 'payday loan' as expressed in the particular regulation.

This model of avoidance has also been used in Australia. In New South Wales, when a 2001 comprehensive interest rate cap was introduced for 'short

⁴⁰¹ King and Parrish, *Springing the Debt Trap*, p.13.

⁴⁰² King and Parrish, *Springing the Debt Trap*, p.13.

⁴⁰³ Parallels for such avoidance behaviour can be seen in industry responses to similar regulation in the US (see chapter three) and also in well documented abuse in Australia of the 'business purpose declaration' to exempt loans from the protections provided by the then UCCC. See for example *Joint Consumer Response September 2007 to the Consumer Credit Code Amendment Bill 2007: Consumer Credit Amendment Regulation 2007-09-04 - August 2007* (CCLC submission to Credit Review).

⁴⁰⁴ See, eg, Cash Converters International Limited, *Annual Report 2008*, p. 10.

term loans' (loans of 62 days or less), high-cost short term lenders simply altered their repayment periods to 63 days and thereby avoided the regulation. Similarly, when Queensland introduced its cap in 2008, Cash Converters sought to avoid the regulation by re-branding its payday loans as "VIP Advantage Loans" - a false pawn-broking arrangement that was ultimately shut down by the Queensland Government.⁴⁰⁵

In addition to the above measures, high-cost short term lenders in Australia are likely to point to reforms introduced under phase one of the *National Consumer Credit Protection Act 2009* (**National Credit Act**), as measures that will effectively prevent exploitative high-cost lending practices.

It is true that these reforms were significant.

Amongst other measures, phase one of the National Credit Act introduced the first national licensing regime for providers of consumer credit in Australia, and required those licensees to belong to an approved external dispute resolution scheme. Probably the most important feature of the reform was the introduction of new responsible lending requirements, which all credit licensees are required to meet.

In essence, the responsible lending requirements require lenders to make an assessment when providing credit, that the credit is 'not unsuitable' for the borrower, because the credit meets their requirements or objectives and will not cause the borrower hardship.

As important as these reforms are, it is unlikely that they will have a significant impact on high-cost short term lending.

In relation to the licensing regime, although it is useful that credit providers will have to be licensed (and this will certainly make it easier to assess the scale of the industry in the future), licensing in itself will not prevent lenders from conducting harmful lending practices.

As discussed above, Western Australia has applied a licensing regime to non-bank lenders for many years. This has not prevented the high-cost short term lending industry from flourishing in Western Australia (see 5.2.6). Of course

⁴⁰⁵ Patrick Lion, *State Attorney-General swoops on dodgy payday lenders*, The Courier Mail, 6 January 2009.

any licensing regime is only as good as the requirements it imposes on licensees.

The primary failure of the phase one reforms in relation to high-cost short term lending is that the small amounts lent out as high-cost short-term loans, at least when assessed in isolation, may not meet the definition of 'unsuitable' for the borrower. The responsible lending requirements are, in fact, uniquely unsuited to addressing harmful high-cost lending. When the average loan size for a high-cost short term loan is around \$300, it is quite possible that the loan - individually - may not be regarded as irresponsible.

What this masks of course, is that it is not the individual impact of one high-cost short term loan that is likely to harm the borrower or be unsuitable. Instead, it is the cumulative impact of a number of high-cost short term loans, borrowed one after the other over a period of time that is likely to cause harm and be 'unsuitable'. This impact will not be identified by the assessment of whether each loan in turn is 'not unsuitable' - and is perhaps the single most important reason why the phase one reforms are unlikely to have any significant impact on high-cost short term lending.

Quite apart from this factor, it should also be noted that the unique dynamics of the high-cost short term lending industry (where the majority of consumers are driven by financial desperation and borrow to meet basic needs) greatly increases the probability that borrowers will mislead lenders in order to obtain a loan. Lenders, for their part, may be unusually inclined to be misled in order to maintain loan volumes. In a system that requires accurate information for the lender to make their assessment of 'suitability', this will seriously undermine the impact of the reforms.

A final point to make about the phase one reforms is that they rely on individual complaints and a case by case approach by the regulator (ASIC). This is costly, labour intensive and a far less comprehensive method of regulation than the 'bright line' approach of a comprehensive interest rate cap - which is clear-cut, easy to enforce and comprehensive.

It is extremely unlikely that consumers of high-cost short term loans will lodge complaints in any great number, if at all, whether that complaint is to a court, a regulator or an external dispute resolution scheme.

In any event, high-cost short term loans are relatively simple products that do not generally cause disputes between lenders and borrowers. The sum of any one high-cost short term loan is unlikely to justify the time and effort required by the consumer to pursue or even lodge a complaint, especially when it is known that most high-cost short term loan consumers are dealing with financial hardship in addition to other life pressures. It is unrealistic to expect that consumers of the product will be inclined to pursue such action - in relation to each individual loan it would simply not be worth their while. This does not change the fact, however, that the cumulative impact of repeat borrowing can still cause significant hardship to borrowers.

Despite the shortfalls in the above reforms for the purposes of addressing high-cost short term credit, lenders are likely to claim that they amount to 'tighter' regulation that will provide adequate protection for consumers, and negate the need for the 'blunt instrument' of a comprehensive national interest rate cap.

These claims should be seen for what they are - that is, misleading attempts to obfuscate the debate and to avoid truly effective regulation.

Perhaps the best indication that the licensing, enforcement and responsible lending provisions of the National Credit Act are unlikely to have any great impact on high-cost short term lending is provided by the industry itself.

In their annual report of 2008-2009, Cash Converters stated of the phase one reforms:

*“The company has devoted significant resources to addressing the legislative environment. As a result, legislation introduced into Parliament in August is consistent with all our recommendations made to Government and the Federal takeover of consumer credit does not currently threaten any of our lending products”.*⁴⁰⁶

High-cost lenders appear satisfied with the course of consumer credit regulation to this stage, as it has transitioned from a state-based system into the Federal arena.

⁴⁰⁶ Cash Converters Annual Report 2009, p 17.

The impression is that high-cost lenders are happy to work closely with Government, and have positioned themselves almost as policy advisers, assisting the Government to guide the reforms through.

Cash Converters, for its part, professes a desire to 'educate' Australian borrowers. In its submission, Cash Converters foreshadows its desire to "...work with Government..." to provide "...relevant information that is consistent for all Australians...".⁴⁰⁷

Cash Converters then goes on to state that it has "...continued to work with Government and have developed and recommended a number of alternatives based on the introduction of a cap."⁴⁰⁸

These 'alternatives' are examined below:

- ***Alternative 1: Adopting the Victorian Model Nationally***

As frequently mentioned throughout this report, the Victorian cap is ineffective as it does not include fees and charges. Accordingly, adopting the Victorian cap nationally would have no impact on the cost of credit and would do nothing to curb high-cost short term lending.

- ***Alternative 2: A Cap Supported by Lender Review***

Under this model, a 48% interest cap (excluding fees and charges i.e. the 'Victorian Model') would be accompanied by a "reasonableness test".

The 'reasonableness test' is one previously proposed by the Ministerial Council of Consumer Affairs and would provide a mandate for courts to assess whether fees and charges on a particular loan were reasonable upon the bringing of an application for review by the individual consumer.⁴⁰⁹

⁴⁰⁷ Cash Converters, *Position Paper*, July 2008, p. 14.

⁴⁰⁸ Cash Converters, *Position Paper*, July 2008, p. 14.

⁴⁰⁹ Ministerial Council on Consumer Affairs, *Consumer Credit Code Amendment Bill 2007*, *Consumer Credit Amendment Regulation 2007: Consultation Package*, Department of Tourism, Fair Trading and Wine Industry Development Queensland, August 2007.

An obvious flaw in this proposal is that it relies on a case by case approach with cases to be lodged by consumers. The nature of the high-cost short term lending industry mitigates against this kind of 'after the fact', case by case regulation. The sum on any individual loan is too small for it to be worth pursuing through a court or dispute resolution system and the consumer base (low-income, struggling to meet daily expenses and other life pressures) is hardly likely to do so.

As a result, such a 'test' would not restrict most current high-cost lending practices and would only affect a tiny number of the most extreme cases. For the most part this would have no impact on the cost of credit and would do nothing to prevent the vast bulk of harmful high-cost short term lending.

- ***Alternative 3: A Total Cost of Credit Limit***

Under this proposal, a lender would not be able to charge more than 100% of the total amount that had been borrowed i.e. the total cost of credit could not exceed the amount borrowed.

Accordingly, Cash Converters would be 'limited' to charging \$100 on a \$100 loan for example.

As Cash Converters currently charges \$35 for a \$100 loan (repayment amount, \$135), it is hard to see how this proposal would reduce the cost of this sort of credit and prevent harmful high-cost short term lending. Further, it could have an undesirable and unintended impact on many mainstream credit products such as home loans, where the interest rate may remain under 10% for the life of the loan but over a 25-30 year period the total cost often exceeds the principal borrowed.

- ***Alternative 4: Two Independent Caps***

Under this approach, a 48% cap would apply to interest and an independent cap would apply to fees and charges. The aim of this approach would be that the two caps combined would prevent the cost of credit exceeding the amount borrowed.

This would 'limit' the repayment due on a \$100 payday loan to \$200. As with the option above, this does not affect the cost of high-cost

short term loans while, conversely, it may have an unintended impact on other types of credit.

- ***Alternative 5: A Total Cost of Credit cap***

Finally, Cash Converters suggests that rather than *annualising* the 48% interest rate cap, it should instead be made the total cost of credit. Accordingly, the cost of credit could not exceed 48% of the amount borrowed and this cost could be charged over the period of the loan.

Under this model, a \$100 loan would yield \$48 in charges - i.e. the required repayment would be \$148. This is still \$7 more than Cash Converters' current rate. Cash Converters claims such a limit would:

*"...protect the community from unacceptable usury interest rate charges and allow a well regulated, competitive short term loan industry to continue."*⁴¹⁰

All of the 'alternative cap models' presented by industry proponents, along with other alternative regulatory measures, are preferred to interest rate caps because they will allow a 'competitive' short term loan industry to continue - whereas an interest rate cap will not. It is for that reason such measures are promoted and interest rate caps vehemently opposed. The well-being of the industry drives such arguments, not the well-being of consumers.

5.5 Conclusion

This report attempts to provide a comprehensive overview of the high-cost short term lending industry in Australia.

In doing so, it is hoped the report can make a useful contribution to the current policy debate surrounding the potential implementation of a comprehensive, national interest rate cap.

The report confirms the core consumer base for high-cost short term loans is made up of young consumers on low or very low incomes.

⁴¹⁰ Cash Converters, *Position Paper*, July 2008, p. 15.

Borrowing is usually undertaken to supplement an inadequate income in order to meet basic living expenses. Critically, the majority of these expenses are recurrent, increasing the likelihood the consumer will undertake further and repeat borrowing.

Although empirical evidence of repeat borrowing remains unclear in Australia, anecdotal evidence suggests it is a significant feature of the industry. This is supported by the explosive growth of the industry since 2002 and the statements of Australia's leading high-cost short term lender, Cash Converters.

Certainly, evidence from the American payday lending industry strongly suggests repeat borrowing is inherent to high-cost short term lending and may be an essential feature of the business model.

The American industry is approximately ten years older than its Australian counterpart and provides a sobering indication of the potential scale of high-cost short term lending (on a per capita basis) and its potential social impact. The recent trend in America has been towards comprehensive interest rate caps, implemented as a direct response to harm caused by the industry. The American example also shows that alternative legislative approaches have been unsuccessful.

In both Australia and America, lenders have been consistently creative in their attempts to avoid regulation designed to limit harmful payday lending. Only a comprehensive interest rate cap has been proven to have the desired effect.

On that basis, this report takes a clear position in favour of a national interest rate cap as a positive and necessary consumer protection measure to shield consumers from harmful high-cost short term lending.

After a long history of State and Territory based regulation, the shift to a national consumer credit regime represents a unique opportunity for this reform.

The arguments frequently raised against interest rate caps are unconvincing, often alarmist, and are almost always made by those with a direct financial interest in high-cost lending.

The arguments in favour of an interest rate cap remain compelling.

High-cost short term lending is a form of 'sub-prime' lending - it is the extension of credit to those who cannot afford to borrow. This creates the inherently unsustainable dynamic of increasing the cost of living for those who are already struggling to meet that cost.

In the case of high-cost short term loans, any risk to the lender is mitigated by the repayment structure of the product. The risk of default is shifted from the lender to the borrower, so when loan repayments cause further financial stress, the borrower borrows again - and so commences the cycle of repeat borrowing. That this does not impact on the lender does not mean it is sustainable, or safe, for the borrower.

High-cost short term lending creates the perverse situation where those with the least resources pay the highest price for credit. From an equality or social justice perspective, this is indefensible.

Once obtained, high-cost short term lending takes a 'first stake' in the borrower's income. Repayment of the loan is prioritised above all other expenses. Again, this is indefensible.

The collective drain, when applied to hundreds of thousands of consumers, can have a broad negative impact and prevents consumers from becoming stable, economically productive participants in the mainstream economy.

A comprehensive national interest rate cap has the potential to end this practice in Australia.

It should be made clear that an interest rate cap will not solve the problem of financial hardship, nor is it intended to. A cap will merely act to prevent a particularly poor - and illusory - 'solution' to that problem.

A more genuine solution to the problem of financial hardship is likely to depend on a range of measures; from better income support for vulnerable consumers, to the provision of assistance in reducing debt, to the means to build assets - amongst many, many others.

At some point, lenders should be prevented from extending credit to those who cannot afford to pay. If they are not, then the provision of credit becomes counter-productive and causes harm to the borrower.

This is usury.

It is up to every society to decide for itself the point at which acceptable credit ends, and usury begins. In Australia, that point has traditionally been set at 48% APR. The coming months will determine whether or not that point remains.

In the meantime, the only certainty is that for as long as usury is permitted, desperate borrowers will continue to borrow - and lenders will continue to lend.

Appendix A

Quantitative Research: Consumer Action Online Survey

NOTE:

The raw data generated by the Consumer Action Online Survey can be found at the following web-link:

<http://www.consumeraction.org.au/publications/other-publications.php>

Survey Questions

Q1. Have you obtained a pay day loan in the last 18 months?

- Yes
- No

Q2. How many payday loans have you taken out in the last 18 months?
(Open text response)

Q3. Thinking about your most recent payday loan, what amount of money did you borrow (excluding fees or interest)?

- \$0-\$50
- \$51-\$200
- \$200-\$500
- \$500-\$1,000
- \$1,000-\$2,000

Q4. From which company did you obtain the loan? (Open text response)

Q5. For what time period did you obtain the loan? (Open text response)

Q6. For the last time you borrowed money in the form of a payday loan, did you?

- Borrow the exact amount of money that you required
- Borrow more than you required because the lender required you to borrow a minimum amount
- Borrow less than you required because the lender would not go to your desired amount

Q8. Do you know what the interest rate was for the loan? If so, how much?
(%) (Open text response)

Q9. The main reason for taking out the loan was?

- To pay rent
- To pay utility bills (eg, Gas, electricity, water)
- To meet mortgage repayments
- Car repairs
- Food or other essential expense
- Medicine
- To help a member of my family
- To help a friend
- To pay back another pay day loan
- To pay another loan or credit card bills
- Other

Q10. What was the main reason that you chose that company to provide the loan?

- Nearby/convenient
- Only one that would lend me the money
- Good rates
- Low fees
- Has used them before
- Other (please specify)

Q11. Are you aware of any other companies that offer similar loans to the one that you used?

- Yes
- No

Q11a. How many companies are you aware of? (Open text response)

Q11b. Can you name these companies? (Open text response)

Q12. Have you ever had more than one payday loan at the same time?

- Yes
- No

Q12a. Were these pay day loans with different companies?

- Yes
- No

Q13. Have you ever been unable to pay back a payday loan on time? If so, what did the lender do?

- Charge a fee
- Refinanced the loan (rollover)
- Threatened legal action
- Other (please specify)

Q14. Have you done any of the following to repay a pay day loan?

- Refinanced from the same lender (rollover)
- Borrowed from another pay day lender
- Borrowed from family/friends
- Pawned something
- Other (please specify)

Q15. Prior to getting a payday loan, what other options did you consider for getting money?

Q16. Have you used any of these forms of credit over the past 12 months?

- Credit Card
- Bank or co-op loan
- Centrelink advance payment
- Pawnbroker
- Finance company
- Loan from family or friend
- Other type of small amount cash loan

Q17. Would you be willing to participate in a more in-depth interview in relation to this topic?

- Yes
- No

Demographics

DA. Are you?

- Male
- Female

DB. Which age group do you belong to?

- 18-24 years
- 25-34 years
- 35-44 years
- 45-54 years
- 55-64 years
- 65+ years

DC. Where do you live?

- NSW
- VIC
- QLD
- WA
- SA
- ACT
- TAS
- NT

DE. Which of the following best describes your household structure?

- Single household
- Couple with no children
- Shared household with more than 2 adults
- A Couple with children
- Single parent with children

DF. Do you have children under the age of 18?

- Yes
- No

DF1. Which age group does your child/children fall into?

- 0-2 years
- 3-5 years
- 6-9 years
- 10-14 years
- 15-18 Years

DG. What is your highest level of education?

- Some secondary school
- School certificate
- Higher school certificate
- TAFE

- University (under graduate)
- Other College
- University (post graduate)

DG1. What level of school did you leave?

- Year 9
- Year 10
- Year 11
- Year 12

DH. What is your current employment status?

- Full time (more than 30 hours)
- Working part time
- Not currently working
- Full time student

DH1. What is your occupation?

- Professional
- Manager
- Administrator
- small business owner
- Sales
- clerical or service worker
- transport worker
- labourer
- tradesperson
- home duties
- retired
- unemployed
- Student

DI. What is your current income?

- Under \$20,000
- \$21,000-\$40,000
- \$40,001-\$60,000
- \$60,001 - \$90,000
- \$90,001 - \$120,000
- \$120,001 - \$150,000
- \$150,001 - \$180,000
- \$180,001 - \$210,000
- \$210,001 - \$240,000
- Over \$240,000

- Prefer not to say

DI1. What is your household income?

- Under \$20,000
- \$21,000-\$40,000
- \$40,001-\$60,000
- \$60,001 - \$90,000
- \$90,001 - \$120,000
- \$120,001 - \$150,000
- \$150,001 - \$180,000
- \$180,001 - \$210,000
- \$210,001 - \$240,000
- over \$240,001
- Prefer not to say

DJ. Which country were you born in?

- Africa
- Argentina
- Asia
- Australia
- Austria
- Bangladesh
- Brazil
- Cambodia
- Canada
- Chile
- China
- Colombia
- Croatia
- Denmark
- Finland
- France
- Germany
- Greece
- Holland
- Hong Kong
- India
- Indonesia
- Iran
- Iraq
- Ireland
- Israel
- Italy
- Japan

- Jordan
- Kenya
- Lebanon
- Mexico
- Netherlands
- New Zealand
- Norway
- Pakistan
- Peru
- Philippines
- Poland
- Portugal
- Romania
- Russia
- Samoa
- Scotland
- Serbia
- Singapore
- Slovakia
- Slovenia
- South Africa
- South Korea
- Spain
- Sweden
- Switzerland
- Taiwan
- Tanzania
- Thailand
- Turkey
- USA
- United Kingdom
- Vietnam
- Yugoslavia
- Other (please specify)

DK. What is your first/primary language?

- Arabic
- Cantonese
- Chinese
- Dutch
- English
- Filipino/Tagalog
- French
- German
- Greek

- Hindi
- Indian
- Indonesian
- Italian
- Japanese
- Korean
- Macedonian
- Malay
- Mandarin
- Marathi
- Nepali/Nepalese
- Norwegian
- Polish
- Portuguese
- Punjabi
- Romanian
- Russian
- Serbian
- Sinhala
- Slovenian/Slovene/Slovak
- Spanish
- Swedish
- Tamil
- Telugu
- Thai
- Tongan
- Turkish
- Ukrainian
- Urdu
- Vietnamese
- Other (please specify)

DL. Are you from Aboriginal or Torres Strait islander descent?

- Yes
- No

Appendix B

Qualitative Research: Open Mind Research - Exploring Payday Loans



Exploring pay day loans

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KEY POINT SUMMARY

Pay Day Lending is a complicated subject which affects people's lives in many ways. On the basis of this very small scale study we would suggest the following as key insights:

- People who use/have used Pay Day Lending tend to fall into three main groups: those who live on or close to the poverty line (we have called the Financial Desperates); those who aspire to a lifestyle that is beyond their income (Keeping up with the Joneses); and young people who defer responsibility to enjoy today (Young and Irresponsible's). Each has a slightly different set of motivations and are inclined to use the money for different purposes. In this study there were also differences in the incidence of each across Melbourne and Geelong.
 - Financial Desperates: These are people who have fallen into a cycle of debt and borrowing. They tend to be living in low socio economic areas, on fixed incomes with spasmodic work at best and have struggled with money management and debt for many years. Their lives beyond their financial struggles are similarly difficult; for some this includes personal or emotional problems, for others it was family breakdown and drug addiction. For them pay day loans supplement other loans to pay for real necessities or pay off other loans in what is a systemic cycle of debt and borrowing. The fundamental driver for pay day loans (and a factor that clearly differentiates this group from other pay day borrowers) is that they need the money to pay core bills or to meet an imminent financial crisis. They were over represented in Geelong.
 - Keeping Up with the Joneses: They tended to have a steady, if low, income and borrowed money to 'have' some of the things they feel they deserve but cannot afford... In Melbourne a few who were holding down steady jobs and living in middle class areas, had taken out a short term loan as a result of a one-off emergency. An emergency had arisen that meant a (relatively) small amount of cash was required immediately and consequently they felt their only option was a pay day loan. Others were

cyclical borrowers but their motivation was less about making payments on bills (like the 'Financial Desperates') and more about enabling particular 'luxuries': a dress for a wedding, a holiday for the family, a down-payment on a new car...

- Young and Irresponsible: The common thread here is that they are young and struggle to manage money, living over their means, not understanding how to budget, building up high debt on phones, or simply getting hold of short term money to pay for entertainment and fun 'today', knowing that they have so much debt a little more won't make much difference. They may have started borrowing money while they still live at home because their family cannot assist them financially. Others had found the move out of home financially challenging (particularly in Geelong) the only way to pay rent or bills is to take out a loan.
- There is an element of 'shame' to taking out Pay day loans, and admitting to being unable to cope financially: by turning to well advertised, nationally recognised names (such as Cash Converters) people feel this behaviour is normalised.
- Importantly, across the sample the consistent initial driver to pay day loans was an emergency of some kind: however, definition of what constitutes an emergency differed from rent or a utility or medical bill that must be paid; but also buying the children a Wii for Christmas or taking the family out during the holidays: or a 'big night' with friends.
- For most, pay day loans are a last avenue. The other options reportedly exhausted by respondents included:
 - Family and friends
 - Banks (personal loan)
 - Hardship schemes (for some bills)
 - Credit Cards
- People perceive Pay day loans are the only way to get a small amount of money, immediately. The process is quick and easy; the outlets visible

and convenient and once that door has been opened, and people learn just how easily they can get their hands on money, it is all too easy to return even though all borrowers acknowledge that they're being 'ripped off' with very high charges. However, there was very little understanding and in fact considerable confusion about the actual interest rate percentage charged... Hearing of figures as high as 35-48% did shock many of these respondents.

- Further, there are limited options of repayment terms offered by lenders. Respondents report that repayments are direct debited out of their account over the course of two fortnights. An increase in the options for repayment – e.g. direct debit fortnightly over six weeks instead of four for example or weekly for 8 weeks etc) has the capacity to assist borrowers in repaying their loans.
- Borrowers report understanding the steps involved: they come in with documents to verify their identity and their income; and seek approval for a specific amount of money – a 'short term cash loan' or 'cash advance' in 'Cash Converters' language – at which point they are presented with a schedule of their repayments in dollar terms (e.g. your repayment on a \$200 loan will be \$270) and the terms of repayment (direct debited over consecutive fortnights of \$135 each fortnight). While the information gives the illusion of transparency, at no time is the interest rate mentioned. Only those who have done the calculations themselves acknowledge that the interest rate is 35% (and can be more). Borrowers see that the loan is expensive, but don't know the specific percentage of interest they are being charged. Further, they are aware that there are charges should they default on the loan but they are not sure of the interest they would incur.
- Borrowers do not feel they are being 'duped' or but are not aware of rules or regulations governing the behaviour of pay day lenders. They don't feel protected and this suggests an opportunity to promote the fact

that lenders borrowers have rights – regardless of where they borrow their money.

- On the one hand people are grateful to pay day lenders for offering a unique service many really rely on. On the other, lenders are seen to be taking advantage of them when they are in dire need. Access is very easy; counter staff come across as friendly and approachable; the process of taking out a loan is easy, quick, straightforward; information needed (ID, bank statements etc.) is easy to get. All respondents claimed to have been given the terms and conditions of repayment though few had read these in any detail, and some were not expecting direct debit to start immediately.
- Lenders are reported to be undertaking a range of activities that appear to be exploitative. They offer special deals for repeat custom; contact those who have borrowed previously encouraging them to borrow again; offer incentives to refer friends... The result is that those who have borrowed once are often tempted to borrow again – the loan no longer comes about due to an emergency but as a result of availability and visibility and eventually, habit. It remains possible that encouragement from the lender could tip them over and result in their (re)entering a cycle of debt.
- Advertising on TV by Cash Converters has clearly served to increase visibility and, in a more subtle way, to normalise this as a way of dealing with a cash shortfall... Cash Converters is the best known and is the default term used when referring to pay day lenders; and is the lender most respondents had experienced. For some, the number of stores and the fact that they have seen the brand on TV results in a level of trust – which is exactly what they are seeking for any financial transaction. For those who seeking a smaller lender there are reportedly numerous advertisements offering short term loans on radio and online. The choice of who to go with is difficult and borrowers are not sure how to differentiate between them beyond what the loan will cost them to repay.

BACKGROUND

The Consumer Action Law Centre is a Victorian independent, not-for-profit casework and policy organisation, pursuing a law reform agenda across a range of consumer issues at a governmental level, in the media, and in the community directly.

One of the organisation's priorities for 2008 is the issue of high cost credit and, in particular, small amount lending commonly known as 'payday' or 'fringe' lending.

Given that the majority of payday borrowers can be assumed to be low income householders or consumers, considerable hardship and financial difficulty often result from these high interest loans. While the Victorian Government has capped the interest rate on payday loans at 48%, there is no restriction on the fees that can be levied by lenders.

The issues associated with payday lending are complex and Consumer Action believes that there needs to be a holistic approach taken at a national level, which brings together fair and efficient regulation, with state and community based initiatives that address underlying issues such as financial exclusion and poverty. However, apart from a 2002 Consumer Law Centre Victoria report, there is little publicly available data on the number and frequency of loans made and the demographics of consumers. Consumer Action is aiming to produce an empirical study of the impact of high-cost, small consumer loans in Australia, identifying the main purpose of these loans and the short and long-term impact on individuals who obtain these loans.

RESEARCH OBJECTIVES

The overarching objective of this project was to consider the drivers to pay day loans and the impact these loans have on borrowers. More specifically, this study considered the following:

- The specific characteristics (both sociological and psychological) of payday borrowers
- The drivers of payday borrowing... why, specifically, people take out these loans
- Understanding the borrowing experience
- The impacts of short-term borrowing upon the individual/family

RESEARCH APPROACH

This small scale study used a combination of group discussion, depth interviews and extended in home interviews. In group discussions, borrowers shared their experiences amongst peers, allowing insight into the culture and social context of payday lending. The depth interviews and extended interviews provided the opportunity to example more closely the histories, circumstances, views and feelings of borrowers, and investigate in more detail the broader contextual themes and important individual and social implications of payday lending. These are illustrated in the case studies appended.

The following sample was adhered to:

		Outer (e.g. Footscray*)	Regional (e.g. Geelong)
Singles (18-35 years)		1 standard depth 1 in home	1 standard depth 1 group
Families (at least 2 children at home, any age)		1 in-home 1 group	1 standard depth 1 group
Older singles (35+)		1 standard depth 1 group	1 standard depth 1 in home
TOTAL:	4 Group Discussions 5 Standard Depth Interviews 3 In Home Interviews		
Note:	To be recruited from Consumer Action Law Centre lists or via in-house resources: 'have taken out at least one short-term (i.e. 1 week-2 months) loan from a non-bank provider in the past two years'		

Group discussions and in-depth interviews were undertaken in Melbourne at Open Mind Research offices, and extended interviews in the homes' of respondents. Fieldwork was undertaken between October 28th and November 6th 2008.

CONSTRAINTS

The study reported here was qualitative in nature and must be interpreted as such. Qualitative research explores ideas and develops hypotheses. It is not intended to be

a precise and definitive index of what happens in the community. The approach adopted in the study was basically interpretive and relied upon a relatively free and unprompted conversation between participants. The report is based on observations and interpretations of the moderators, together with analysis of the transcripts. Verbatim comments from respondents have been included in the report to illustrate opinions.

DETAILED FINDINGS

FINANCIAL HISTORIES AND CIRCUMSTANCES

As noted respondents often recount long and usually complex financial histories leading up to the situations where high-interest, short-term loans become necessary. The background of those who participate in payday lending can be marked by a series of traumatic and devastating circumstances; their current situations too often complicated and gruelling. But while these circumstances are true for most respondents in the study, findings reveal that such conditions have seemingly, although with exceptions, been experienced more ‘acutely’, and experienced more widely amongst respondents in Geelong than those in Melbourne. Nonetheless, for most respondents payday loans are often a last-ditch alternative for those who have come to the end of their tether financially.

The following examples of the circumstances that led to the need for this type of loan reflect the situation of the majority of borrowers in Geelong and many in Melbourne.

“I have just come out of being homeless. My lease ran out and I couldn’t find rental in my price range and I was homeless with three children. I lived in a motel put up by the Salvation Army and then got an emergency unit and then a private rental and am on a waiting list for Ministry of Housing. Now I have bills from the old house, the emergency housing and this house.”
[single mother, Geelong]

“A few years ago I got evicted from Norlane [Ministry of Housing] after having my first-born and I came home from hospital and the locks were changed. I was at my partner’s

house for a while then fell pregnant again, which I wasn't expecting, and was on the streets and pregnant...We got a house in Geelong but I'm still paying the debt back for the old house and where I am now the wiring is all gone and everything needs to be fixed." [partnered mother, Geelong]

"I've been a single mother for a long time with no extra help. I moved here for a better life and fell into a real slump. It cost me a lot of money to move and I ended up having to put stuff into storage and move in with my brother... I had a few different loans and it was mainly with GE Capital Finance. I just couldn't get rid of them because of the interest rate. The credit card bill was huge." [older single mother, Geelong]

"My life was okay for a while, then my mother died...and now I've been diagnosed with cervical cancer...I can't go to my mum for help now and I have to try and get to all the doctor's appointments...and get treatment...I had to take out another loan from Cash Converters just to put petrol in the car to get to the...hospital...I've just paid the last one...it just keeps coming." [female, north-west Melbourne]

"I grew up hanging out on the street in Perth...for a while I was off the rails a bit with drugs and stuff...and well, when there was money around, I just spent it on drugs and whatever I wanted...my mates were the same... I've had a bit of counselling over the years...financial and head shit...but it's hard you know." [male, south-east suburbs, Melbourne]

External financial advice often becomes necessary at some point and many in Geelong had been referred to Jindara, a community based centre offering financial advice and counselling. Some in Melbourne had received financial counselling through the Salvation Army and some reportedly through financial institutions such

as the Commonwealth Bank and the National Australia Bank. Most didn't know that the bank offered such assistance; one respondent offered an explanation as to why –

"Yeah most people...get to the third or fourth letter where they're thinking 'I'm in all sorts of shit here...I won't even open this now, I'll just throw it in the bin...so you don't even realise that service is actually there and available to you.'" [male, northern suburbs, Melbourne]

Debt consolidation and filing bankruptcy are (reportedly) two of the main choices available to people in desperate financial straits. There is however, some resistance to both of these options. Declaring bankruptcy brings a certain sense of shame, while opting to consolidate debts can reportedly result in a damaged credit rating. Nonetheless, debt consolidation is viewed more favourably than bankruptcy, and along with personal loans and, on a smaller scale, short-term payday loans, is considered a means of avoiding bankruptcy.

"Quite recently I've worked out that speaking to different financial institutions where I've got loans...like GE or the Commonwealth Bank and debt collection agencies and things like that...because I'm not working at the moment and on government benefits for the time being, they're actually quite understanding believe it or not, and able to...basically they put it all together, work out a minimum monthly figure and that's sort of worked out from there...[this strategy has been applied to] my personal loan, the car loan...and you know, the loan with GE...and debt collection agencies...it's easier to manage just one thing." [male, south-east suburbs, Melbourne]

"I was going to put my credit cards into one loan on lower interest, but the bank told me that if I did this, I'd get a bad credit rating because I was admitting I couldn't pay the credit cards...I didn't want that, so I keep trying to pay them...sometimes I need a short-term loan to be able to do this on time." [female, Melbourne]

Many are reluctant to speak openly about payday lending, viewing it as a last resort; a shameful and embarrassing thing. As some reported...

"It made me feel like I wasn't smart enough, just stupid to get to that point." [female, Geelong]

Even though such borrowing is apparently common in these circles, many claim to keep this kind of business to themselves and say that information about payday loan options is rarely conveyed by word of mouth.

"No-one talks about it." [female, Geelong]

"I don't tell anyone that I do this to get by... I don't want people to know about it." [male, northern suburbs, Melbourne]

UNDERSTANDING BORROWERS

In considering how people approach pay day lending, this study has identified that pay day borrowers fall into three main groups.

Financial Desperates:

These are people who have fallen into a cycle of debt and borrowing. They tend to be living in low socio economic areas, on fixed incomes with spasmodic work at best and have struggled with money management and debt for many years. Their lives beyond their financial struggles are similarly difficult; for some this includes personal or emotional problems, for others it was family breakdown and drug addiction. For them pay day loans supplement other loans to pay for real necessities or pay off other loans in what is a systemic cycle of debt and borrowing. The fundamental driver for pay day loans (and a factor that clearly differentiates this group from other pay day borrowers) is that they need the money to pay core bills or to meet an imminent financial crisis. They were over represented in Geelong.

Keeping Up with the Joneses:

They tended to have a steady, if low, income and borrowed money to 'have' some of the things they feel they deserve but cannot afford... In Melbourne a few who were holding down steady jobs and living in middle class areas, had taken out a short term loan as a result of a one-off emergency. An emergency had arisen that meant a (relatively) small amount of cash was required immediately and consequently they felt their only option was a pay day loan. Others were cyclical borrowers but their motivation was less about making payments on bills (like the 'Financial Desperates') and more about enabling particular 'luxuries': a dress for a wedding, a holiday for the family, a down-payment on a new car...

Young and Irresponsible:

The common thread here is that they are young and struggle to manage money, living over their means, not understanding how to budget, building up high debt on phones, or simply getting hold of short term money to pay for entertainment and fun 'today', knowing that they have so much debt a little more won't make much difference. They may have started borrowing money while they still live at home because their family cannot assist them financially. Others had found the move out of home financially challenging (particularly in Geelong) the only way to pay rent or bills is to take out a loan.

The following considers these groups in some detail:

In Melbourne few young singles participated in the project, but in Geelong, many in this group display some of the attitudes noted above – a sense of shame or self-defeat that they haven't been able to manage independently. Digging deeper, though, it is apparent that many of these young people who have resorted to fringe lending to get by, do not enjoy the same family supports that others in the community might. Most claim that their parents are also struggling and would be unable to help them out with a loan when things get tight; in fact, most would not ask their parents knowing that such a loan would be unaffordable for them. Others do not have strong family relationships.

"My Mum is struggling anyway. She lost her house in the divorce." [single mother, Geelong]

As well, some young singles face unemployment or underemployment, which can be particularly stressful when they are living out of home for the first time. Some indicated too, that they felt ill-equipped to be embarking on adulthood and responsibility, and had little idea of how to manage money or the consequences of debt.

"I had a period of grief at the loss of my grandmother and I was unemployed for about a year. It's almost impossible to keep your car going, apply for jobs, and rent and food. There's no sociable aspects to my life at the moment. I go and pay the rent straight away and get rid of whatever bills have come up."
[young single male, Geelong]

"I'm looking for office work. With brick laying and concreting and stuff it's affected by the weather and you don't get paid if it's raining whereas office work is more stable." [young single male, Geelong]

"Mum and Dad just did everything...I had no idea how to do anything...then Mum died and Dad got sick...and I...well it took me a long time to get my shit together...I had no life skills...definitely no money skills... the transition from home to moving out into my own environment where I had to make my own rules and realise that if I didn't keep them, that I only stuffed myself over...it's not going to hurt anybody else but me."
[female, north-west suburbs, Melbourne]

Discussions in Geelong revealed another group of young singles – 'unsettled' singles – those who do not run their own home, and who like to go out clubbing and partying, present a different attitude to payday loans. For them, the prospect of a night out

drinking will not be dampened by a lack of money. Several reported opting for a payday loan to fund a night or a weekend of drinking and other entertainment and, to them, there's no shame in any of this.

Similarly, some older respondents in Melbourne - aged in their 30's and 40's - recall seemingly less vital reasons, such as the desire for a holiday, a night out with friends – both labelled a 'break from reality', or new clothes or home entertainment goods, described as 'emergencies' which were accommodated in the short term by taking out a payday loan. For some in this group, there seemed a priority in keeping up with broad urban social norms; a sense of 'If they have it, we need it too', which may be understood perhaps as an effort to position oneself within the 'mainstream'; to be considered a 'worthy' or 'successful' part of, and included in society. For others though, there was a perceived need to escape, even for a short while, their arduous and sometimes cheerless reality. Some of these people justified their labelling of a perhaps less essential item such as a weekend away with the family, with a reassertion of accommodating priorities such as 'my family is my priority'.

"I decided I wanted it [a new larger, flatter screened TV]...I want to be comfortable at home you know, it's important...you've got to have some comforts...everyone does." [male, northern suburbs, Melbourne]

"I wanted to go on a holiday to the Gold Coast for 8 days...my mates were going and I didn't want to tell them I couldn't...I'd just be embarrassed...so I got a loan from Aussie Cash." [male, Melbourne]

"Just keeping up with people who are making a bit more than you're making...just going out for drinks or a meal or something like that...you just can't afford it as often as other people can...I find that really hard and annoying...and pretty embarrassing...sometimes I take out a small loan so I can do it." [male, north-west suburbs, Melbourne]

"We went a bit silly and went oh, maybe we can use this money to...go away for the weekend...went with the kids sort of thing, so there's \$300 gone...[and] that money was budgeted...to pay a bill...and then you've got those bills due...and so I took out a loan for those from Cash Converters." [male, south-east suburbs, Melbourne]

"If you need a little bit of cheering up...you just take the credit card or get a quick loan." [female, Melbourne]

"I like spending...I'm a person who likes to spend...I like to spend my money...I'm not just going to be like not spending my money...I can't live like that, it's very restrictive...I can't be a scrooge...I want things like an i-Pod and some new clothes." [female, Melbourne]

One respondent suggested that her friends who seemed not to be able to escape the debt cycle are...

"...people who are desperate to have a dream, [and] they're the ones that debt gets the most because they're the ones that are most willing to do anything for it...I have a friend who always asks me for money for her bills but spends a fortune going to expensive bars because she likes to be seen there...some people she knows go there...it's mental desperation." [female, north-west suburbs, Melbourne]

The wish and efforts to portray oneself and one's behaviour and circumstances as 'mainstream' and like every one else in society might also underpin the many times, various respondents of all ages made comments such as...

"We all have financial struggles, we're only human...because people on high wages, a lot of them spend more you know...we all have the same problems really". [female, Melbourne]

MANAGING MONEY

The big question is how do these people manage their money? And the answer is that they are often remarkably resourceful in attempting to stretch very finite resources. They try some proven and some not so usual strategies in order to make their money last until the next payday, usually employing a range of strategies in an effort to manage their money.

Discussions reveal that for some who utilise payday loans when they are out of cash, the concept of budgeting and its associated implication of 'blame' is troubling, while the notion that one can sit down and write a budget and somehow adhere to it is laughable.

"It's easy to write down on a piece of paper but not in practice. My four-year-old wets the bed and I can't afford to buy the toddler nappies or the bed liners. I haven't got a computer and I don't even know how to use one." [partnered mother, Geelong]

However, discussions indicated too that many do utilise some form of budget, for some it is a series of calculations in their head, for some it is scribbled on a piece of paper, and for others it is created and automatically calculated on a computer spreadsheet. What seems common to most who try to make and adhere to a budget, is that it is always in motion, always being adjusted and readjusted. While naturally, a budget must have some flexibility, many spoke of their budget as simply an exercise in listing expenses rather than a guide to how earnings need to be spent. There seemed few exceptions to this observation.

"We work off a budget, so I have a budget set up on the computer...[We use it] because I get paid monthly, and being monthly you're rich for the first time of the month, and then that's it, you're broke for the next three weeks...I suppose with the extras that come up unexpectedly, bills and that sort of thing, you try and plan for those, so you've got to sort of see the future a bit, so you work that into the budget, as well. I'm

always fiddling with it...sometimes it works, sometimes it doesn't work." [male, south-east suburbs, Melbourne]

"I like using the budget because I like to know where the money's going." [male, northern suburbs, Melbourne]

Young singles seem less likely to budget, especially those who are still living with a parent. For them, the consequences of 'blowing the budget' are usually not so severe.

"What's a budget? We get the food and rent and that's about it. Everything else is pretty much blown on the weekend. During Grand Final weekend we had no money so we went to Cash Converters to get a small loan – just to go out." [young single male, Geelong]

"I will sit down on a Monday and write out my budget for rent, food, smokes, \$100 for going out or whatever, and I will just use my keycard but when I check the balance there will only be \$6 left and then you need money for food or petrol or if you want to go out clubbing." [young single female, Geelong]

"It depends on the time of the year. When the weather is cold you hibernate more in the winter months and try not to spend. There are more parties and social things going on in the summer months and those times are harder to manage." [young single male, Geelong]

Many, particularly the mothers in the Geelong, utilise CentrePay (Centrelink) to help manage their money and bills; CentrePay appearing to be not only the most utilised, but also the most useful money management strategy employed by families in Geelong. Most reported that they had been advised of the service through other government agencies.

*"I have had a Ministry of Housing house for six years and I live on the pension. I have all my bills Centre paid (by Centrelink). When I first signed up with the Ministry of Housing they suggested CentrePay for the rent and I do it with all my bills."
[single mother, Geelong]*

Others in Melbourne and Geelong reported adhering to a pre-pay utilities instalment plan, to avoid the 'big' gas and electricity bills. Some arrange with utility and telecommunication providers such as Telstra and Foxtel, to pay their bills in small repayments in order to avoid service disconnection.

"With something like a Foxtel bill...so you might be \$300 behind in your Foxtel bill and they send you out letters for two months saying 'we're going to disconnect you', but if you rang...and organised something...they'd be prepared to take \$20 a week...they'd rather get something than nothing...and you can keep the service while you're paying" [male, northern suburbs, Melbourne].

But while this measure brings short term relief, some report that such arrangements must be made in relation to each bill; utility providers not allowing these to be established as permanent procedure. In having to make such arrangements perhaps 4 times a year (assuming that most utilities are billed quarterly) and for perhaps 3, 4 or more different services, people experience a great, and an accumulated sense of shame and embarrassment, and a diminishing sense of self-esteem and independence.

"I had to ring for the gas, I had to ring for the electricity, for the phone, for the water, for everything...and I had to do it every bill every three months...I just couldn't face it after a while...I felt so ashamed...and depressed...I ended up letting the phone get cut off..." (female, Melbourne).

Two participants actually stuff different amounts of money into separate envelopes to dole out over the coming fortnight, each allotted to a different purpose. Others 'juggle' debts, transferring them between credit cards, some seeming overly

optimistic about the 'advantages' of this, yet aware of the financial institution's commercial priority...

"if you've got a credit card debt or whatever else...you can take out...a credit card with another company and they'll basically pay out your debt...you sort of get 6 months or 12 months at a different interest rate in which to try and sort of catch yourself up...its like a transfer...they also sort of give you inducements...like 'we'll also give you an extra \$3000 to play with in the meantime'...an incentive to get you to sign on the dotted line...they want your debt...they'll make money out of it in the long run." [male, northern suburbs, Melbourne]

Some choose to lower the limit on their credit cards when making repayments, meaning that once the money is repaid, it cannot be re-borrowed. Many people used pre-paid mobile phone services, opting to not receive a bill which they might not be able to afford. Many too, spoke of the advantages and flexibility of lay-by, as well as the advantages and ease of taking up interest free terms when purchasing household goods. One person told of temporarily taking a part-time job in order to pay accrued debts and establish a buffer of savings in an attempt to avoid debt in the event of future emergencies. Others, most particularly those who have had very serious financial problems in the past, tend to pay the rent and outstanding bills first and if there's nothing left over for food will manage on canned soup and spaghetti or charity foodbank handouts – the latter, anecdotally, are becoming harder to get in Geelong with the current financial situation.

"I have tried getting all of my cash out on payday and have it in my wallet but you have it til Thursday or Friday and you wake up Monday or Tuesday and you've got nothing." [young male]

Some report having become more resourceful and 'streetwise' as their family increases in size, or times become tougher, or sometimes both. Some are aware that school excursions can be paid off over time; others have 'holidays' in the backyard with tents and camp-beds; some bartering of goods and/or services takes place between families. Singles too reported bartering goods and services between neighbours, and noted the added benefit of growing community belonging and

camaraderie. For families though, as children grow older their needs (and demands) become greater and it becomes more difficult to cope. Children are very easily embarrassed around their peers and many mothers in Geelong expressed their willingness to go to great lengths to ensure that their kids don't suffer in this way.

"When the kids are little you can get away with things but as they get into teenage years and secondary school it gets much harder." [single mother, Geelong]

"My [17-year-old] son doesn't go out because he doesn't have the clothes or the shoes and he has lost his confidence. He is very withdrawn and very anxious and I think it's going to permanently affect him. He won't go to school and if I take him to look for a job he won't get out of the car. He just sits in his room all day." [single mother, Geelong]

"My son is like that. He's 24." [single mother, Geelong]

"I would never embarrass my kids. I have really gone without for my kids and I don't get anything for myself." [single mother, Geelong]

"I have actually thought of putting my kids into welfare because they would be better off in terms of having food and clothing and dental, more than I can give them now. When you are in this situation you are giving your kids less than best." [single mother, Geelong and former ward of state]

For most, continued and frequent debt is contended with by increasingly tightening the purse strings and above all prioritizing necessities such as paying rent, bills and food, with little left over for socialising or leisure activities. People juggling family needs and debt management speak of continuously re-assessing and re-evaluating their priorities in order to accommodate as many necessities as possible, and while they don't see this as an easy task, they see it as imperative.

"When I did have a job the money would go a lot quicker. Whatever was over after paying the necessities would go. Now I have to watch it so much more close. I don't go out." [young single female, Geelong]

"Once I pay the rent, bills, food for the animals, petrol and a bit of food for me, there's barely anything left...and when there is I have to think hard about how to use it best." [female, north-west suburbs, Melbourne]

"Sometimes I don't know where to start...what's more important?...the electricity bill or new sneakers for my son because his have holes in them? Sometimes I just want to put all the necessities in a jar...and pull one out and decide what to pay that way...it's too stressful working it out." [male, south-east suburbs, Melbourne]

"...the priority is petrol in the car and cigarettes to smoke but you've also got to cut back on a lot of things that aren't really necessities." [male, south-east suburbs, Melbourne]

"I just try to work out what's coming in and what's going out...in the next month, the next couple of months or even the next fortnight, and trying to work out what are the essentials in that time period...if there's a bit left you might go out for a few drinks or dinner or whatever, but if you can't, you can't." [male, northern suburbs, Melbourne]

The difficulty is that nobody appears to have anything left for emergencies and everything else is an emergency – illness, car breakdown, the children's shoes, house maintenance issues and so on. There is nothing to fall back on when an emergency arises. All options have apparently already been exhausted. So what they

tend to do is either borrow (short-term) or not pay an outstanding bill and, either way, this leads to more trouble.

Ultimately, whether these people are poor money managers or whether they simply do not have sufficient income to live on is arguable. What is clear is that there is a cycle of debt which many find almost impossible to recover from. The slate is never wiped clean for some; for others debt comes and goes, but is never far away. Those that reported having taken some outside financial advice (both paid and un-paid) which resulted in all debts being consolidated and either paid off or being paid off regularly with no further debts accruing, have little left to live on, and even less to accommodate an emergency but, for the time being at least, the pressure has lifted and they are feeling better about themselves.

DEBT

It is not only short-term payday loans that are used, but longer-term personal loans also play a large role in this segment's financial issues.

On balance it seems that it is the larger loans and credit cards that get them into trouble rather than the small amount, 'payday' loans. Car loans, particularly loans for a relatively cheap car (under \$5,000 or so), are common. More often than not the loan lasts for much longer than the car and it is not unusual for people to go out and buy a second, more expensive car when the first car turns out to be unserviceable – and struggle to fund the two loans.

Some seem to find themselves in trouble too after taking up interest free terms when purchasing household goods. While there were few stories of the repayments for the goods themselves becoming impossible to pay, many reported having been sent a pre-approved credit card application following the purchase of goods and the establishment of a contract with a finance company; the pre-approved card offering immediate to access to up to \$10,000 credit. Given the difficulty in managing money and the high level of debt carried by some people, it is easy to see why many are tempted to take this option as a means of 'paying' other debts.

"I bought something interest free at Harvey Norman...and I was under the impression I had a contract with Harvey Norman...24 months interest free...[and thought] I'd be receiving a bill some time later, about a month later in the mail I received a \$5000 credit card pre-approval." [male, south-east suburbs, Melbourne]

"I had purchased \$1500 worth of goods on credit, then...in the mail a week later, I then get from GE Credit Line, a credit card saying 'Congratulations, your credit limit is \$3000...and I haven't activated it or anything...because if I do...that's the end, it'll be spent...I'll just want to have a good time.'" [female, Melbourne]

Unemployment, illness and relationship breakdown are other major factors leading up to the need to take out a loan. What is affordable when one has a partner can be unaffordable if that partner leaves. It is not unusual for people to be paying off two or three personal loans simultaneously.

"I have two personal loans and a car loan... I was short of money between jobs and I had enough in the bank for about four weeks' living expenses and I went to Cash Converters and they gave me a short-term loan for \$1,500 and I had to use the money I had in the bank to make the first few payments. Then I got a personal loan for my first car and it turned out to be a bomb so I got a better car for \$6,000 and that's my third loan." [young single male]

"I took out a personal loan when I was first married. I was young and I thought I could do everything and provide everything and I took out a loan and it was way over our heads. Hubby was working and then he stopped working and it fell on me to not only pay the basic bills but to pay the loan as well. I didn't get that paid." [young partnered female]

"I have got a credit card before and tried to pay it off and they wouldn't give you a pay-out figure. I rang and asked and they

said no, we can't tell you. Then they sent me another credit card application. That was GE Money." [young single male]

"I got a car loan with GE four years ago and they always send me letters inviting me to get a credit card or a personal loan with them." [young male]

Only one study participant (in Geelong) was buying her own home and, for this family, the high mortgage payments meant that finances were extremely tight.

"Our biggest burden is our \$230,000 mortgage. We have two kids and my partner is paying maintenance for another. We have a good support network and the kids are baby-sat regularly but it seems we never get ahead." [young partnered mother]

Not just private housing but public housing, too, comes at a price. A good many of these families are struggling to pay off old debts to the Ministry of Housing. While the payments have been kept low, they appear to be never-ending and few can see a time when they will be paid out in full.

It is perhaps safe to say that the majority of families participating in this study in Geelong have, or had in the past, more debt than they were ever likely to be able to pay off and that bankruptcy was a major option for most. While the young singles also tended to have significant debt levels, the potential for debt repayment was probably better in this segment.

Being in debt, understandably, is harrowing and causes extreme anxiety – for the individual and for the family.

"You feel uncomfortable, harassed. I have changed my phone number three times in two years. You know you have made a mistake but it's just beyond your means." [single mother]

“Optus was going to cut me off for \$38... You can be a loyal customer for 12 years and it really stinks. It’s all about the money.” [single mother]

“You are embarrassed and you don’t want to talk about it... I was working in three jobs when my husband left.” [older single mother]

In Melbourne, like Geelong, many of those participating in the study, while carrying significant levels of debt, attempt to juggle and accommodate not only regular financial commitments, but ‘emergencies’ and life’s expenses as well. In Melbourne though, the definitions of ‘emergency’ offered by many include what might be considered non-essential items, such as a holiday and a new TV, suggesting that perhaps the ‘emergency’ is not the item per se, but the need to feel included in, and an independent, worthy member of society.

PAY DAY LOANS

THE PURPOSE:

Often the decision to take out a high-interest, short-term loan is a last resort, coming after a series of financial mishaps, disasters and interventions. By their very nature these loans are for a small amount – reportedly as low as \$50 and up to \$250 to \$300 or a little more. It’s a stop gap measure and the feeling is “*you can’t get into too much trouble*” because the loan amount is so low. In the majority of cases, a payday loan is used to cover the end-of-the-line emergencies (described earlier) not covered in the weekly or fortnightly budget. It can be used for:

- Car repairs
- Food
- Medical expenses
- School excursions
- Help set-up self-employment (for example, a computer, a Mary Kay package)
- Petrol, and for some,
- Alcohol, entertainment, holidays or even drugs.

But, also, payday loans are used simply to cover budget shortfalls and ordinary living expenses towards the end of a pay (or pension) period.

“The reason I got the loan I did from Cash Converters was to help pay for a school excursion... I didn’t find out til later that you could pay it off.” [young single mother, Geelong]

“You need money to pay bills and you’re desperate. You are getting all these letters and you think what am I going to do? I went to Cash Converters because I had some rings but I got my ring back when I paid the money back.” [single mother, Geelong]

“I got a loan from Cash Converters four months ago. My daughter was really sick and she had to have chest X-rays. My

parents are quite wealthy but I didn't want to ask them, it was my pride... I borrowed \$200 and paid back \$250 a few days later. There was just no other solution." [young partnered mother, Geelong]

"You might have paid all your bills and you just need food and you can't go to the foodbanks." [single mother, Geelong]

"You don't get loans to go and do a bit of shopping – its in desperation – you want to keep the home going." [female, Melbourne]

For many parents, regardless of location, the pressure and wish to provide for their children's needs and wants, including school excursions, entertainment, Christmas and birthday presents, coupled with already difficult financial circumstances often explains the need for a payday loan.

"Last Christmas was when I started to need them...I just had my kids and my girlfriend's three kids...and it was just like...where are the presents coming from?...stuffed if I know...it's like I don't have enough money to cover this and regular payments...I needed and extra \$500 just to cover this because I've been promising the kids." [partnered father, north-west Melbourne]

Most people claim to have taken out such a loan between one and three times. Digging deeper, however, some reluctantly concede to far more borrowing occasions. It is difficult to be precise about actual numbers, but a figure of five to six borrowing occasions may be closer to the truth for many.

THE LENDERS :

Cash Converters would appear to be the payday loan market leader. It differentiates itself quite well from the other contenders – City Finance, Money 3, Amazing Loans, Ezy Trade, AMIX, Aussie Cash – by virtue of its 'security loan' image. All, however, have a highly visible presence, with downtown shop-fronts, extensive local paper advertising and some direct marketing. (Note one person who had borrowed from

another lender was targeted by Amazing Loans when it commenced operations in the area.) Cash Converters' above the line TV campaign is also influential, especially with young singles. Moreover, lenders do not allow customers to forget them easily! Cash Converters reportedly sends customers birthday and Christmas cards reminding previous customers of their services at 'this time of year in which we all want to give but feel the financial pinch'. As well, two participants claimed that Cash Converters had written to them promising them a 'spotter's fee' should they refer someone to the organisation, and that person take a payday loan.

"There's four or five of those payday loan places in Geelong. They are in your face." [young female, Geelong]

"I looked in the paper under 'finance'. Even your local paper has these payday loan ads every second page." [older single mother, Geelong]

"I saw the TV ads for Cash Converters, showing people with all different occupations. The brickie was doing a job and didn't have enough money and he got a loan against his mixer... It planted a seed." [young male, Geelong]

"There's all sorts of advertising for them [money lenders] at the moment on TV... 'the world is having a money crisis...are you having one too?' [female, Melbourne]

"Mostly, they advertise in the newspaper." [young female, Geelong]

"Companies like Amazing Loans, they rang me up in June or July and asked if I was interested in taking out a personal loan with them. They have just come to Geelong. There is a \$50 non-refundable application fee, even if your application is knocked back." [young male, Geelong]

“Cash Converters constantly sent me mail for months and months. They said we have credit waiting for you, you just have to come in and sign and I’ve been to the bank to stop Cash Converters getting into my bank account. I fell into a trap that I was constantly borrowing from them.” [single mother, Geelong]

“Once you become a customer of theirs (AMX)...they start sending you birthday cards...and letters saying ‘we haven’t seen you for a couple of months...we’re still here if you need us’ kinda thing.” [male, northern suburbs, Melbourne]

“I received a letter saying ‘you know if you send anyone along to us we’ll send you \$100’...” [male, south-east suburbs, Melbourne]

“In the environment I was in [the drug scene] everyone knows just go down to Cash Converters.” [young female, Geelong]

Many borrowers were adamant that they had not heard about these short-term lenders via word-of-mouth, claiming that no-one would speak openly about such borrowing. In Geelong, greatest awareness is created via the ‘high street’-type visibility the lenders aim for. In Melbourne, where in some areas shop fronts also have high visibility, most participants reported learning about short-term lenders via TV advertising.

THE PROCESS:

In many cases, people will go into Cash Converters to borrow some money against a piece of jewellery, a camera, or some such. The deal offered is described as ‘poor’: for example, one person reported being loaned \$80 against a \$360 camera..... If they come in late to redeem the item, it may well be sold or else the ‘interest rate’ has increased steeply. One young single mother ended up losing her car through a City Finance loan.

"If you don't go and pay back on your possessions the interest rate increases after a certain amount of weeks, it goes up and up... it's like a set amount, not interest." [young single]

"You have four weeks to pick it up and if you don't pick it up they put it in the shop and sell it and you've lost it. You either have to go in and pay the interest to get another month on it or you lose it." [young female]

"They give you crap value, not the real value like a brand new TV worth a grand they will give you \$100 or \$200 for it." [young male]

"If it's a camera or something you end up paying three times the amount it was worth in the first place." [young female]

"I went to City Finance and got a \$500 loan to get a computer to try and set myself up and I had to put my car up as insurance and I ended up losing my car.:" [young single mother]

There is a sense cutting through, though, that Cash Converters perhaps prefers to lend against the security of regular income (either a pay check or a government benefits payment) than against possessions. Certainly, people believe they have been 'encouraged' to take out a straight loan, rather than a secured loan.

"At Cash Converters they have these payday loans where you can go and say I get paid next Wednesday and they will give you \$100 and they will take it out of your [bank] account on that Wednesday. You have to show them proof that you have money going in... If you borrow \$100 you end up paying back \$160." [young male]

Lenders require potential borrowers to submit bank statements confirming regular payments coming into the account (either via wages or benefits payments) and the

outstanding money will be subtracted from the account on the day the income is to be credited. It is also necessary to set up a direct debit arrangement.

"I only got a couple of hundred dollars from Cash Converters and I had to set up a direct debit and they take it straight out as soon as you get paid, plus an extra \$30 or \$40." [single mother]

"You give your banking details and driver's licence, no other security." [young partnered female]

AWARENESS OF INTEREST RATE :

In Geelong, not one study participant was able to replay the actual interest rate they were charged on the short-term loan they took out. In fact, they tended to greatly under-estimate the rate they believe they were charged (some guessing 13%, 15% or up to 20%). They tend to think more in terms of amount borrowed vs. amount repaid, rather than interest rate *per se*. Amongst Melbourne participants, many stated an interest rate of 33%, 35% and 38%, considerably higher than the rates supposed by Geelong participants.

"Last time I got a loan I borrowed \$300 and they took \$102 out of my account for four weeks." [young male]

"With Cash Converters you borrow \$100 and you pay \$156 back. I think it's disgusting, too high. I can't afford to lose \$56." [single mother]

"It depends how much you borrow. If you go for \$60 you have to pay back an extra \$20 on top of that and if they attempt to take it out via direct debit and there's nothing in the account you have to pay a \$40 fine on top of that, even if you tell them the day you get paid and they take it out on the off week." [single mother]

"I think they're not allowed to go over 27% in Victoria." [single mother]

Some lenders also charge a non-refundable loan application fee and service fees. As well, some participants claim that the loan transaction is rushed leaving them confused about the specifics of the loan terms and conditions, and not wanting to risk further embarrassment and ask questions.

"With City Finance you have to pay \$50 for the application fee and if you don't get approved you don't get the money back; with the other places you have to be working." [single mother]

"it's not til you take the documents home and read through all the fine print...and the fine print is...it's like a \$15 service fee, a \$25 one-off start up fee...and that's just to borrow \$100...you get stressed from it...so much fine print...it was explained...but it was all done so quickly...it's breezed through...I should have asked but I was embarrassed and tired and wanting it done...but then when you get home it's like 'oh shit'." [female, Melbourne]

THE EMOTIONAL ASPECTS:

Payday borrowers often express a sense of shame and guilt at having to resort to such a loan. There is certainly no warm and fuzzy feeling when they enter a payday lender's premises. Rather, they describe feeling *"like a criminal"* or *"a failure"*.

"Cash Converters just make you feel little, degrading." [single mother, Geelong]

"It makes you feel anxious." [single mother, Geelong]

"They almost laugh at you so it upsets you. I think they feed off your anxiety and your needs and they make you feel there's no other option." [young single mother, Geelong]

"I felt subhuman, I think is the best word to describe it." [female, north-west suburbs, Melbourne]

Despite the negative emotions attached to short-term, high-interest borrowing, such loans do offer one last bastion of hope. Borrowers know they're being 'ripped off' but, also, know that they might just be lucky enough to access that sorely needed \$100 or \$200, so perhaps it's worth the negativity of going into a payday lender.

"They know the game...they make a lot of money...a lot of profit" [female, Melbourne]

"They know they've got the advantage over us...they have the power." [male, northern suburbs, Melbourne]

"It takes the pressure off. You pay the bill." [single mother, Geelong]

"You are relieved. When you have paid what you need to pay, there is some relief and there is even bigger relief when you've paid off the loan. You use it as a tool to get through but it's very easy to become a habit." [single mother]

"It gets you out of a pinch short-term but it's too convenient. There's too many in Geelong." [young partnered female]

Whilst the vast majority claim they would never do it again (and, incidentally, tend to under-estimate the number of borrowing occasions), the reality is they just may have to.

"I have only had one loan and I wouldn't do it again – probably. When you get into debt and live a life of going from this person to that person..." [older single mother]

"I have had four loans and I tell myself every time you are going to lose \$200 to get \$300, because I'm after the quick fix... One of them, Money Specialists I think, they charge you \$50 and a yearly fee to be a member and you have to put your fridge and washing machine and TV as security to get the loan." [single mother, Geelong]

THE IMPACTS:

With many study participants undergoing a cycle of debt and poverty, they find it somewhat difficult to separate out the specific impacts of payday or short-term loans.

Nevertheless, the following comments point to some of the flow-on effects of short-term borrowing.

"It's had a huge impact on my finances and my life. You are constantly paying the money back and are constantly stuck at home. I feel better now that I have broken out of it." [older single mother, Geelong]

"I am still feeding the cycle. I haven't had a loan for a couple of months but my partner has fallen into the trap and once he pays one off he goes back for another one." [young partnered mother, Geelong]

"I think you go through stages. You are embarrassed but you have no choice. You put your head down and you get it." [single mother, Geelong]

"It can result in financial hardship because if you don't have the money in the first place and they look at your wage and say you should be able to pay this back, you end up getting further behind." [young partnered female, Geelong]

THE ALTERNATIVES :

Discussions around the alternatives to payday lending were unconvincing, with references to garage sales, eBay, charity agencies, family, friends and bartering. Though referred to, borrowers did not feel as though there are any actual alternatives to the service offered by pay day loans.

"Are there places like the Salvation Army where you can go and get a second-hand washing machine or a microwave?" [single mother, Geelong]

"Uniting Care gives you points for food that they give out. I used to get 20 points but now it's down to 15 points because of the recession and you can only get an appointment once every six weeks." [single mother, Geelong]

"A friend of mine with five kids has moved to a six acre property and we go to the Sunday market and buy bulk fruit and vegetables and we are starting a community vegie patch, trying to share the lot between all of us." [single mother, Geelong]

"Maybe have a garage sale, make some money that way." [single mother, Geelong]

"I'm a bit too sort of stubborn to ask family and friends...I'd prefer to do things on my own...and I don't want people to know my business." [male, northern suburbs, Melbourne]

Banks are not seen as offering an alternative in this market, given their much higher minimum loan amount.

"The minimum amount at a bank is \$5,000 and a bank wouldn't lend to me, that's why I went through a credit union for my car loan." [young male]

There certainly is a feeling that times are getting tougher. Families have had to tighten up even more in order to cope.

“Just the little treats that you could buy every now and then, you can’t do that. You can no longer go to the cinema or bowling or buy an ice-cream down the beach. My kids are missing out on a lot of social activities.” [young partnered mother]

“I do volunteer work sometimes with Foodbank and we have working couples coming in for food now.” [single mother]

While the vast majority would like to think they won't be taking out payday loans in the future, the reality is that they probably will. They are encouraged to do so by the lender and the barrier that may have existed prior to the first loan no longer exists. Once a person's details are on file, they feel it is easier to go back the next time.

“If you are desperate and you need money, I think do it.” [single mother]

“I wouldn't do it again. Well, I would do it and lie to my husband because he'd go off. I'd go to the same place because they have all my details and I wouldn't have to go through the whole process again.” [young partnered female]

“I always go to the same place...its already all done, the paperwork...now I can ring them [AMX] up [and arrange the loan]...I just say 'hey it's [name]'...they know me by first name...'I'm in a bit of bother, I need to borrow about \$1000', and they say 'yep, no worries'...they'll even deposit into my bank account on the day if I haven't got time to go there.”

LOOKING TO THE FUTURE

It must be noted that those who have found themselves in a cycle of debt struggle to envisage a future *without* access to payday loans. Such loans may be widening the cycle of debt but they remain a significant last-ditch option for many families. For many, payday loans provide for emergencies/necessities such as car repairs, medical and dental treatment, and petrol. For such loans not to be needed and resorted to there would need to be a significant improvement in the circumstances of those who use them. For some, particularly young mothers with three or four kids to support there are few prospects of these improvements being realised.

"I would like to get into the workforce properly. I am a chef by trade but it's all after hours and weekends and you can't get childcare at those times. I have to look at a new career and I have no knowledge of what's out there now." [single mother, Geelong]

"We'd have to finish our house renovations and sell the house and buy something in a cheaper area." [young partnered mother, Geelong]

"I think today everyone has become too greedy, we need to go back to basics." [older single mother, Geelong]

"For me, I need more training to pursue my career." [young single mother, Geelong]

"My husband would need to get regular work, that's the bottom line for us. If we had an income from him we wouldn't have to resort to going without or borrowing." [young partnered female, Geelong]

For a minority though – a minority which includes people of varying ages - payday loans provide the means with which to more easily access the goods, services and activities considered 'mainstream'/'typical' in our society; goods, services and activities which are perceived as important to partake in if one is also to be

considered ‘mainstream’ and included in our society. This is also a perception and cycle which is difficult to break.

APPENDIX ONE: CASE STUDIES

CASE STUDY ONE: BARBARA* - GEELONG

(* indicates that this is not the respondent’s real name; respondents were assured of anonymity as a condition of interview)

Barbara is a 44-year-old divorcee with two children – a 21-year-old daughter away at University and an 18-year-old son still at home. Barbara lives in a Ministry of Housing home with her son and is in receipt of a disability pension. The house is dark, old and unadorned, but scrupulously clean. Barbara doesn’t have a lot of interests, but does like reading and is interested in fashion even though she can’t afford to buy much.

Barbara has had a succession of relationships, each time hoping that this is ‘the one’ and each time being left with some ‘inherited’ debt. Her most recent relationship broke down only a few months ago.

Budgeting and Managing Money:

Barbara is clearly careful with what little money she has and does not buy much or go out very often. Having lived on a pension for many years she believes she has learned to make do with little.

“I have learned how to be smart with my money the hard way, by struggling. I tend to set a budget but when you only have a limited amount of money you don’t have much option... You can’t worry about what you haven’t got.”

Barbara uses Centre Pay and rent, gas, electricity and water come out of her disability pension before she receives it. What is left is to cover everything else – food, clothes, other expenses. Her son also gives her part of his youth allowance but he is moving away soon and that will then cease.

She went on to point out that when her recent partner left *“he took a lot of money with him”*. They had some good times, but she was left to foot the bill.

For Barbara, it is necessary to be mindful of expenses and not extravagant when it comes to food. She always takes a shopping list with her to the supermarket and debates whether or not something is really needed before she purchases it. If possible she will think ahead and buy in bulk. She’s tried Aldi but feels the quality of the food they sell is very poor.

Debt:

Barbara had two credit cards with a combined debt of about \$7,000 and says she was managing well while she was partnered. However, the relationship foundered and her partner left her.

“Both the credit cards were in my name – to help someone else in another relationship because he was bankrupt with the promise that he would pay them and our relationship broke up so the debt was in my name. I paid the price for that. I took full responsibility but couldn’t pay the repayments. It got to the stage where I wouldn’t answer the phone. I did try the hardship departments of the bank but they did not accept my illness because I was diagnosed two years ago.”

Barbara had been diagnosed with bipolar disorder two years earlier but the banks would not accept this as a reason for not being able to pay her credit card debts. With her recent partner moving out, it all became too difficult so she was advised to declare herself bankrupt.

“I went to a community financial adviser in Belmont and she said not to declare bankruptcy and to work out my finances but I

couldn't make the money go any further and the stress it was creating was ridiculous."

There has been a mixed impact from this, both positive and negative. At the time she felt there was nothing else she could do. She had approached her brother for a loan but he refused her.

Payday Loans:

Prior to the bankruptcy, Barbara was really struggling to survive and her son needed surgery on his knee. Rather than having him wait on the public list she took out a short-term loan so that he could have the operation immediately. She borrowed \$300 through Instant Cash Loans in Geelong.

"My son had to have knee surgery and have it done straight away and he was going to have to wait 3-4 years on the waiting list so I went to Instant Cash Loans and they were quite happy to give me about \$300."

The lender was advertised in the newspaper and this is how Barbara heard about it.

"Not so much word of mouth, none of my friends as far as I know would have done that. Anyway I wouldn't have asked them because there is some guilt or shame about having to say you're in trouble. When you are a single Mum there's a bit of a stigma and you are almost expected to fail somehow, even by family members."

Prior to this occasion, Barbara had a loan through Cash Converters about two years ago.

"They charged an arm and a leg, the interest rate is ridiculous. For every dollar you borrow it's about a \$5 charge."

On both occasions there were no other options, according to Barbara. She is pretty much on her own and says her family has proven unreliable in the past. There is also the sense of *"I got myself into this mess..."*. She also says that banks were not an option (*"banks wouldn't touch me"*). In the past she has applied to the bank for a loan but they will only give her a credit card and that is simply *"too much of a temptation"*.

"With a credit card when the bill comes in you think there's no real hurry, I'll pay it next week. With a loan when that money is due, it's due."

The benefit of a cash loan (as Barbara calls it) is that it is instant money. On the downside, however...

"They are a trap. They give you a false sense of security because that money is not yours, it has to be paid back. It doesn't help you deal with reality, it just puts it off. It just adds to your debt and you can be facing bankruptcy."

However, Barbara is not fully aware of the fees and charges involved with a cash loan. She knows that a loan through GE Money can cost about 27% but estimates her short-term loan's interest rate was probably about 15%.

The Alternatives:

As noted, a personal loan from a bank is not an alternative to a cash loan, at least in Barbara's opinion. She did sell some jewellery earlier on to stave off bankruptcy but says she was 'ripped off' in this respect.

"I had a lot of jewellery my partner gave me and I sold the lot, piece by piece, at Cash Converters, not at a good price. It was disgusting. Only gold and diamonds get a good price, you get nothing for anything else. I promised myself I would not look in the place to see how much they were selling it for – one of my rings which cost \$1,000 they gave me \$100 and they had it for sale for \$700."

Ultimately, these short-term loans have had an impact on Barbara's life (along with the credit cards).

"They have had a financial impact and emotionally as well, I felt I was not smart enough, if I had only done this or that, if I had my time over again."

Having recently declared bankruptcy, Barbara has only the following advice to offer others:

"If it was my son I would say work harder, don't spend money on booze and cigarettes."

CASE STUDY TWO: ROSS* - SOUTH-EAST SUBURBS, MELBOURNE

(* indicates that this is not the respondent's real name; respondents were assured of anonymity as a condition of interview)

Ross is 41 years old and married with two children, a daughter aged 4 and a son aged 2. He works full time in the administration section of a construction company, and his wife Sharon* operates a family day-care centre from their home. They live in private rental property in the outer south-east suburbs in Melbourne.

It is since Ross' employer began paying employees monthly, rather than weekly that he and his wife have found it more difficult to fulfil their financial commitments, particularly those arising towards the end of the pay month.

Ross emphasises his family as his priority, and likes to spend his time at home with his children and "mucking around" on the computer.

Budgeting and Managing Money:

Ross makes and endeavours to adhere to a budget each month. Wanting to “know where his money was going”, he set up a budget on a spreadsheet on the computer about 10 months ago, not long after he began being paid monthly rather than weekly. Despite this effort however, Ross still finds that he and his family are “*rich for the first week of the month, and then...broke for the next three weeks*”. Ross often needs to adjust and re-adjust his budget to accommodate unforeseen expenses such as car repairs, and overlooked utilities bills. Sometime his priorities include weekends away with his family so that they might not only enjoy some time together, but escape their current pressures, despite knowing that there will be increased financial hardship as a result. Ross often pays for these ‘emergencies’ with a credit card, but admits that it is currently, and often, “maxed out”. When a credit card is not an option, Ross takes out a payday loan from Cash Converters.

“During the month, I have to constantly redo the budget...I have to try and rework it...then if I can’t work anything on the budget, if I can’t work a miracle, I redo the numbers, and I redo them and redo them, and sometimes it’s just like no, it comes up with the same equation all the time, and well okay, we’ll have to do it, we’ll have to go to Cash Converters.”

Debt:

As mentioned, Ross’ credit card is “maxed out”; his wife’s card is also, and together they have a credit card debt of nearly \$15,000. As well, they have a car loan which required a large deposit, most of which they had, but what they didn’t was covered with a payday loan. On top of that, Ross and his wife recently took out a personal loan with a bank for \$5000 (the minimum loan amount available from banks) which was needed to pay \$2000 of outstanding bills such as utilities and car registration. The remaining \$3000, Ross and his wife kept “*dipping into...all the time, [their attitude], ‘oh this has come up, the money’s there, you know’.*” Ross explained, pointing out that it wasn’t the first time they’d been in this situation -

“Oh look, you got money in the bank, you’re going to spend it. It’s like two grand left or something like that, you’ve covered what you need or something, and yeah, it’s going to be an impulse buy, okay, we can get this plasma TV or buy something for the kids, you know, spend it. We’ve done it before too”.

Ross has considered utilising either utility and telecommunications pre-paid or repayment plans, but when giving reasons why, ultimately, he has not taken up these options, he explains that *“things just happen...get in the way...and it’s hard to get everything done.”* Seemingly contrary to this attitude, Ross and his wife are both anxious about their increasing level of debt and their capacity to service this.

Payday Loans:

Twelve months ago Ross’ employer began paying employees monthly, rather than weekly. Since then, Ross and his wife have struggled to fulfil their financial commitments, particularly those arising towards the end of the pay month, finding themselves ‘rich’ at the beginning of the month, and ‘poor’ at the end. Two months after the change to his pay schedule, Ross found that he needed to borrow \$300 to pay the electricity bills. The money budgeted/allocated for the bill had been spent earlier in the month on a weekend away with his family. He borrowed the \$300 through Cash Converters.

“We use[d the] money to...go away for the weekend...went with the kids...so there’s \$300 gone...[and] that money was budgeted...to pay a bill...and then you’ve got those bills due...and so I took out a loan for those from Cash Converters.”

Ross had seen the Cash Converters advertisements on TV, and believing the lender to be reputable and well-established, decided to approach them for the loan.

“I suppose Cash Converters have been around for a long, long time, a long time. I suppose I wanted...something more reputable like Cash Converters, whereas you hear of these

other little dodgy places that are advertised in the papers and that sort of thing. I'd rather go somewhere that's got some sort of backing behind it, you know, the history of the place."

Since that time, Ross estimates that he has taken four or five short-term loans through Cash Converters, the last time only two weeks before his participation in the project. He has borrowed amounts ranging from \$250 to \$500, and while the reasons for the loans sometimes differ, Ross describes each as having been 'unforeseen', 'an emergency', or as 'having just cropped up'. Each time he visits the same shopfront and is served by the same customer service officer. Ross suggests that this continuity of lending organisation and customer service officer makes the transaction/the process feel more typical of the transactions most in the community would undertake.

"There's this one lady, like she's full-time there. It just so happens that each time I've gone there, she's served me...she remembers me from the first time because she had a lot of trouble using this particular camera to take my photo, so she sort of remembers it in that way...when I last went there a couple of weeks ago...we were having a yarn while she's doing all the stuff on the computer...just like at the bank talking to the teller...I can forget that this is Cash Converters."

Ross suggests that the benefits of a payday loan is that it is instant and easy - particularly on the 2nd and subsequent visits, and maintains that despite the "exorbitant [and] astronomical" fees, the small amount borrowed means that one cannot generally get into trouble with these loans.

The Alternatives:

As mentioned, Ross and his wife's credit cards are both "maxed out", and as well, they have a car loan and a personal loan. This leaves few other avenues from which to source urgently needed cash. Ross and his wife have asked friends and family in the past but feel that they have -

“...exhausted that [option], and...couldn’t keep on exhausting it [as friends are] going to get jack of it....[In the end], you can only ask friends so many times, and then to save face...we turn to Cash Converters to fulfil what we need.”

Ross maintains that the answer to a brighter financial future for his family is in him earning more money. Optimistically, he thinks this is a possibility, having recently applied and been called for an interview for a new job. Ross suggests that this would

-

“put [them] on a good wicket...[allowing a] lifestyle [which] would be different for [them, one which meant that they]...wouldn’t be scrounging...every month. [They] would have money to spare, [to] do those extra things with the kids and not have to suffer the consequences later.”

CASE STUDY THREE: ALICE* - NORTH-WEST SUBURBS, MELBOURNE

(* indicates that this is not the respondent’s real name; respondents were assured of anonymity as a condition of interview)

Alice is 28 years old and lives with her partner of about 5 years and their 2 dogs, 3 cats, and 6 chickens in a private rental property on a quarter acre block in Melbourne’s north-west suburbs.

Alice’s financial woes began on moving out of home when she was 19, and according to her, ill-equipped to make the transition to independent living. It was the death of her mother and her father’s illness, and later her own diagnosis of cancer which prompted Alice to re-think her priorities and learn to manage her life, including her finances, in a more sustainable manner.

“Mum and Dad just did everything...I had no idea how to do anything...then Mum died and Dad got sick...and I had no life

skills...definitely no money skills... the transition from home to moving out into my own environment where I had to make my own rules and realise that if I didn't keep them, that I only stuffed myself over...[that] it's not going to hurt anybody else but me...having had a whole series of things happen to me, I've had my eyes opened a lot to the fact that yes, money is important; however, if you let money rule your list of importance, then that's it, you're only ever going to be searching for a way to increase your money...there are more important things...[and] I have had to make sure that I was there for myself." [female, north-west suburbs, Melbourne]

Budgeting and Managing Money:

Alice manages the household finances and is extremely resourceful in making her annual disability pension of \$11,000 and partner's annual income of about \$25,000 stretch to cover the necessities of life. She utilises a budget -

"brainstorm[ing] whatever [she has] to do, so pay the rent, pay the electricity, register the car, get the cat's microchip or whatever, just all sorts of whatever, factor that all in...I put the money for each in a separate envelope...each one is labelled with the things the money is for...and if I have to I add a bit each fortnight to the envelope til I have enough and the bill is due."

Alice also employs a range of other strategies to manage her money, earn a little more and make what she has last. She has arranged the direct debit of rent and utilities bills "because if you don't have the money in the first place, you can't spend it", and has refused offers of credit cards from her bank, refusing to live beyond her means. Alice's commitment to this life rule means that she would rather –

"...exercise some discipline and go without...than go into debt...[and explains this saying] I think, I'm really, really, really against getting a credit card for myself because I know that I

don't have the means to pay the money back. Like it's all good and well to say oh yes, but I really, really need it now. Well, like I said, things can happen when you least expect it, and you might think you need it now, well you need it ten times more in the future"

Alice employs other money management strategies too –

"...only ever fill[s] up on a Tuesday morning with my four cent off a litre ticket...petrol's cheapest on Tuesday and with the ticket...well that's as cheap as you're going to get it. What else? Like coupons are a big thing in my household. Coupons are great. Buy one, get one free....Flybuys is great because it's free, and every 2,000 Flybuy points I get 20 bucks, yay! 20 free dollars that nobody would give me. What else? My garden...my garden is just incredible. I've got tomatoes and zucchini and eggplant and capsicum, onions, peas, beans, carrots...I literally spend about three hours a day in the back yard, tending to everything so that we've got food...look, it sounds silly, but a bag of carrots from Coles used to be 99 cents. Now it's \$2. That \$1 could've bought me an extra litre of milk. I've just got everything. I've got chickens! I've got my own chickens. I have little eggs. It's great! They are undoubtedly the tastiest, most rewarding little bumnuts that you can get, really! You get to feed the chickens, and then you love them, and then they give you something in return. I love it, love it! But the reason that I go so far is that I don't get much through Centrelink and I have to make it stretch."

Alice sells her fruit, vegetables and eggs to neighbours, but more often than not, exchanges them for a lift to an appointment or the shopping centre. Her partner too fixes neighbours computers in return for use of gardening or home-handly equipment.

"My neighbours, my street and I, are great. We swap a lot of stuff. So like – this sounds really gross, doesn't it! One lady that I go to has got some dogs. I'll pick up the dog poo for 20 bucks, once a week, and that's extra money. If I'm running low on petrol and I don't have any actual cash on me, say I got a couple of pumpkins, a dozen eggs and a bunch of carrots, I'll go down, there's neighbours that loves my fresh fruit and veg, and they'll give me five bucks so I can go and put petrol in the car...or in exchange for a lift to the hospital or down to K-mart."

As well, Alice has negotiated with her landlord a two year lease during which there will be no rise in her rent. She explains how she went about this and the benefits of her action.

"When I first moved in, the first year that I was living there, it was \$155. It's a two bedroom, ¼ acre. And then, once that lease...came up, I...thought to myself, and that's when the rental started to rise, and I was thinking 'hmm, this is not looking good, I don't want to move out even further...[and] be really stuffed in woop woop somewhere doing nothing, that's now how I want to live my life'. So I spoke to the landlord, he was really happy that we wanted to stay in the property for an extended period of time, because then that's security for him, his property is going to be rented, regardless, no matter what. And we got VCAT, the housing people, come and evaluate the property and give a general quote on what they think it should be. Then I said to him 'All right, let's put that up \$5. So they want 165, I'm willing to pay 170, as long as I can sign a two year lease. And so that should cover any rises or anything like that, security for you, security for me'...look, asking doesn't hurt. You can only ever get a 'no'. So I don't mind maybe looking a little bit silly for 5 minutes, feeling a bit sheepish, and then asking – especially these days...[you have to be] really smart with how you look after yourself, so if I hadn't have signed that lease...well, there

were rental properties around my area and just in my street, exactly the same homes, they're \$40 more expensive than what I'm paying now, and I'm rapt, I'm rapt. So for the last 12 months I've saved myself \$40. Yes, the rent might go up when this lease is finished; however, I can then sign another extended lease, choose a reasonable rental amount, so that even if the rental market goes up or down or whatever, it can be a reasonable amount"

And when Alice wants to 'spoil herself' she will purchase only something reduced in price.

"My therapeutic shopping method is discount therapeutic shopping – everything with a discount sticker on it is okay."

Debt:

As a consequence, partly at least, of Alice's disciplined efforts to manage her money, she has no accumulated debt. She admits however, that since being diagnosed with cancer and the consequent need to visit the hospital and other medical service quite frequently, she *"now spends about \$50 a week more now just getting [her]self to and from [these] places"*, and as a result has had to resort to on two occasions borrowing \$50 from her sister-in-law, and also on two occasions having to borrow \$50 and \$100 from Cash Converters.

Payday Loans:

Alice first learnt about payday loans nearly 10 years ago when she first moved out of home. Her boyfriend at the time had a drug habit and a criminal record, and so asked her to pawn items in her name rather than his. She doesn't look back at this time fondly.

"When I first moved out of home I was going out with this guy who was addicted to speed, as in the drug, and he used to get

me to go, because he had a criminal record, he used to get me to go in to Cash Converters and sell stuff for him so that he could get money and score. Isn't it horrible. I know, but honestly, that's what it was. That's how I first found out about Cash Converters. Isn't that gross! But that happens every day, that happens every day, especially for example say you've, and this is why I went on this guy's behalf, because he had been caught a couple of times bringing in stolen goods, okay, so he couldn't sell anything under his own name. He still needed the cash pretty quick – you work out a way to get around that."

Only since being diagnosed with cancer Alice has taken two payday loans, one for \$50 and one for \$100. Each loan was used for petrol so that she could visit the hospital and access other medical services. Her most recent loan (\$100) was taken out only a few days prior to her participating in the project. Her loan for \$100 is to be paid within a month and will attract \$44's in fees/interest. She labels the charge 'ridiculous' and a 'rip-off', and describes her feelings at needing to take the loans -

"...it makes me feel low, it makes me feel desperate, it makes me feel sort of scummy, and I don't like that."

as she has done previously with the first Cash Converters loan and two loans of \$50 from her sister-in-law, Alice is determined and confident that she will pay the loan within the month.

The Alternatives:

Alice seemingly utilises as many as possible means to manage her money and make it stretch. While her life includes few luxuries, she seems optimistic and enthusiastic about life. Naturally though, she admits to wishing for -

"...just a little extra income...[so that] these [payday] loans aren't necessary...[as well as]...a degree of stress when [she has] to take them out."

The reality seems however, that with little more 'stretching' to be had, Alice's financial constraints will only be alleviated with an improvement in her circumstances, more specifically perhaps, recovering from illness and finding employment. While she looks forward to that prospect long-term, there seems little chance that this will be realised soon.

Appendix C

Qualitative Research: Financial Counsellor Survey



ATTN: Zac Gillam, Snr. Policy Officer

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Payday Lending - Case Study Template

Financial Counsellor Details		
Name:		
Work Location:		
Contact Details:	(Ph)	e-mail:
Client's Details (Anonymous - For Statistical Purposes)		
Demographic Data	Client's Age:	
	Client's Sex:	
	Employed/ Unemployed:	
	Centrelink Recipient:	
	NESB/ English Speaking:	

Client's Borrowing Behaviour - Payday Loans

Please briefly outline why your client first presented to you for assistance, and their circumstances at that time:

Did your client engage in <i>repeat borrowing</i> from payday loan providers? (i.e obtaining a new loan, immediately or soon after paying off an old loan)	
Describe the <i>frequency</i> of repeat borrowing exhibited by the client. (i.e. weekly, fortnightly, monthly)	
Describe the <i>duration</i> of repeat borrowing exhibited by the client. (i.e. to your knowledge, how long had the client been repetitively borrowing from payday lenders)	
In your estimation, how many payday loans would your client be likely to take in a <i>twelve month period</i>?	
To your knowledge, did your client ever hold <i>multiple payday loans</i> from differing payday lenders at the same time ? If so, was this common?	
If your client did have multiple payday loans at any one time, how many loans would they be likely to have?	
In your opinion, did your client have difficulty breaking a <i>debt cycle</i> created and/or exacerbated by payday loans?	

**Please add any further comments below, if you wish to do so.
(i.e. Any information to help flesh out your client's story)**

Appendix D

Draft Literature Review



**CONSUMER ACTION LAW CENTRE
PAYDAY LENDING REPORT – DRAFT LITERATURE REVIEW***
Written by Neil Ashton, Policy Officer/Solicitor

<http://www.consumeraction.org.au/publications/other-publications.php>

* This draft literature review has been undertaken with funding from the Consumer Credit Fund, approved by the Victorian Minister for Consumer Affairs.

Appendix E

The Online Industry - A Sample Table (August 2009)

Lender	Web Address	Date Registered (ASIC)	Loan charges (Repayment amount)	APR 14 day term (30 day term)	Loan limit	Repayment period
AdvanceCash	http://www.advancecash.com.au/	18/01/2005	Lends in multiples of \$100. Charge: \$29.98 per \$100. Loan: \$300 Charge: \$89.94 (\$389.94)	781.6% (364.7%)	Unclear	Pay cycle
billRescue	http://www.billrescue.com.au/	20/09/2004	Loan: \$250 Charge: \$62.50 (\$312.50)	651.7% (304%)	\$500	15 days (608.3%)

Cashpal	http://www.cashpal.net.au/	30/04/2007	Loan: \$250 Charge: \$85 (\$335)	886.4% (413.6%)	\$1000	Two instalments of \$167.50 Application date: 12/5/09 Repayment dates: 29/5/09; 12/6/09 (i.e. one month)
Cashdoctors	http://www.cashdoctors.com.au/	21/09/2005	Loan: \$250 Charge: \$65 (\$315)	677.8% (316%)	\$600	Pay cycle
Cash Today	http://www.cashtoday.com.au/	9/02/2006	Loan: \$250 Charge: \$76.50 (\$326.5)	797% (372.3%)	\$500	Pay cycle
Payday Cash Loan*	http://www.paydaycashloan.com.au/	Unknown	Loan: \$250 Charge: \$65 (\$315)	677.8% (316%)	\$600	Pay cycle
Payday Direct	http://www.paydaydirect.com.au/	22/02/2000	Loan: \$250 Charge: \$62.50 (\$312.50)	651.7% (304%)	\$500	Pay cycle
Payday Online*	http://www.paydayonline.com.au/	Unknown	Loan: \$250 Charge: \$65 (\$315)	677.8% (316%)	\$600	Pay cycle

Payday Mate.com.au#	http://www.mypaydaymate.com.au/	Unknown	Lends in multiples of \$100. Charge: \$29.98 per \$100. Loan: \$300 Charge: \$89.94 (\$389.94)	781.6% (364.7%)	Unclear	Pay cycle
Payday Finder	http://paydayfinder.com.au/	Unknown	Broker "Service"	-	-	-
Cash Advance Finders	http://www.cashadvancefinders.com/	Unknown	Broker "Service"	-	-	-

* - Affiliated with "Cashdoctors"

- Appears to be affiliated with "Advancecash"

Appendix F

Analysis of Cash Converters Annual Reports 2003 - 2009

Information about Cash Converters' revenues during the period 2003-2009 has been taken from publicly available documents on either Cash Converters' own shareholder website or in the case of the 2007 Annual report from the ASX register of public documents. The following reports have been used:

- 2004 Annual Report
- 2005 Annual Report
- 2006 Annual Report
- Half-yearly report December 2006
- 2007 Annual Report
- 2008 Annual Report
- 2009 Annual Report

From 2003 to 2004 the annual reports only contained data on the following:

- Total principal loaned for high-cost short term loan products
- Total commissions paid by consumers for high-cost short term loan products
- Total number of loans

In 2005 and subsequent years, the fields of 'Customers' and 'Average Loan Amount' were added to the reporting data although we note that the 2008 annual report failed to provide specific figures and opted instead for

commentary in relation to the percentage of increase to the previous year's figures. Please note that Cash Converters refers to its primary high-cost short term lending product as a 'Cash Advance'.

'Cash Advance' revenues as stated in Cash Converters' Annual Reports 2003 – 2009

Cash Advance Revenues	2003	2004	2005	2006	2007	2008	2009
Principal loaned	\$11,601,407	\$29,458,924	\$63,496,993	\$103,037,193	\$124,567,170	Increase of 7.4%	\$124,546,527
Number of loans	58,077	137,737	280,908	439,913	486,590	not reported	not reported
Individual customers	not reported	not reported	92,927	154,458	202,325	Increase of 18.7%	231,262
Average loan size	not reported	not reported	\$226	\$234	\$256	\$281	\$303
Commissions on loans	\$399,775	\$798,808	\$1,755,754	\$3,213,266	\$7,992,806	\$9,014,306	\$6,916,040

When collating this data, we found numerous discrepancies within individual reports as well as between sequential years' reports. These are noted below:

1. 2004 Annual Report

On page 5, Group commissions from the cash advance business model are listed as \$399,775 in the 2003 financial year and \$798,808 in the 2004 financial year however on pages 10,16 and 50 the amounts are mentioned in commentary as being \$374,692 for the 2003 financial year and \$766,930 for the 2004 financial year.

Our report has used the amounts listed on page 5 in the revenue and profit section.

2. 2007 Annual Report

The amount of \$7,992,806 is reported as the total value of commissions on high-cost short term loan products however it appears to only be for the period 1 October 2006 to 30 June 2007 due to operational restructuring.

3. 2008 Annual Report

Rather than stating defined figures, the 2008 report used commentary in relation to the growth in total principal loaned and customers. It stated the “Total principal loaned increased by 7.4%” and that “Total customer numbers increased by 18.7%”⁴¹¹.

⁴¹¹ Cash Converters International, *Annual Report 2008*, p. 4.

For the purposes of this report, we have extrapolated this data out to reflect a figure of \$133,785,141 principal loaned in 2008 based on adding 7.4% to the total principal loaned in 2007 and a figure of 240,160 customers in 2008 based on adding 18.7% to the total customers in 2007.

The 2008 document also reports an increase of 9.3% on MON-E commissions (the technology Cash Converters uses to manage its 'Cash Advance' products) however it also provides a dollar amount of \$9,014,306 which reflects a 12.78% increase on the 2007 commissions total. Either it has miscalculated the percentage increase, or the figure listed in the 2007 report was skewed by reporting only nine months of profits. If the latter, the total for the 2007 financial year would be closer to \$8,736,137.

4. 2009 Annual Report

Total Principal Loaned: the report states there is a 0.2% decrease from 2008 to 2009 however also provides a dollar amount of \$124,546,527 which would mean the 2008 total was closer to \$124,796,119 instead of the amount returned by increasing the 2007 figure by 7.4%.

Total Customers: the report states there was an increase of 11.9% from 2008 to 2009 but also provides the figure of 231,262 customers. If (using the 2007 figure as a base) there truly was an increase of 18.7% in 2008, then this further increase should have resulted in total customers of 268,739.

Average Loan Amount: the report states there was a small increase on the 2008 average loan amount but misquotes the 2008 figure as \$286 (2008 document reports this as \$281 and this is what we have used).

Worth noting also is that the decrease in commissions from 2008 to 2009 was due to a reduction in licensing fees between Cash Converters International and its franchisees, not as a result of reducing fees to the consumer.

Below is the table from above including the missing information that we were able to derive from prior or subsequent years' data:

Revenues	2003	2004	2005	2006	2007	2008	2009
Principal loaned	\$11,601,407	\$29,458,924	\$63,496,993	\$103,037,193	\$124,567,170	\$133,785,141	\$124,546,527
Number of loans	58,077	137,737	280,908	439,913	486,590	not reported	411,045
Individual customers	not reported	not reported	92,927	154,458	202,325	240,160	231,262
Average loan size	\$199.76	\$213.88	\$226	\$234	\$256	\$281	\$303
Average loans per customer	Unavailable	Unavailable	3.02	2.85	2.40	Unavailable	1.78
Commissions on loans	\$399,775	\$798,808	\$1,755,754	\$3,213,266	\$7,992,806	\$9,014,306	\$6,916,040
Commission increase Year on Year	Unavailable	99.81%	119.80%	83.01%	148.74%	12.78%	-23.28%

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