NEWS

Cap on payday loans

Fees and interest to be reduced.

Government legislation capping fees and interest charged by finance firms issuing short-term loans is being investigated by a parliamentary committee.

These loans are generally of between $100 and $2,000 and are regularly used as a stopgap measure by people who have run out of money before their next payday. They often include compulsory charges and interest worth as much or even more than the amount of money lent, leaving consumers at risk of needing to borrow more money to cover repayments.

Introducing the Consumer Credit and Corporations Legislation Amendment (Enhancements) Bill 2011, Assistant Treasurer Bill Shorten told parliament around $500 million a year was lent in short-term loans.

"At one end it can include small loans in which a person borrows $300 which must be repaid plus interest a week or two later, on the borrower's next payday," Mr Shorten said."It also covers larger loans up to $2,000."

Mr Shorten said the vast majority of short-term loans are sought by low paid workers or people on Centrelink benefits.

"It is estimated that nearly half of payday borrowers have incomes of less than $24,000 a year, and up to two-thirds earn less than $36,000.

"We do not believe it is acceptable that these consumers are left to pay exorbitant rates of interest because they have a very urgent need for a small amount of money."

Mr Shorten said some lenders are charging huge amounts in interest and fees such as $2,000 on a loan of $1,000 taken out over a year. These already stretched borrowers then face a real risk of a debt spiral, where their existing loan is extended or rolled over into a new loan.

"Borrowing money at very high interest leaves the underlying financial difficulties unresolved," he said.

"When the direct debit payment comes out automatically at the next payday, it can leave the borrower with no cash for the next week's basics, so they have to go and get another loan, trapping them again in a cycle of debt."

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The bill will cap upfront lending fees to 10 per cent of the amount of the loan and then two per cent each month for the life of the loan.

"This cap delivers real outcomes for consumers," Mr Shorten told parliament. "It ensures that borrowers who are in need of a small amount loan will not face relatively high costs, and will reduce the risk of an ongoing cycle of dependency through the continued use of this form of credit."

However the chair of the National Financial Services Federation, Mark Redmond, fears many short-term lenders will go bust if the legislation is passed unamended, threatening an important source of funds for hundreds of thousands of Australians.

"We agree with Assistant Treasurer Bill Shorten that vulnerable and disadvantaged Australians should be protected from spiralling into ever larger amounts of debt," Mr Redmond said.

"We also agree that unlicensed loan sharks should be hunted out of the industry and we are continuing to work with regulators to ensure lenders are licensed and abide by responsible lending rules already in place.

"But the government's planned cap on fees and charges for short-term loans is too low and if put in place without amendment will send many short-term lenders out of business."

Mr Redmond also cautioned that the need won't go away when an authorised lender is put out of business.

"People will need money and there will always be those that are desperate enough to get those funds through loan sharks, backyard means, and the like," Mr Redmond said.

The legislation will also introduce Australia's first statutory protection against negative equity to better protect seniors seeking to take out a reverse mortgage on their home.

Reverse mortgage lenders and brokers will be required to meet specific disclosure requirements by walking consumers through the different scenarios before they take out a reverse mortgage.

"The most significant risk to our senior Australians is that they could end up with a debt greater than the value of their home, known as negative equity," Mr Shorten said.

"For example, they may borrow too much while still relatively young and unknowingly restrict their future choices if they later need to move into aged-care accommodation or have greater health bills."

Federal parliament's Corporations and Financial Services Committee is examining the legislation, with more than 40 submissions received. •

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