



Your Ref:
Our Ref: SC :
Date: 22 October 1999

Contact: Simon Cleary
Telephone: (07) 3238 3015
Facsimile: (07) 3238 3400
Email: scleary@legalaid.qld.gov.au

Productivity Commission – Gambling Inquiry
PO Box 80
BELCONNEN ACT 2616

Dear Sir/Madam,

FRINGE LENDERS AND PROBLEM GAMBLERS

We note that the Productivity Commission is currently reviewing the Gaming industry, and that one of the issues raised in the Interim Report was that of loan sharking. We understand that the date for submissions may have closed but hope that you will nevertheless accept these submissions.

The Consumer Protection Unit at Legal Aid Queensland advises and represents consumers across the state in relation to, among other things, consumer credit matters. We have close links with the financial counselling movement. Drawing from this experience we wish to make some comments on the growing “fringe” consumer credit market in Queensland, and particularly in the South East corner.

Loan Shark Lending

In May this year the Office of Fair Trading released a Report – “Fringe Credit Provider. A Report and Issues Paper” – which dealt with the “loan shark” phenomena in South East Queensland – that is a network of men giving small loans of usually between \$500 and \$2000 at extremely high interest rates in excess of 150%. We enclose a copy for your information.

You will note that the Fair Trading Report, in assessing causes for the increase in loan shark activities (and the fringe credit market place more generally), pointed to a range of possible factors, including “changes in gambling patterns” (see p15 of the Report). The Report, in its data-collection phase, did not specifically ask borrowers whether the reason for their having to borrow from a loan shark was related to a gambling problem. You will see on page 8 of the Report, however that over 60% of people described the purpose of the loan as either “household bills” or other personal expenses”. It is very difficult in a study of the nature of that conducted by the Office of Fair Trading, given the extreme reticence many problem gamblers have in disclosing that problem, to gather reliable information on the impact of gambling on borrowers turning to loan sharks.

Some of the links between problem gamblers and loan shark borrowing are, however, revealed anecdotally. This Office has advised in excess of 70 people who have borrowed small amounts of money from loan sharks for personal use. A significant number of the people we have assisted, have, in the course of handling their debt problem with the loan shark, disclosed that they have gambling problems. They told us that they have turned to the loan sharks for money either to gamble immediately, or for cash to pay for living expenses, their income having been previously lost in gambling.

One man entered into six loans totalling \$11,500 with a loan shark over a 6 month period, paying one loan off before entering into another. Another woman entered into 3 loans with a loan shark to fund her gambling on poker machines, while a second woman and her husband entered into more than 6 loans with a number of fringe lenders (including loan sharks) to finance, partly, her gambling problem.

Problems associated with loan shark borrowing include:

- The ease of obtaining credit – with no reliance on CRL checks (etc);
- The fact that the loans, and the loan sharks, do not comply with the consumer protection provisions of the *Consumer Credit Code*
- Enforcement procedures which are commonly unlawful and include threats – veiled or direct - to the personal safety of borrowers or their families', as well as other forms of intimidation.

The increase in the "fringe" consumer credit market can be seen not only in the emergence of the loan sharks identified in the Report by the Office of Fair Trading, but in the establishment in the marketplace of a range of other types of fringe credit providers. These types include lenders of personal loans of up to \$2,500 which attempt to comply with the *Consumer Credit Code*, businesses which promote themselves as lenders but in fact merely give advice to people on how to fraudulently change their identities so as to obtain credit under a new name, and the most recent entrants in the marketplace – "pay day" lenders.

"Pay-Day" Loans

A number of these so-called "pay-day" lenders have commenced operations in Queensland recently, and adopted American small loan lending practices for amounts of between \$100 and \$1000. These loans promote "instant cash", or approval times which it has been observed allow people to borrow, literally, between races at the TAB. The pay-day lenders give advances on pay, or give advances on cheques, while taking a sizeable fee as profit.

Summary

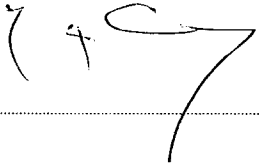
While the consequences for problem gambler borrowers may include intimidation and physical threats in the case of loan shark loans, what is a common consequence of borrowing from any fringe credit provider, including loan sharks, is that a person's debt problem is likely to be magnified rather than relieved. The personal and wider social ramifications of falling into unmanageable debt are manifold, and have been discussed at some length in the Productivity Commission's recent report on Gaming.

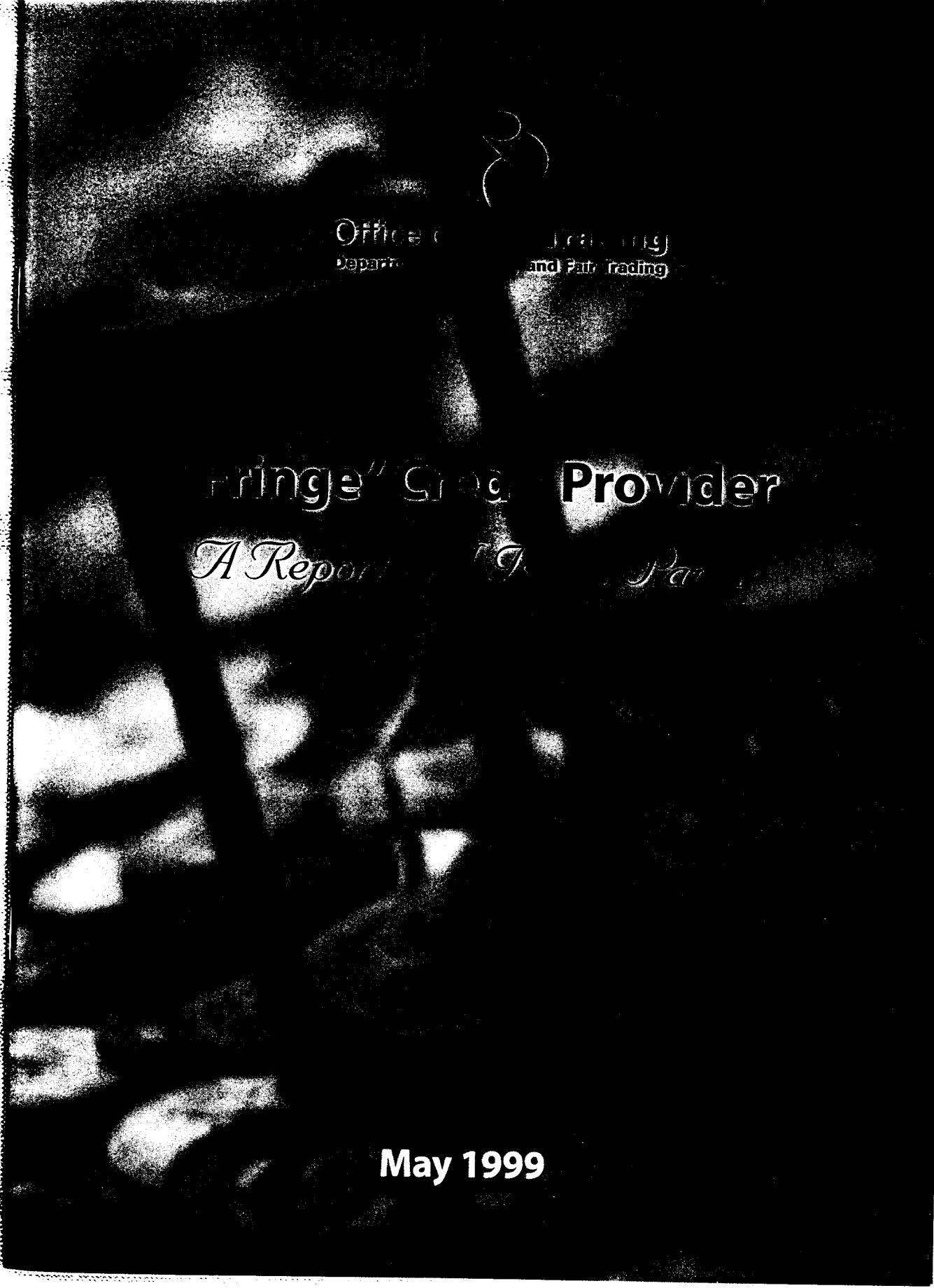
Recommendation

The relationship between problem gambling and the proliferation of fringe credit providers in South East Queensland is a matter which ought to be the subject of future research. We urge government to ensure that this research is undertaken in order to assist the development of strategies to best protect problem gamblers and their families from the increased financial burdens of loans from fringe credit providers.

We would be happy to discuss any of the matters raised in this letter with you.

Yours faithfully,
LEGAL AID QUEENSLAND

Per  _____



Office of Learning
Department of Justice and Fair Trading

"Fringe" Credit Provider

A Report on the Fair Trading

May 1999

CONTENTS

1. INTRODUCTION	1
1.1 Background	1
1.2 Aim of Project	
2. METHODOLOGY	2
2.1 Information Sources	2
2.2 Phone-In Methodology	2
2.3 Limitations of Paper	2
3. SUMMARY OF PHONE-IN RESULTS	3
4. "LOAN SHARK" LENDING	4
4.1 Loan Shark Lending Characteristics	4
4.1.1 Loan Contracts	4
4.1.2 Promotion	6
4.1.3 Enforcement	6
4.2 Borrower Profile	
4.2.1 Personal Profile	7
4.2.2 Income at Loan Date	7
4.2.3 Reason for Borrowing From Loan Shark	8
4.2.4 Purpose of Loan	8
4.3 Loan Shark Profile	9
4.4 Loan Shark Operations By Region	10
4.5 Lending Practices	10
5. COMPLIANCE WITH THE CONSUMER CREDIT CODE	11
6. LOAN SHARK LENDING - AN EXPANDING MARKET?	12
6.1 The Borrower	13
6.2 The Market	14
6.3 The Loan Shark	16
7. CONCLUSIONS	17

1. INTRODUCTION

This Report and Issues Paper describes the lending practices of a number of credit providers in South East Queensland who typically lend amounts of between \$1000 and \$2000 to borrowers at interest rates in excess of 200% per annum, and who, for the purposes of this Paper, will be referred to as "loan sharks". This Paper canvasses some of the causes of borrowers turning to loan sharks for credit, seeks to identify some of the problems that low-income consumers experience in accessing the main-stream consumer credit market, and asks whether the consumer credit market place is evolving to cater for a larger "fringe" niche.²

1.1 Background

In March 1999 the Queensland Office of Fair Trading ("OFT") commenced a Fringe Credit Provider Project. The Project was a response to complaints which the OFT had received over recent months about a number of loan sharks operating in the "fringe" consumer credit market. "Fringe" credit providers are, for the purposes of this Paper, those lenders who target and promote their loans to borrowers unable to access mainstream bank, building society, credit union or national finance-company credit.

These credit providers, in addition to lending to borrowers who cannot get credit from mainstream lenders, also appeared not to comply with the *Consumer Credit Code* ("the Code") - the consumer protection legislation relating to consumer credit which is administered by OFT.

1.2 Aim of the Project

Although prompted by complaints about loan shark lending, the Project also took the opportunity to call for complaints about other fringe credit providers, with a view to learning more about:

- (a) the lending practices of fringe credit providers;
- (b) the credit products offered by fringe credit providers;
- (c) demographic details of consumers borrowing from fringe credit providers;
- (d) the reasons consumers borrow from fringe operators within the credit market;
- (e) the regions within Queensland in which fringe credit providers are operating; and
- (f) levels of non-compliance with the Code by fringe credit providers.

2. METHODOLOGY

2.1 Information Sources

OFT collected information about fringe credit providers from two principal sources: (1) community groups such as financial counselling organisations and community legal centres, and Legal Aid Queensland, and (2) consumers who contacted a state-wide Fringe Credit Provider Phone-In. The Phone-In provided an opportunity for people who had experiences with fringe credit providers to register complaints about those lenders.

2.2 Phone-In Methodology

Between 12 and 16 April 1999 the OFT conducted a Fringe Credit Provider Phone-In. The Phone-In operated statewide with calls being routed directly through regional offices to Brisbane where they were taken by staff.

The Phone-in was promoted by way of (a) advertisements placed in regional newspapers in Brisbane, Gold Coast, Sunshine Coast, Toowoomba, Maryborough, Rockhampton, Mackay, Townsville, and Cairns (see Appendix 1) on 10 April 1999, and (b) media releases and interviews. The Phone-In received statewide coverage in the print, radio and television media. Media coverage of the Phone-In focussed on the "loan shark" type of lending.

A semi-structured interview was conducted with callers in order to collect information about fringe lending in Queensland. Telephone interviews were of between 10 and 20 minutes duration. The nature of the complaints³ meant that some callers indicated, for reasons including the fear of reprisals from the credit provider, that they did not want to disclose all of the detail of the circumstances of the loan. There were, accordingly, a significant number of survey questions for which there was no answer recorded.

Callers were mainly borrowers, but also included friends or family of borrowers, and professional advocates for borrowers.

2.3 Limitations of Paper

The data collected from the Phone-In survey does not claim statistical accuracy, and this paper does not try to draw statistically valid conclusions about the size of the fringe credit market or loan shark activities in Queensland. It is, rather, an introductory probe into the loan shark market, which seeks to identify some of those loans sharks' lending practices.

3. SUMMARY OF PHONE-IN RESULTS

The Project received 99 responses to its call for information about fringe lenders. Fifty-six of the 99 responses related to loan shark complaints. Fifteen complaints related to car finance of which 8 related to car dealership in-house "interest free" loans.⁴ There were 6 complaints about finance company store finance, 5 complaints about finance brokers, and 5 about solicitor private mortgage lending. The remaining complaints were an assortment ranging from personal loan products to larger business lending.

Of the loan products which generated complaints, loan shark lending and "interest-free" loans provided by used car dealerships were products attracting high-levels of consumer dissatisfaction. Both products are specifically targeted towards the fringe consumer credit market and neither product seeks to comply with the Code. While it is not within the scope of this Paper to address in detail problems associated with "interest free" motor dealer finance, an overview of the nature of those loans is found at Appendix 3. Many of the observations in this Paper as to the social and market forces impacting on loan shark borrowers are likely to be relevant to consumers who purchase motor vehicles on "interest free" finance from second hand car dealers. "Interest free" lending ought to be the subject of future regulatory scrutiny.

The focus of this Paper is loan shark lending practices. The high level of complaints in relation to loan shark credit contracts, and the nature of those complaints, confirms that the loan shark market is a problem area.

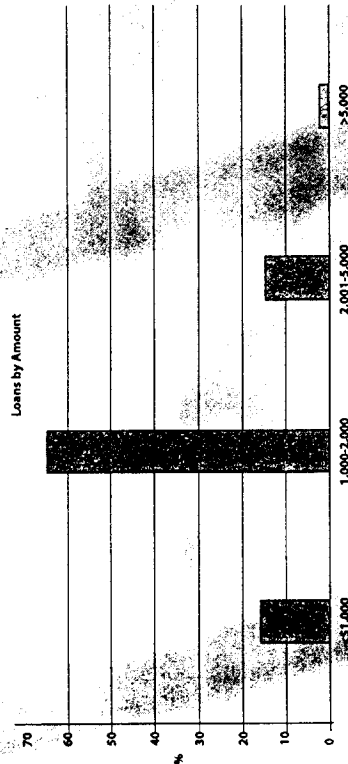
4. LOAN SHARK LENDING

4.1 LOAN SHARK LENDING CHARACTERISTICS

4.1.1 Loan Contracts

Borrowers reported signing written loan contracts.⁵ All loan shark credit contracts were described by respondents as having the following common features:

- (1) Extremely High Interest Rates: Interest rates were set at weekly rates (of 3% or 4%) or in some cases monthly rates of, for example, 20%.
- (2) Loan Amounts Were Small: The loans were all for relatively minor amounts. 64% of callers took out loans for between \$1000 and \$2000. 16% of loans were for amounts less than \$1000, 14% were for amounts between \$2000 and \$5000, while there was only one loan greater than \$5,000.



- (3) Weekly repayments: All the credit contracts required borrowers to make weekly payments.
- (4) Late Payment Fees: Respondents further reported that there were commonly late payment fees of \$5 per day per late payment.
- (5) Attempts by the lender to circumvent the Code by obtaining from the borrower a "Business Purpose Declaration" to the effect that the loan was for business or investment purposes, irrespective of the actual purpose of the loan.

Whereas all of the loan shark contracts were reported by borrowers as sharing the above characteristics, the terms of some of the loans differed. The most significant differences between loan contracts is whether the loan is a (A) Non-Reduction Loan or a (B) Principal Reduction Loan.

(A) Non-Reduction of Principal Loans

These are loans where the normal weekly repayments are "interest only" repayments. Payments to reduce principal can only be made in lump sum unit amounts reported by respondents as either units of \$250 or \$500. Although the reduction of principal is dependent on the borrower making lump sum payments, the contracts are silent about when those lump sum payments are to be made. Accordingly, the term of the loan is open-ended. The effect of the payment of a lump sum unit is that a borrower's weekly repayment was reduced in accordance with the principal having been reduced. For example, one borrower who borrowed \$2000 at an interest rate of 3% per week made a \$500 lump sum payment which reduced weekly "interest only" repayments from \$60 to \$45, with the outstanding principal having been reduced to \$1500.

The consequence of loans of this nature was that borrowers - which as the Project found were, or were likely to be, usually low-income earners - often found it extremely difficult to save a lump sum unit, for example \$500, in order to reduce the principal. This meant that borrowers continued to pay weekly "interest only" payments for considerable periods of time without any reduction of principal. It is not to the advantage of these loan sharks for the principal to be reduced. It is rather, to their advantage that borrowers pay their weekly interest only payments ad infinitum.

Low-income borrowers face a real risk of literally being trapped into these loans without any prospect of paying them off. This is borne out to some degree by respondent's descriptions of the ease or difficulty of repaying the contract. In this respect, 71% of respondents said that it was either "difficult," "very difficult" or "almost impossible" to make weekly payments. Further, 68% of borrowers said that they would not take out a loan from a loan shark again, while 5% said they would do so. The remaining callers did not answer either way.

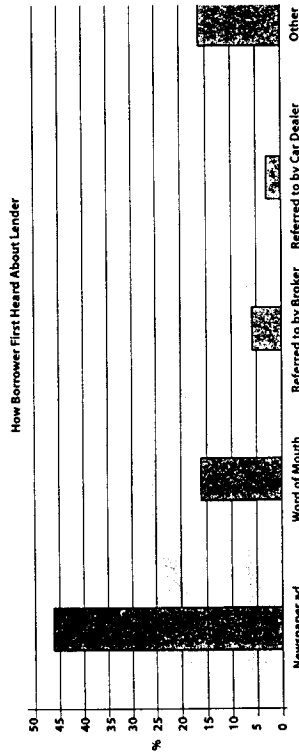
When linked with the enforcement techniques reported by borrowers as being used (see section 4.1.3 below), the nature of these loans are ripe for exploitation of consumers. One man, for example, who borrowed \$2000 in 1997, complained that he had paid back over \$8000 without any reduction of his principal.

(B) Principal Reduction Loans

Some of the loan contracts described by respondents with the common characteristics outlined above, do factor in the reduction of principal into weekly repayment amounts. Respondents reported this category of loans as featuring monthly interest rates of up to 20%. These loans did not disclose on the contract the total amount of interest charges. It was not clear how the interest charges were calculated on these Principal Reduction Loans.

4.1.2 Promotion

Forty-six per cent of callers said that they first heard of the lender through reading advertisements in newspapers, 18% first heard of the lender via word of mouth, while 7% were referred by a broker and 4% referred by a car dealer.



4.1.3 Enforcement

Callers were asked what enforcement practices loan sharks adopted if a borrower could not make a weekly payment and fell into default. No loan shark collection practices were reported which were consistent with Code-compliance.

Some callers reported very serious instances of harassment and intimidation, including assaults and threats which were criminal in nature, in respect of some of the loan contracts. Conduct reported included:

- death threats;
- other threats to physical safety;
- assaults;
- intimidatory language including swearing;
- refusal to recognise bankruptcy;
- threatened repossession of goods when mortgages were not entered into; and
- personal collection of payments, either usual weekly payments or arrears, by the loan sharks or their agents, men described by respondents as being large, extremely muscular and physically intimidating who might attend a borrower's home in groups to collect payments.

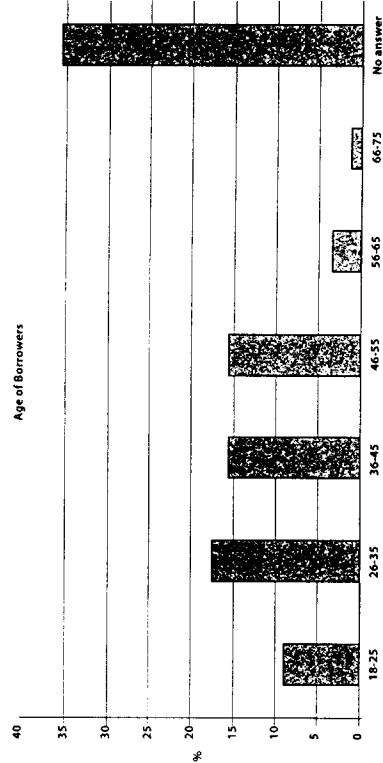
Some forms of loan contracts revealed that "all property" mortgages were taken by some loan sharks. In the consumer credit market credit providers taking security over household items such as kitchen utensils and bedroom furniture property that would not be at risk if the borrower were to enter bankruptcy. These practices had been considered a thing of the past and no longer part of the Australian lending landscape. Threats of the repossession of basic household items pursuant to such mortgages can be powerful enforcement tools.

4.2 BORROWER PROFILE

4.2.1 Personal Information

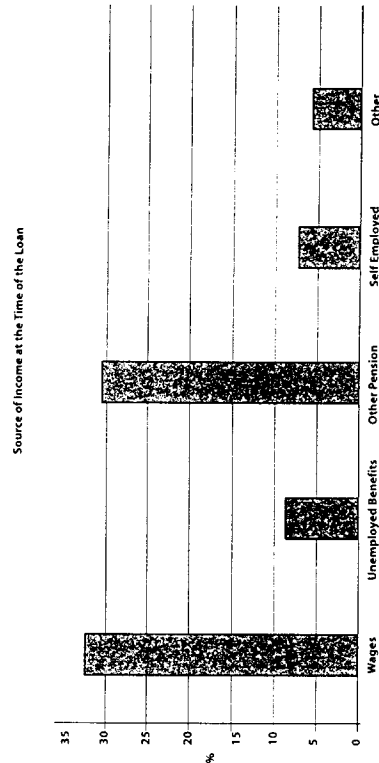
Fifty-seven per cent of callers were women, 43% were men.

Nine per cent of callers said they were in the age group 18-25, 18% in the group 26-35, 16% in the group 36-45, 16% in the group 46-55, while 3 were older than 55. 17 people did not give their age.



4.2.2 Income at Loan Date

The graph below shows the income sources which respondents indicated they received at the time the loan contract was entered into.

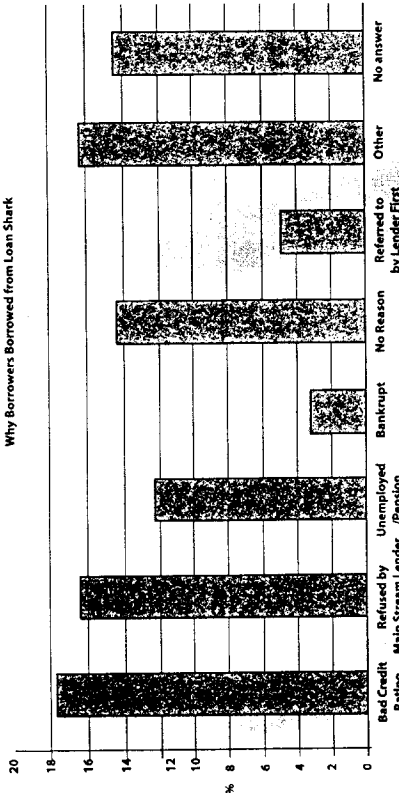


4.2.3 Reasons for borrowing from Loan Shark

Respondents identified the reason they sought loans from the loan sharks "rather than, for example, a bank" as variously:

1. Bad credit rating (18%)
2. Refused finance from a main stream lender (16%)
3. No reason (14%)
4. Unemployed/pension (13%)
5. Referred to lender first (5%)
6. Bankrupt (3%)
7. Other/Didn't answer (31%)

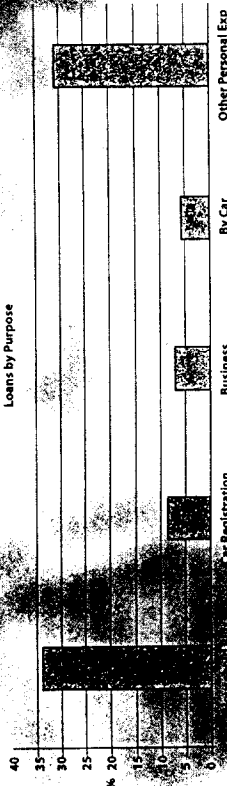
Why Borrowers Borrowed from Loan Shark



Respondents chose one answer. Some of the categories overlap so that, for example, a bankrupt borrower would have a bad credit rating, may also be on a pension and might also have been earlier refused finance from a main-stream lender before seeking finance from a loan shark.

4.2.4 Purpose of Loan

Loans by Purpose



Thirty-four per cent of callers said that the purpose of the loan was to pay household bills, 9% said to pay car registration, and 5% to buy a car while 7% said the loan was for a business purpose. Thirty-six per cent of callers said that the loans were for a variety of "other" reasons which they specified as including buying Christmas presents for children, paying for hospital bills, paying debts, repairing the car, spending money overseas and paying off a pawnbroker.

Only 7% of borrowers said that their loans were for business purposes. The overwhelming majority described their loans as being for purposes that would fall into the category of being "personal, domestic or household".

The data also suggests that the purposes of the loans were mainly for essential items rather than discretionary spending on luxuries.

Despite those findings, 43% of borrowers said they signed Business Purpose Declarations, 21% did not know whether they did or not, while 16% did not answer that question. 12 callers said they had not signed a Business Purpose Declaration.

In the circumstances where (a) most borrowers were not given copies of the loan contracts (see section 4.5), (b) large numbers of borrowers believed that the loan contract was not fully explained to them (see section 4.5), and (c) the vast majority of loans were non-business, then it is distinctly possible that the loan sharks who lent money to those borrowers who answered that they did not or did not know if they signed Business Purpose Declarations, did in fact obtain such a Declaration.

Of all callers, 77% said that the lender knew what the purpose of the loan was, whereas only 3 people said that the lender did not know. The remaining respondents did not know or did not answer this question.

4.3 LOAN SHARK PROFILE

Loan sharks were reported as operating as individuals, under business names, and as companies. Callers often reported a reluctance by some individual loan sharks to identify themselves other than by a first name.

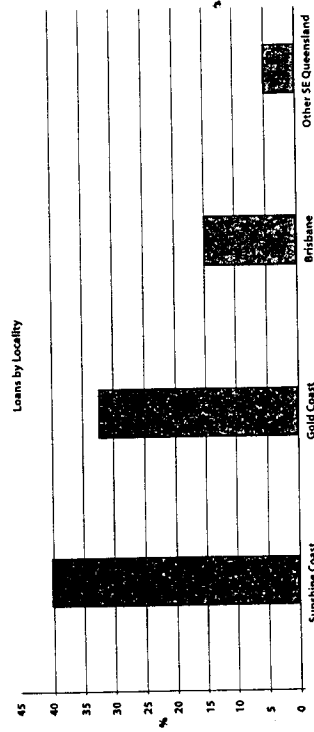
Loan sharks were commonly reported as not operating from traditional office premises, but operating either from residential premises which doubled as offices or, by attending the homes of the borrower. A large percentage of respondents reported that they had first heard of the loan shark by reading an advertisement in a newspaper. The advertisements were reported as one or two line advertisements which read to the effect of "Cash unsecured no credit checks. Ph ...". The advertisements gave mobile phones as contacts but do not give the lenders names.

Many of the loan sharks were reported as using the same standard form loan contracts, and documents, and using similar enforcement techniques. It is likely that some of the loan sharks are connected by way of either formal or loose networks.

Many of the loan sharks were reported as being of a physically very large build.

4.4 LOAN SHARK OPERATIONS BY REGION

Although the phone-in was statewide, all of the loan shark complaints originated from South East Queensland and most particularly the Gold and Sunshine Coasts. Forty per cent of complaints were from the Sunshine Coast, 35% from the Gold Coast, 15% from Brisbane with the remainder from other areas within South-East Queensland.



The conclusion that only South East Queensland regions have loan sharks operating within them should be tempered by acknowledging that the study is self-selective in that the Office of Fair Trading called on consumers with experience with fringe credit providers to come forward. Many of those who did were fearful of reprisals. Newspapers on both the Gold Coast and Sunshine Coast had previously published reports on loan shark activity.⁷ It is possible that if people outside South East Queensland have borrowed money from loan sharks, then the fact of no-one "coming forward" in the media previously, combined with fear of reprisals, may have discouraged them from contacting the Phone-In.

Nevertheless, the fact of all respondents coming from South East Queensland, and their reporting of similar patterns of lending activity, suggests that loan shark lending, in the form discussed in this Report, might be isolated to South East Queensland.

4.5 LENDING PRACTICES

39 of the 56 callers said that they were not given a copy of the loan contract while only 10 people said that they were given a copy. The remaining callers did not know or did not say either way.

Over half of the callers (54%) said that they were not satisfied that the contract was fully explained to them, while 11 people said that they were satisfied with the lender's explanation of the contract. 15 of the 56 callers did not answer this question.

88% of callers said that they would not take out a loan with the credit provider if they were in the same circumstances again. Three callers said that they would do so again, while 15 did not know or did not say either way.

5. COMPLIANCE WITH THE CONSUMER CREDIT CODE

There is no requirement in Queensland for credit providers to be licenced. Anyone may set up a consumer credit lending business in Queensland. The *Consumer Credit Code* regulates the provision of consumer credit.

The loan contracts do not appear to attempt to comply with the information disclosure requirements of the *Consumer Credit Code*. The lending practices reported by borrowers do not appear to attempt to comply with the Code in other ways.

The loan sharks obtain, as a matter of practice and irrespective of the purpose for which the credit is to be used, a "Business Purpose Declaration" ("BPD") substantially in the form of that required by the Regulations to the Code, by which the loan sharks seek to evade entirely the operation of the Code. The use by the loan sharks of the BPD form indicates that, although not complying with the Code, they utilise a mechanism provided by the Code to "explain" their non-compliance. The exploitation by a credit provider of the BPD does not, however, irrevocably take a particular credit contract outside of regulation by the Code.⁸

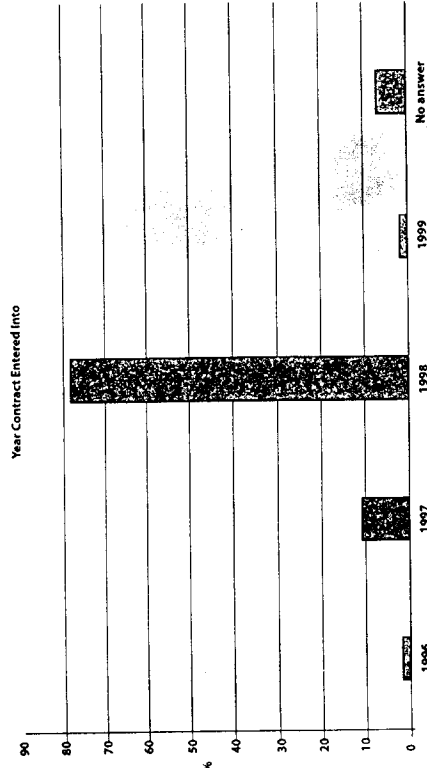
In the event that a loan contract of the type provided by the loan sharks is found to be regulated by the Code, it is likely that those contracts would be found to contain mass breaches of the information disclosure and other requirements of the Code, for which the loan sharks would be vulnerable to both criminal and civil penalties. Examples of likely contraventions include the failure to disclose an annual percentage rate on the loan contract, charging interest greater than allowed by the Code, the failure to provide borrowers with copies of loan contracts and the failure to provide regular statements.

In the absence of any licensing requirements, the ability of a credit provider to provide consumer credit in Queensland is controlled by what is known as a system of "negative licensing", pursuant to which the Office of Fair Trading may seek one or more of a range of orders from the District Court which can restrict or prohibit a credit provider's business in Queensland.⁹

6. LOAN SHARK CREDIT - AN EXPANDING MARKET?

The results of the Phone-In pose the question, why it is that significant numbers of people in South East Queensland turn to loan shark lenders? The superficial answer is that most, if not all, of the borrowers were unable to access the mainstream consumer credit market and turned to loan sharks as a relatively readily available alternative.

Has there been an expansion of loan shark activities in Queensland? The parameters of the Project and the nature of the data collected cannot provide a definitive answer to this question. A number of indicators point, however, to the conclusion that the "loan shark" phenomenon may, in the form revealed by respondents to this Project, be a relatively recent phenomenon in South East Queensland:



- all of the loan contracts entered into by callers were entered into in or after 1996, with the majority of them entered into in 1998; and
- the loan shark documentation has been tailored to take into account the Consumer Credit Code which commenced on 1 November 1996.

A critical question to ask is "why?"

This Paper seeks to explore that question by looking separately at three components in the loan shark lending dynamic: (1) the borrower, (2) the market and (3) the loan shark.

6.1 THE BORROWER

The borrower profile gives support to the common-sense view that those people who have taken out loans with loan sharks are those that cannot access the main-stream consumer credit market. The reasons given by respondents as to why they went to a loan shark "rather than, for example, a bank" are instructive.

Seventy three per cent of respondents who gave reasons for borrowing from a loan shark gave a reason which directly reflected an inability to access the main-stream consumer credit market (see section 4.2.3). Those respondents who answered that there was "no reason" or that they were "referred to the lender first" may also have been unable to access mainstream credit.

Previous studies have described the link between low-income and inaccessibility to the mainstream consumer credit market.¹⁰ The data collected supports this link. The survey, for example, indicated that 39% of borrowers were in receipt of government benefits as their principal source of income at the time of taking out the loan.

The data as to the purpose of the loans supports the contention that loan shark contracts are entered into by low-income earners. The data obtained in the survey reveals that the overwhelming purpose of the credit was for small one-off, or emergency, consumer "necessities". That data is consistent with credit usage patterns of low-income earners described in previous studies.¹¹

"For a poor person credit is often a necessity. Even basic goods and services may be beyond the immediate reach of low-income earners, especially those suffering unexpected misfortune such as illness or unemployment."

(Sackville 1975 Federal Government Commission of Inquiry into Poverty, 104)

"Access to some form of credit is a prerequisite in enabling many individuals to exercise their right to basic household goods and other necessities. The use of credit for the low-income earner is governed by need rather than choice."

(Hahn B, Just Credit-Should Access to Credit be a Citizenship Right? March 1997, Good Shepherd Youth and Family Service, p15).

Any increases, therefore, in the relative or overall number of people on low-incomes in Queensland may be a causative factor in an increase in the number of people unable to access main-stream credit and forced to turn to loan sharks. This Report does not attempt to measure recent trends in income or poverty in Queensland, but notes the Queensland Council of Social Security's recent expose on the state's increased poverty trend.¹² The growing number of Queensland people suffering from socio-economic disadvantage may provide loan sharks with an increased potential customer-base.

6.2 THE MARKET

The consumer credit marketplace itself may have changed its shape in recent years so as to have enabled a larger loan shark niche to develop.

The mainstream financial services market, and specifically the consumer credit market, may have evolved in recent years so as to be excluding greater numbers of low-income and otherwise vulnerable consumers.

There are few Australian studies on this area in respect to the accessibility by low-income groups to consumer credit. Hahn (1997) has commented on the "stark contrast" which "exists between the limited credit options available to low-income earners compared to those on higher incomes"¹³ in his important study of the area of access to credit for low-income earners. Cheah and Singh (1993) described the development where main-stream consumer credit providers, such as banks, were moving away from making personal loans of under \$2000, but directing such loans to credit cards,¹⁴ a trend which, anecdotally at least, appears to have continued.

The UK Office of Fair Trading has recently handed down a significant and wide-ranging report on vulnerable consumers and financial services. The Director General of Fair Trading in the UK made note at its launch:

*"Those on low or volatile incomes, ethnic minorities and people with disabilities ... are being left behind in an expanding market where the choice is between a range of costly and highly regulated products primarily aimed at relatively well-off and low-risk consumers."*¹⁵

That Report found in the UK:

*"As in the case of the other facilities they offer, the banks and other high-street sources of credit are moving away from serving the needs of low-income consumers. The shrinking branch network, a more systematic assessment of credit risks, and the imposition of relatively high minimum loan values have further reinforced this tendency. Alternative forms of credit for which risk is priced more individually, including non-status lending and even that provided by unlicensed loan sharks, have expanded to fill this need, but the exclusion curve for traditional forms of high-street short-term credit nevertheless suggests that there is significant income exclusion."*¹⁶

While the observations in the above report relate to the UK experience, those broad trends in the provision of financial services are also observable in Australia.

The Australian, and Queensland experience of the provision of credit has been shaped to some degree since at least 1 November 1996 by the provisions of

the *Consumer Credit Code*. Those provisions include what has been termed the "overcommitment" provision of s70(2)(l). That subsection provides that in deciding whether a credit contract was, in the circumstances in which it was entered into, unjust, a court may take into account whether the credit provider "knew or could have ascertained by reasonable enquiry of the debtor at the time [the contract was entered into] that the debtor could not pay in accordance with it or not without substantial hardship". Although there is no statistical evidence to support such an hypothesis, it might be argued that credit providers are more unwilling to lend to low-income loan applicants for fear of a court "striking out" such loans as unjust. Any such conclusion should, without the support of empirical data, be very cautiously reached, particularly in the light of Cheah and Singh's (1993) study of a sample of one finance company's loan applications which found that "there is no evidence that the outcome of a loan application depends on the applicant's ability to repay... Disposable income does not influence the finance company's decision."¹⁷

Further, the increasing population of South East Queensland may have reached a "critical mass" of potential customers for loan sharks in order that they can operate their lending businesses profitably. Some support for this hypothesis may be found in the fact that all complaints were generated from South East Queensland and that there were none from central or north Queensland. If the reason for an apparent mushrooming in "loan sharks" is that South East Queensland has reached a "critical mass" of inhabitants, then it is reasonable to assume that population centres such as Sydney and Melbourne host similar lending operations.

Other environmental factors which although outside the scope of any analysis in this Report might conceivably contribute to an increase in the size of a loan shark market may include the following:

- the January 1997 restrictions on social security recipients to receiving only one advance pension payment of maximum of \$500 per 12 months;¹⁸
- fewer local corner stores and local retailers which in the past may have offered informal small loans to members of a local community;
- reductions in the amount of emergency or "food voucher" type relief provided by relief agencies; and
- changes in gambling patterns.¹⁹

Whether these factors have any impact on the capacity of low-income earners to access credit might be the subject of future study.

The matters canvassed above are matters affecting only what might be observed as the formation of a new loan shark market. Exactly how that fringe credit market works must be the subject of another study, although previous research exists which suggests that the fringe or small loans market does not operate as a perfect market.²⁰

The performance of the regulatory authority in the market, and in particular whether there has been inadequate enforcement or a culture of tolerance, is a factor which may affect the incidence of illegal activity. The performance of the OFT may fairly be judged on its response to this lending phenomena.

6.3 THE LOAN SHARK

It is difficult for a Paper of this nature, to identify with any certainty the factors related to the loan sharks themselves which may be influential in any recent proliferation of their lending activities in South East Queensland. The reasons for this include the unavailability of information from loan sharks themselves about their reasons for their entry into the market and the fact of no previous research being done on the "loan shark" elements of the fringe credit market.

The following observations may, nevertheless be capable of bearing some weight, although statistically unsupported.

A perception appears to exist that loan shark activities in the past have by and large been restricted to small, locally-based lenders operating out of places like hotels and being part of what was clearly recognisable as an "illegal" market. This study has looked at loan shark lending operations characterised by greater levels of operational sophistication than that of the stereotypically perceived loan shark. In this respect:

- (a) the loan sharks have promoted themselves through advertisements in the mainstream print media's classifieds' sections. This method of promotion may have provided them with a level of legitimacy in the eyes of prospective borrowers which they did not seek in the past;
- (b) the loan sharks have used standard form written loan contracts, which may also have added a level of legitimacy to their operations; and
- (c) the loan sharks appear to have made use of technology by virtue of their use of photocopiers and computer databases;
- (d) the loan sharks have utilised current legislation, in a way which arguably serves the dual purpose of (i) giving an appearance of acting within the law by referring to the *Consumer Credit Code* in their documentation, while (ii) stepping outside it by obtaining Business Purpose Declarations.

It is arguable that a combination of greater use of technology and clever exploitation of the legislation has enabled the loan sharks who were reported by borrowers during this study to expand their market. In this respect Hahn's observations are apposite:

*"Finance companies and small money lenders like pawnbrokers, operating on the fringes of the finance industry, have been able to exploit the financial vulnerability of low income Australians."*²¹

and again:

*"Australian consumer and welfare groups have identified examples where credit products appear to have been developed with low-income earners specifically in mind. In some cases, these products appear to have been deliberately designed to avoid being covered by or to exploit loopholes in existing consumer protection legislation."*²²

A further factor in the matrix of loan shark lending dynamics is that loan shark lending operations might be merely secondary to, or dependent on, other operations, possibly criminal in nature, and that South East Queensland provides the criminal environment for those operations to exist. It is not possible to take this hypothesis any further given the scope of this Report, other than to say that if this was the dominant factor, then it would be unlikely that centres such as Sydney and Melbourne would be spared such criminal operations.

7. CONCLUSIONS

The results of this Project suggest that fringe credit providers, or at least the loan shark variety outlined in this Paper, may have expanded in recent years to claim a larger niche in the overall consumer credit market. A new market might be in the process of taking shape as a result of a range of economic and environmental factors, which this report has sought to identify.

Borrowers using the fringe consumer credit market require the protection provided to other consumers of credit. The early and on-going monitoring of the evolving fringe credit market, and the need to ensure protection for consumers in that market is an on-going challenge to government consumer agencies. The need to protect low-income consumers from some of the conduct reported by respondents to this study is a more immediate one.

END NOTES

- 1 See section 4 for a more detailed discussion of the nature of these loans.
- 2 This paper is not a statement of the policies of the Queensland Government. Its release does not commit the Government or any Minister to the views expressed or to a particular direction for future action.
- 3 See, for example, the case studies at Appendix 2
- 4 See Appendix 3 for a more detailed description and discussion of the nature of these loans.
- 5 See Appendix 4 for a copy of a loan contract.
- 6 P.Bingham, (Jan 1999), *Consumer Law Journal*.
- 7 See for example the Gold Coast Bulletin 15 December 1998, p5 and 17 December 1998, p9
- 8 See Appendix 5
- 9 See Consumer Credit (Qld) Act 1994
- 10 See for example Sackville 1975 *Federal Government Commission of Inquiry into Poverty*, and Hahn B, *Just Credit - Should Access to Credit be a Citizenship Right?*, March 1997, Good Shepherd Youth and Family Service
- 11 See for example: Backman H (1988) *No Loose Change: A Study of the Income and Expenses of Low-Income Families*, Action Research Centre Co-Operative, Melbourne; and Taylor J, *The Cost and Availability of Credit by Low-Income Earners for the Purchase of White Goods*, as part of her Masters of Preliminary Economics
- 12 QCOS, *People and Places. A Profile of Growing Disadvantage in Queensland*, (May 1999).
- 13 Hahn B, op. cit, p10
- 14 Cheah and Singh (1993), *Secondhand Credit: Risk and Information in the Regulated Small Loans Market in Victoria*, CIRCIT, Melbourne, p2
- 15 Bridgeman, quoted in Hewitt, M, *Left Out in The Cold*, April 1999, Fair Trading, UK Office of Fair Trading, p 12
- 16 UK Office of Fair Trading, *Vulnerable Consumers and Financial Services* (Jan 1999), London, p 30
- 17 Cheah and Singh, op cit, p12
- 18 See *Guide to the Administration of the Social Security Act*, chapter 49 and ss 1061EA - 1061EL *Social Security Act 1991*
- 19 See for example Consumer Law Journal, Sept/Oct 1998, Vol 2 No 6
- 20 Cheah and Singh, op.cit.p 1
- 21 Op.cit.p10
- 22 Op.cit.p5

APPENDIX 1



Office of Fair Trading Department of Equity and Fair Trading

"FRINGE CREDIT PROVIDER PHONE-IN"

The Queensland Office of Fair Trading, in response to a number of complaints, is examining the "fringe" credit provider industry to establish the size of the industry, problems faced by consumers and any breaches of consumer protection legislation.

Fringe credit providers lend money to borrowers who are unable to access mainstream credit, often at extremely high interest rates, with contracts containing stringent conditions which may avoid the Consumer Credit Code.

If you have some experience of this industry or you have a complaint, the Office of Fair Trading would like to hear from you.

Brisbane:	(07) 3246 1515
Maryborough:	(07) 4121 8000
Gold Coast:	(07) 5581 3315
Sunshine Coast:	(07) 5430 8915
Cairns:	(07) 4042 3315
Townsville:	(07) 4753 2215
Rockhampton:	(07) 4920 6615
Toowoomba:	(07) 4637 6000
Mackay:	(07) 4969 3000

The phone-in will operate from Monday 12 - Friday 16 April 1999, 9am -5pm.

Any written submissions or comments can be directed to:

The Fringe Credit Provider Project Officer
Office of Fair Trading
GPO Box 3111
BRISBANE Q 4001
Fax: (07) 3239 3730

APPENDIX 2

CASE STUDIES FROM THE FRINGE CREDIT PROVIDER HOTLINE

Case Study 1 A single mother on the sole parent pension was recommended a lender by her neighbour as being a source of a loan for \$1000 so that she could pay some of her family's household bills and buy some furniture. She thought that it sounded like an easy way to organise a loan. The lender came to her home where the contract was entered into. Although the loan was for \$1000 she was only given \$840 - a \$120 application fee and the first week's repayment of \$40 was taken out at the start. She believed that she then had to pay \$40 per week till the \$840 outstanding was paid off - she believed that the \$160 taken out of the loan amounted to the profit of the lender.

She later realised that the \$40 weekly payments were interest-only payments, and that the only way that she could pay off the principal was to pay lump sums of \$250 or more. As she was a single mother on the supporting pension she found it difficult to accumulate lump sums of \$250 or more. On the 2 occasions when she did make lump sum payments the lender refused to treat them as reductions of the principal and maintains that although she has paid over \$1300 off the loan, she still owes the principal of \$1000. She doesn't know what to do.

Case Study 2 Another woman took out a loan of \$1500 in 1998 to pay for personal bills after answering an ad in the local paper. She had previously been refused a loan by a national finance company. The loan was at 4% interest and she had to pay off \$60 per week in interest only payments. Despite the loan being for \$1500, she was only given \$1250 by the lender - approximately \$250 being taken in fees and prepayment of interest. The lender had her sign a document saying the loan was for business purposes even though the lender knew it was for personal bills. The lender said that if she wanted the money she had to sign it. Because she needed the money desperately she did. She did not know what effect the document had, and did not know that by having her sign it the lender was trying to deny her rights under the Consumer Credit Code.

Two big men from the lender came to her door every fortnight to collect her payment. When she fell into arrears the lender made death threats, and threatened that she "would not be safe." A friend has now paid out the loan.

Case Study 3 Another man on a Totally and Permanently Incapacitated pension (disability pension) needed about \$2000 to repair his car. He was refused a loan from a mainstream lender. He contacted a number in the finance section of a newspaper. The lender he spoke with told him that he could give him the loan. He had to pay \$40 per week for each \$1000 he borrowed, being \$80 per week. The payments are interest only and the man could only pay off the principal by lump sum payments. He was not given a copy of the loan contract. The man has since gone bankrupt but the lender refuses to recognise the bankruptcy and forcefully insists that the man continue to make payments into the lender's bank account. The man has paid off over \$3000 in total and continues to pay even though he is now bankrupt because he is fearful of the consequences if he doesn't.

APPENDIX 3

USED CAR DEALER "INTEREST FREE" IN-HOUSE FINANCE

Eight responses to the Project related to used car dealership "interest free" in-house finance products.

Some second hand car dealers use so-called "tiny terms" credit contracts by which they, or an associated finance company, sell a car on "interest free" finance (the Code only applies to loans where there is a credit or interest charge). In these "tiny terms" credit contracts the amount financed is the purchase price of the car, and a borrower is only required to pay back that amount. It appears, however, that dealers selling cars on this type of finance have a practice of artificially "jacking up" the purchase price of the car so that there is an interest component "built-into" that price.

The contract form used varies between dealers. Some dealers simply make notations on the side of the standard Motor Traders Association of Queensland ("MTAQ") motor vehicle purchase contract to the effect that the purchaser must make a specified number of payments of a specified amount to the dealer.

Other dealers document the sale as being a lease by the dealer to the consumer whereby at the end of the lease period, and having paid the dealer the amount of the purchase price of the car, ownership passes to the consumer. Consumers have complained that they were not aware that they were "only" leasing the car, and had always intended and believed that they had bought the car.

Borrowers receive little or no written contract information, no statements, and report being subjected to ad hoc enforcement tactics by the dealer who may not provide reasonable periods for the borrower to pay arrears.

These methods of documenting the credit contracts take them, *prima facie*, outside the scope of regulation by the Code, as the Code only applies to credit contracts for which there is a charge for providing the credit (s6(1)(c) of the Code).

DEED OF LOAN

This deed is made on the [redacted] day of [redacted] 1998

BETWEEN

[redacted] in the state of Queensland of the one part (hereinafter referred to as the lender)

AND

[redacted] of [redacted] in the state of Queensland of the other part (hereinafter referred to as the borrower)

THIS DEED WITNESSETH AS FOLLOWS:

- A. Upon the parties entering into this deed, the Lender will lend to the Borrower the sum of \$[redacted] (hereinafter called the principle sum) as stipulated in the schedule annexed hereto.
- B. The borrower shall repay the principle sum, interest and any monies payable under this deed to the lender upon demand.
- C. In consideration of the lender agreeing to lend the principal sum to the borrower under or pursuant to the deed of loan, the borrower agrees to execute a collateral security over the property described in the schedule in favour of the lender as security for payment of the principal, interest and any other monies payable by the borrower to the lender under this deed of loan.
- D. Interest shall be calculated and charged on the principal sum from the [redacted] day of [redacted] 1998 (hereinafter called "the date of the advance") at the rate of 3% per week, and shall be paid weekly in advance by the borrower to the lender (hereinafter referred to as the repayment amount) as stipulated in the schedule, the first instalment to be paid on the [redacted] day of [redacted] 1998, and subsequent instalments to be paid on the corresponding day of each week thereafter for so long as any monies remain owing by the borrower to the lender under this deed of loan.
- E. All principal, interest and other monies payable under this deed of loan, by the borrower, shall be paid to the lender by the due date for repayment and without deduction at [redacted] in the state of Queensland, or at such address as the borrower may direct in writing from time to time.

- F. The borrower acknowledges that they are entitled to make lump sum repayments off the principal or interest or both together at anytime without penalty.
- G. The borrower agrees to complete the application form provided by the lender and to abide by all the terms and conditions contained in any security documents collateral to the deed of loan.
- H. The borrower agrees that nothing herein or in the application form referred to in G above shall be taken to imply any agency or partnership between the parties.
- I. The borrower will act in good faith toward the lender at all times.
- J. The borrower will immediately advise the lender of any change to their address or telephone number, either temporary or permanent.
- K. Time shall be of the essence under this deed at all times.

DEFINITIONS:

- I. For the purpose of this Deed of Loan, "other monies" shall include any expenses incurred in the recovery of any monies owing under this Deed.

IN WITNESS WHEREOF THE PARTIES HAVE HEREUNTO EXECUTED THIS DEED ON THE DAY AND YEAR HEREINBEFORE MENTIONED.

Signed by the borrower [redacted]

in the presence of [redacted]
An independent witness

Signed by the lender [redacted] (Director)

In the presence of [redacted]
An independent witness

\$1,000 - 2000

Repayment amount:

On the day of 1998

On the corresponding day of each week thereafter for so long as any monies remain owing by the borrower to the lender under this deed.

س. ١٠٠

Although advised by you to seek independent legal, accounting and such other advice as ~~I~~we may require in relation to the loan and ancillary documentation before entering into and signing same, ~~I~~we chose not to do so. Further, ~~I~~we have read the terms of the Deed of Loan and ancillary documents relating to this transaction and ~~I~~we understand the meaning and effect and consequences of this said Deed and ancillary documents and the rights and obligations of the parties thereunder. Further, ~~I~~we have voluntarily signed the said Deed of Loan and ancillary documents.

Date this 14 day of July 1998

**DECLARATION OF PURPOSES FOR
WHICH CREDIT IS PROVIDED**

I/we ...
Declare that the credit to be provided to me/us by the credit provider is to be applied wholly or predominantly for business or investment purposes (or for both purposes).

IMPORTANT

You should not sign this Declaration unless this loan is wholly or predominantly for business or investment purposes.

By signing this declaration you may lose your protection under the consumer credit code.

Print name borrower
Signature borrower
Date signed

Period to which this Understanding Applies

This information may be given before, during or after the provision of credit to you.

**NOTICE OF DISCLOSURE OF YOUR CREDIT
INFORMATION TO THE CREDIT REPORTING
AGENCY (PRIVACY ACT 1998)**

... (hereafter called "the Lender") may give information about you to a Credit Reporting Agency for the following purposes:

- (a) To obtain a Consumer Credit Report about you, and/or:
- (b) To allow a Credit Reporting Agency to create or maintain a Credit Information File containing information about you.

This information is limited to:

- (a) Identity particulars – your name, sex, address, date of birth, name of employer, and Driver's License number;
- (b) Your application for credit or commercial credit – the fact that you have applied for credit and the amount;
- (c) The fact that the Lender is a current Credit Provider to you;
- (d) Loan repayments which are overdue by more than sixty (60) days, and for which debt collection action has started;
- (e) Advice that your loan repayment is no longer overdue in respect of any default that has been listed;
- (f) Information that, in the opinion of the Lender you have committed a serious credit infringement (that is, acted fraudulently or shown an intention not to comply with your credit obligations);
- (g) Dishonoured cheques – cheques drawn by you for \$100.00 or more which have been dishonoured more than once.

Dated this ... day of ... 1998
Borrower

APPENDIX 5

BUSINESS PURPOSE DECLARATIONS

The Code allows the mechanism of the Business Purpose Declaration (as long as it is substantially in the form provided by section 10 of the Consumer Credit Regulation 1995) to shift the initial presumption of the regulation of a contract by the Code.

The initial presumption is that "in any proceedings ... in which a party claims that a credit contract ... is one to which this Code applies," the Code will apply "unless the contrary is established" (s11(1)). BUT where a Business Purpose Declaration is signed - to the effect that the credit is to be applied wholly or predominantly for business or investment purposes (or both) - then credit is "presumed conclusively" not to be for personal or domestic or household purposes. The consequence is that the Code does not apply.

HOWEVER, the Business Purpose Declaration will be "ineffective" if the credit provider "knew or had reason to believe," at the time the declaration was made that the credit was in fact to be applied wholly or predominantly for personal, domestic or household purposes.