



# Trappings of easy money

Desperate for quick cash? You could be digging a big hole for yourself, writes **Jason Bryce**.

**I**T WAS 10 days to payday and Michelle's electricity was about to be cut off. Her car wouldn't start and the kids were sick of being left waiting at the school gate.

There was no money in the bank and even the bowl of loose change she keeps in the kitchen was empty.

Michelle was flat broke so she went looking for help only to get ripped off even more.

Like a growing number of people, Michelle turned to a payday lender for some quick instant cash. What she got was an even bigger debt problem.

Michelle paid her electricity and managed to get her car back on the road but she paid dearly for the privilege — an effective interest rate of almost 200 per cent a year.

"I had no other way to get through," she says.

"I filled out an online application form, someone rang me an hour later and I had an Eftpos card with \$2000 on it the next morning."

By payday nine days later, Michelle owed almost \$3000 after fees and charges were added to the balance.

Now, nine months later she still owes close to \$3000 despite regular fortnightly repayments.

What is worse, her electricity bill is due again and she has no way to pay it. The regular repayment amounts cut too deeply into her income for there to be anything left over each payday.

Michelle is now seeing a debt counsellor and may have to file for bankruptcy.

## Payday boom

Across Melbourne and regional Victoria the rise of the short term cash brokers — the so-called payday lenders — is continuing.

"This is a great time for payday lenders at the moment," says Richard Foster, chief executive of the Financial and Consumer Rights Council.

"With the shortage of credit from the major lenders and things getting tighter in terms of what credit is available plus the difficult financial times, people are turning to payday lenders in a big way," Mr Foster says.

"Financial counsellors are seeing increased numbers of people who have got into trouble with debts to payday lenders."

## Fee loophole

Consumer laws can easily be avoided.

According to Mr Foster, Victorian law allows payday lenders to ask for interest rates that banks and mainstream lenders would not be allowed to charge their customers.

"It is not unusual for payday lenders to impose interest and fees that effectively amount to hundreds of per cent on a per annum basis."

In Victoria there is a maximum legal interest rate of 48.5 per cent per annum. However, that cap does not include fees and charges lenders can then impose.

"In Victoria we have a cap on the interest rate that lenders are allowed to charge consumers," Nicole Rich, a solicitor with the Consumer Action Law Centre says.

"The cap is 48 per cent if it is an

unsecured loan or 30 per cent if it a secured loan like a mortgage or car loan," Ms Rich says.

"In Victoria payday and fringe lenders get around the cap by charging extra high fees.

"In New South Wales, the ACT and Queensland governments have introduced what we call a comprehensive cap which includes fees and charges.

"There is a formula for converting the fees into an effective interest rate and the lenders can't go above that.

"But in South Australia, Tasmania and Western Australia there is no cap at all. So when consumer law goes federal we don't quite know what is going to happen with the payday lenders."

## Fancy sidestep

Even in states with a comprehensive cap some lenders find ways to avoid the laws.

They dress up the loan as a purchase or they say it was a pawn-broking transaction.

## Not all bad

Last year National Australia Bank entered into a trial with a small lender to provide fast cash in loans that do not charge the maximum interest rate.

As a result of that experiment, NAB found lenders could break even with an interest rate on the original loan amount of around 16 per cent.

"What this demonstrates is that fringe lenders who are charging annual interest rates as high as several



hundred per cent are preying on consumers who have limited options," NAB community finance spokesman Richard Peters says.

Money Fast chief executive Justin Hatfield says the pilot project his company undertook with NAB sought to demystify a sector where many players exploited loopholes to charge vulnerable people with high rates and charges.

"Fringe lending is an area that takes advantage of people facing difficult times," Mr Hatfield says.

"Recent indicators are that more people are entering this market as a result of a downturn in financial circumstances due to employment status and income levels.

"Under the pilot, we saw a reduction in small loan applications prior to Christmas due to the Australian Government's stimulus package, although this was followed by a spike in January applications.

"A similar pattern is expected as a result of the Government's latest stimulus package.

"Expectations are that tough economic times will force people who have not previously accessed fringe lenders to go down this path.

"They are not necessarily high-risk borrowers but find themselves in difficult circumstances."

### Day in court

While many payday lenders pride themselves on being responsible lenders who do not lend to people

without jobs and do explain the total fees and charges, others appear to prey on desperate people in desperate situations.

Consumer Action Law Centre recently initiated legal action against a prominent short term lender. The legal action is on behalf of a borrower who is dependent on Centrelink benefits for their main income.

Consumer Action alleges unconscionable conduct in relation to the fees and interest charged.

"Our client, who relies on benefits from Centrelink but supplements her income with part-time work, applied for a small loan of \$2000 and was charged a loan advance and administration fee of over \$1600,"

**Financial counsellors are seeing increased numbers of people in trouble with debts to payday lenders.**

said Consumer Action policy officer Sean Carroll says.

"This was combined with an interest rate of 17.9 per cent or an amount of \$804 in interest.

"That means the total amount

payable was \$4422 for a loan of only \$2000.

"Any credible assessment of her income would have highlighted that she would find it difficult to pay the loan without experiencing severe financial hardship."

### What to do

People who get caught with a high interest short term debt and have trouble repaying it need to prioritise that debt ahead of all others, advises Financial and Consumer Rights Council chief executive Richard Foster.

"Everything depends on a person's individual circumstances of course but often financial counsellors will advise people who have got themselves caught up with payday lenders to prioritise that debt and get it cleared as soon as possible if they can.

"These loans are not something that usually can be negotiated because the debts are not usually subject to the requirements of the Consumer Credit Code," he says.

Under the Consumer Credit Code, banks and mainstream lenders must help their customers who get into difficulty — but payday lenders don't have to.

"Many payday lenders are less inclined (than mainstream lenders) to be flexible with customers who claim they are in hardship," Mr Foster says.

"That's a general comment and

## Scams and shams

ONE short term lender based in Queensland reportedly sells diamonds to people who then take the jewel to an associate and on-sells it for the agreed amount of cash.

The borrower then makes repayments against the purchase of the diamond. This sidesteps money lending laws and gives the lender a much greater return on their cash than the 48 per cent cap allows.

### Sham brokers

Another way some lenders escape the interest rate cap is to set up the

loan as a sham pawnbroking arrangement.

"Pawnbroking is not covered by all of the consumer credit code," Ms Rich says.

"The interest rate cap does not apply to pawnbrokers.

"So what we have seen in some states is 'sham' pawnbroking, where a lender says 'yes we will give you the loan but bring in an old CD to pawn against the loan amount'.

"It is obviously not a pawnbroking transaction but they try to get around the cap by doing that," she says.



there are exceptions to that but broadly speaking they are a lot less co-operative.”

And if you get into a dispute with a payday lender your options are very limited.

“Payday lenders are not usually members of an alternative dispute

**“ (A fee of) \$25 per week is cheaper than the penalty fees a bank will charge you for going into overdraft.**

resolution scheme such as the financial ombudsman either.

“Basically if you can't repay the loan and you can't negotiate with the lender it will result in bankruptcy.

“And you only need a debt of \$2000 to be forced to go bankrupt,” Mr Foster says.

### Avoid the rip off

Knowing that you are being ripped off doesn't mean that you can avoid being ripped off.

Our case study borrower, Michelle, says she didn't really have any alternative to the short term lender who is now chasing her for twice the amount she borrowed.

“I need my car to be on the road and obviously I need to pay my electricity bill.

“I had nowhere else or no-one else to turn to so that's how I got into this situation with the high interest loan.”

Consumer Action Law Centre solicitor Nicole Rich says many people know that they will be paying high

fees when they sign on to a payday loan but may not realise the full extent of the costs.

“People often say to us: ‘I knew it was expensive but I didn't have any other option’.

“For example the consumer may have been told they would be charged a fee of \$15 per week for every \$100 outstanding, as one lender does, and they think that means an interest rate of 15 per cent,” said Ms Rich.

“It is not that these loans are just more expensive than a credit card or a loan from a bank, they are exorbitantly more expensive.”

It is one thing to say beware of the payday lenders but that isn't much good to the person who thinks they have no other options.

Ms Rich says that the two main reasons people go to payday lenders are outstanding bills and car repairs.

“If you have an outstanding phone or utility bill make sure you talk to the supplier first, tell them you are struggling and make an arrangement to pay.

“Yes, it is a hassle and they may not be as friendly as the payday lender but it is a lot cheaper in the long run.”

### Weighing up the costs

Typical fees and charges on a payday loan are between \$20 and \$30 for every \$100 outstanding per pay period says Lucas Bates, chief executive of online small lender Paydaydirect.com.au.

“Fees vary but are generally based on your payday cycle,” Mr Bates says.

“So the borrower gets told what they will be charged per hundred dollars for every fortnight or week

that the loan is not paid off.”

As an example, if you ask for \$200 to tide you over until next week, you can expect to repay between \$240 to \$260 back to the lender.

That is an effective interest rate of 1000 per cent per year but that is not necessarily unreasonable says Phil Johns, the chief executive of the National Financial Services Federation, the umbrella industry group representing almost non-bank and payday lenders.

“\$25 per week is cheaper than the penalty fees a bank will charge you for going into overdraft,” Mr Johns says.

“Some banks charge \$35 if a direct debit takes your account into the red by just \$1, so \$20 or \$25 per week per \$100 is cheap compared to that.

“These loans are mum and dad loans, generally speaking. I saw a family recently who were concerned that their rent payment direct debit might drive their bank account into the red and attract a \$35 over limit penalty fee — or worse, be rejected.

“They took out a \$100 loan to top up their bank balance for a week, were charged \$25, and effectively saved themselves \$10. Plus they maintained their perfect rental payment record and saved themselves a week of worry.”

Mr Bates says it's not just low income earners who are turning to payday lenders.

“A lot of demand is coming from people earning good money, like \$50,000-\$60,000 per year. We regularly get calls from high income earners on more than \$100,000.

“Everyone can get in a jam and need cash now but don't want to go to family and friends,” he says.



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