

13 May 2013

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Dear Mr Mikula

Treasury discussion paper: Changes to disclosure requirements for small amount credit contracts

National Legal Aid (NLA) welcomes the opportunity to contribute to the review of disclosure requirements under the National Credit Code (Schedule 1 of the *National Consumer Credit Protection Act 2009*) for small amount credit contracts.

About National Legal Aid

NLA represents the Directors of the eight state and territory legal aid commissions (commissions) in Australia. The commissions are independent statutory authorities established under respective state or territory enabling legislation. They are funded by state or territory and Commonwealth governments to provide legal assistance to disadvantaged people.

NLA aims to ensure that the protection or assertion of the legal rights and interests of people are not prejudiced by reason of their inability to:

- obtain access to independent legal advice;
- afford the appropriate cost of legal representation;
- obtain access to the Federal and State and Territory legal systems; or
- obtain adequate information about access to the law and the legal system.

Each of the commissions assists a significant number of consumers with credit related problems each year.

NLA supports the introduction of a Financial Summary Table as recommended by the March 2010 'Simplification of Disclosure Regulation for the Consumer Credit Code: Empirical Research and Redesign - Final Report' (the UniQuest Report).

This paper responds to the general questions posed by Treasury and suggests improvements to the Financial Summary Table to ensure the cost and features of small amount credit products are disclosed effectively. The comments of NLA are prefaced by the observation that while improvements in disclosure requirements for small amount loans are welcomed and certainly valuable, pre-contractual disclosure is more effective when consumers are engaged in their credit choices. In the small amount credit space, pre-contractual disclosure will not have the same impact given the vulnerability of consumers¹ and their limited access to alternative credit options².

Responses to General Questions

NLA provides the following in response to the general questions posed by Treasury.

1. *Whether credit providers should continue to be required to provide an Information Statement to borrowers under section 16 of the National Credit Code.*

Credit providers should continue to be required to provide an Information Statement under section 16 of the *National Credit Code* (NCC). The Information Statement provides useful, user friendly information about a consumer's rights and obligations under their credit contract. The need for this statement is not negated by the introduction of the proposed Financial Summary Table and the Credit Guide currently required by section 126 of the *National Consumer Credit Protection Act* 2009 (NCCPA).

The Financial Summary Table sets out key product features and costs necessary for *pre-contractual* disclosure, while the Credit Guide sets out the credit providers' license details, responsible lending obligations and the consumer's dispute resolution rights. The Information Statement currently prescribed by Form 5, Schedule 1 NCCPA sets additional matters useful for the consumer *during* the course of the credit contract such as:

- How can I get a copy of the final contract?

¹ 30% of current Legal Aid NSW clients with small amount credit contracts report experiencing mental illness and/or addiction at the time of their loan. Also note Chapter 3 of Banks, Marston, Karger and Russel, *Caught Short: Exploring the role of small, short-term loans in the lives of Australians Final Report*, July 2012.

² A recent report found that nearly three million Australians are fully or severely excluded from mainstream financial products: Connolly C, Georgouras M, Hems L and Wolfson L, *Measuring Financial Exclusion in Australia*, Centre for Social Impact (CSI) – University of New South Wales, for National Australia Bank, 2011 at 6.

- Can I terminate the contract?
- Can I pay out my credit contract early?
- How can I find out the pay-out figure?
- Can my contract be changed by the credit provider?

It is therefore the position of NLA that the requirement to provide consumers with an Information Statement should continue.

2. *Whether any of the matters required to be disclosed in section 17 of the Code should be altered (in particular, the way in which commissions are disclosed).*

In relation to small amount loans, NLA is of the view that section 17(4) NCC should be amended to require the disclosure of a comparison rate in small amount credit contracts. From 1 July 2013 small amount credit contracts will no longer be able to impose interest charges, only fees consistent with s31A *Consumer Credit Legislation Amendment (Enhancements) Act 2012*. This means that small amount credit contracts will not be captured by the same disclosure requirements as other credit providers under section 17(4).

NLA proposes that section 17(4) be amended to include a requirement that where the contract document relates to a small amount credit contract, the comparison rate must be disclosed. Further comments on the need for a comparison rate to be disclosed in the Financial Summary Table are made at page 6.

3. *Whether credit providers should be required to provide pre-contractual disclosure documents, where practical, at an earlier point in time than is currently the case.*

The UniQuest Report found that disclosure is more effective the earlier it is made in the process of a consumer entering a credit contract. To this end, it is the position of NLA that disclosure should happen at the earliest point possible.

Currently the Credit Guide is required to be provided to the consumer "as soon as practicable after it becomes apparent to the licensee that it is likely to enter into a credit contract with a consumer who will be a debtor under the contract": section 126 NCCPA. NLA supports the continuation of this provision and proposes that the Financial Summary Table should be provided within the same time frame.

NLA recognises that in relation to small amount credit contracts the actual period of time between the consumer enquiring about a loan and it becoming apparent that the consumer is likely to enter into a loan may only be a matter of minutes. Research also tell us that consumers using small amount credit products are some of

the most vulnerable - consumers are generally on low incomes³ and use the loan funds for essential living expenses⁴. In these circumstances, effective disclosure at the earliest opportunity is crucial.

To ensure that the Financial Summary Table has maximum effectiveness in disclosing the key product features and costs to the consumer, we suggest the following requirements in relation to this pre-contractual disclosure document. The Financial Summary Table should be:

- a) the first document provided to the consumer;
- b) physically separate from the other contract and disclosure documents;
- c) provided to the consumer with sufficient time to read the document; and
- d) signed by the consumer to acknowledge that it has been read and understood.

It is the view of NLA that the additional requirements for the Financial Summary Table should not only be applied to small amount credit contracts, but credit contracts generally.

Response to Specific Questions

1. *Are there any additional matters required to be disclosed by section 17 that should be included in the Financial Summary Table (instead of being set out below the table)? In particular, would it be helpful to include a statement of the fees that would be charged for late payment?*

NLA agrees the Financial Summary Table should include a statement that default fees may apply for late payment. However, in the interests of drawing the consumer's attention to the most important information (loan amount and repayment details) it is not necessary for the specific fees to be set out. The proposal at annexure A (NLA's proposed table) provides an example of how we suggest fees for late payment should be disclosed in the Financial Summary Table.

2. *Should two disclosure models be allowed, according to whether or not the establishment fee is included in the amount of credit being provided, or should only one model be allowed (and, if so, which one)?*

³ Banks, Marston, Karger and Russel, *Caught Short: Exploring the role of small, short-term loans in the lives of Australians Final Report*, July 2012 at 15

⁴ *Ibid* at 32

No. NLA is strongly of the view that the establishment fee should always be disclosed *in addition* to the loan amount and that a single model be used reflecting this position. It is confusing for the consumer if the "loan amount" in the table is a different amount of money to what they receive in the hand. Our proposed table encompasses this position. In this model, the establishment fee is specifically disclosed in addition to the loan amount.

3. *The Financial Summary Table refers to both 'Fees and Charges', using the same language as in section 17(8) of the Code, which refers to credit fees and charges. Is there any distinction between fees and charges, or could the disclosure in the Financial Summary Table be simplified by only referring to fees?*

Based on our casework experience NLA does not see that there is any distinction between fees and charges. In these circumstances the terminology "fees and charges" is confusing and the Financial Summary Table should be amended to use the term "fees" only. Our proposed table reflects this position.

4. *The models propose two different models for disclosure of when the repayments are due. Views are sought on whether one approach is preferred to the other, or whether both should be allowed as alternatives.*

Given the principle that disclosure should be as clear and simple as possible, NLA supports both models being used as alternatives depending on the length of the loan. For example, if repayments are made weekly for a 6 month period, it may be overwhelming for each repayment date to be listed. However, if payments are made each month for 6 months it would be useful to list the repayment dates so there is no confusion about when the repayments are due.

5. *Other comments on the proposed Financial Summary Tables*

The Financial Summary Table proposed by NLA incorporates the comments above and includes some additional features which are explained below. Note that the bolding, italics, layout and spacing have been deliberately designed to draw attention to the most important aspects of the table. NLA prefers the design of our proposed table to the fully bolded versions in Model 1 and Model 2.

Removal of "Loan amount paid as follows"

Based on our casework experience we have not seen loan funds from small amount credit contracts directed to parties other than the debtor (other than parties associated with the credit provider). Given that fees can only be charged

consistently with section 31A *Consumer Credit Legislation Amendment (Enhancements) Act 2012*, and loan funds will almost always be paid directly to the debtor, we do not see this section is necessary and only distracts from other, more important, information in the table.

Insertion of breakdown in fees

Given there are only two types of fees charged in relation to small amount credit contracts it is useful to specify these in the Financial Summary Table. While Models 1 and 2 disclose the establishment fee, they do not state that a monthly fee applies and the amount of that fee. NLA believes it is essential to disclose this fee in the Financial Summary Table because it is the only ascertainable fee charged to the contract on an ongoing basis. The monthly fee is particularly important for the consumer because if the loan contract extends beyond the agreed time frame (due to non-payment) the fee will continue to be incurred. For these reasons the fees in our proposed table have been broken down and the monthly fee specified.

Inclusion of the Comparison Rate

NLA is of the view the Financial Summary Table should include a comparison rate similar to that proposed for other credit products. Although interest is not able to be charged on small amount loans, the monthly fee of 4% of the loan principle can be easily confused with the standard form of advertising interest on a *per annum* basis. Given the significant difference between these amounts in dollar terms, including a comparison rate in the Financial Summary Table is vital for a consumer to understand the product costs and features of a small amount loan. It is also the only meaningful way that a consumer can differentiate between the costs of a small amount loan and other credit products. NLA's proposed table therefore includes a comparison rate.

Explanation of limits on the cost of credit

NLA strongly supports the Financial Summary Table including a statement that advises the consumer of the limits on the cost of credit under Commonwealth law. However, the statement in Model 1 and Model 2 does not meet this objective as well as it could. Given the distinction between fees, charges and interest are unclear to the consumer, NLA suggests this statement be converted into dollar figures that enable the consumer to compare the limits as stated to the amounts disclosed in their contract.

Our proposed table includes the following statement:

"Under Commonwealth law, the maximum that you have to pay XYZ Pty Ltd for this loan is an establishment fee of \$200 and monthly fees of \$40, as long as you make your repayments on time.

If you do not pay on time, the maximum you will have to pay back (including default fees, establishment fees and monthly fees) is \$2,000.

XYZ Pty Ltd can also charge you enforcement expenses as well as default fees (for example, the cost of hiring a debt collector) if you fall behind in your repayments."

We submit this statement would be easy for the lender to complete, given that the fields could be automatically populated from the other figures in the table and much more effectively alerts the consumer to the limitation imposed by Commonwealth law.

In the view of NLA these amendments to the Financial Summary Table will better meet the objective of ensuring the cost and features of small amount credit contracts are effectively disclosed to consumers before entering into the contract.

Conclusion

We thank you for the opportunity to make this submission. Please do not hesitate to contact us if you require anything further.

Yours sincerely

A handwritten signature in black ink, appearing to read 'A Reilly', written in a cursive style.

Anthony Reilly
Chair

Financial Summary Table

Loan by XYZ Finance Pty Ltd (“The Credit Provider”) to Waldo Smith

Loan amount	\$1,000
<i>Plus</i> total known fees	\$440
	Establishment fee \$200 PLUS Total monthly fees \$240 (\$40 per month x 6 months)
<i>Equals</i> total to be paid back	\$1,440
Comparison Rate	X%
By repayments of	\$240 per month for 6 months, starting on 1 January 2013 OR \$240 per month for 6 months, with the first payment due on [insert date] and the 5 other payments due on [insert dates and amounts]
Default fees, up to a limit, can also apply to your loan if you do not make your repayments on time.	
Under Commonwealth law, the maximum that you have to pay XYZ Pty Ltd for this loan is an establishment fee of \$200 and monthly fees of \$40, as long as you make your repayments on time. If you do not pay on time, the maximum you will have to pay back (including default fees, establishment fees and monthly fees) is \$2,000. XYZ Pty Ltd can also charge you enforcement expenses as well as default fees (for example, the cost of hiring a debt collector) if you fall behind in your repayments.	