CONSUMER LAW AND FRINGE CREDIT PROVIDERS

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1. INTRODUCTION

One in two problem gamblers borrow money to gamble[i]. The spectrum of lenders from which they borrow stretches from main-stream lenders such as banks and finance companies to less formal arrangements with friends and families. That spectrum also includes "fringe lenders" to whom borrowers commonly turn when they are unable to access the mainstream credit market.

Many of those fringe lenders either fall outside the regulatory scope of the *Uniform Consumer Credit Code* – the basic consumer protection laws in the area of credit – or have practices which flout them, and make a borrower's reliance on them difficult, if not entirely illusory. This paper looks at the nature of those loans and the regulatory responses available to law enforcement agencies which will best protect problem gamblers from the excesses of the fringe credit industry.

2. THE "FRINGE CREDIT" MARKETPLACE AND GAMBLING

There is an array of credit providers who operate in the fringe marketplace. It is, in some respects, a booming and vibrant marketplace. Fringe lenders include both relatively visible lenders such as pawnbrokers and the "new kids on the block" - the pay-day lenders - to the far less visible loan sharks such as those frequenting casinos in search of losing gamblers, and loan shark networks of the type uncovered in South East Queensland recently and which is currently the subject of extensive court action in Queensland.

Because problem gamblers do not always borrow money to gamble directly, but commonly use the loan proceeds to replace income that has already been gambled (and money which may have been needed for day-to-day household necessities), the relationship dynamic between lender and borrower is also varied. Sometimes it is the lender who targets the problem gambler as a lucrative customer, other times it is the gambler who seeks out the lender; sometimes aware of the gambling problem, sometimes not. Either way, once the relationship has been established, the consequences for the borrower can be devastating.

Consequences for borrowers which flow from the relationship include the high cost of the loans, the risk of financial overcommitment and the personal and social costs which usually follow, unfair or unlawful enforcement practices, and lack of access to law enforcement agency protection. These are discussed in more detail below.

3. SOME SPECIFIC TYPES OF FRINGE LENDERS

3.1 Pawnbrokers

Pawnbrokers have been part of the fringe lending landscape for many years, and are regulated by their own specific state-based legislation.[ii] Although it is not uncommon for problem gamblers to pawn their goods in order to generate gambling funds, it is other forms of fringe credit where there is uncertainty about how they are regulated, with which this paper deals.

3.2 Pay-day Lenders

The new entrants to the fringe credit marketplace in Australia are the so-called "pay-day" or "cheque exchange" lenders who have commenced American-style small-loan lending practices for amounts commonly of between $100 and $1000. There are a number of forms which these loans take. Pay-day lenders may give advances on wages, or cheques, charging a fee for the loan. A borrower may write a personal cheque payable to the lender for the amount of the loan plus the loan fee. The lender holds the cheque until the next pay day (or another nominated day when funds will be in the account) at which time the borrower either redeems the cheque by paying the lender that amount in cash, or allows the lender to deposit the cheque. Other varieties of the schemes take automatic debit authorities from a borrower's account as the repayment method.

The pay-day lenders charge fees rather than interest, and do not disclose the cost of the credit by reference to an annual percentage rate as other consumer loans must. An example of the operation of one such scheme is that a borrower pays a $20 membership fee to join the scheme, and $20 per $100 of the loan. The loan is then usually repayable within 10 or 14 days, with a maximum term of 62 days.

One pay-day lender's advertising brochure specifically attracts gamblers. It reads:

> "Did you blow your money on that horse that couldn't lose? We'll lend you cash till your next pay day. Hassle Free. Did you walk out of that gambling house without enough money to buy a pie? Don't want anyone to know? We'll lend you cash to your next pay day. And p.s. we won't tell".

These "pay day" loans are not currently generally regulated by the *Consumer Credit Code* because they utilise the 62 day "short term loan" exemption in s 7(1) of the Code which provides that loans which are repaid within 62 days are not required to comply with the Code.

Issues of concern for borrowers include:

- extremely high cost of credit (annualised percentage rates of hundreds and sometimes over a thousand percent);
- enforcement methods dictated only by the terms of the contact;
- failure of the contracts to disclose the cost of credit adequately;
- taking excessive security (e.g. taking the family car as security for a $600 loan);
- financial overcommitment, including repeated "roll-overs" of loans where on the due repayment date the borrower who is unable to pay the loan back merely pays the loan fee again, rolling the loan over to a new repayment date.

3.3 South-East Queensland Loan Shark Network

Throughout 1997 and 1998 a network of loan sharks advertised "cash loans of up to $2000" in the Gold Coast Bulletin and other free local papers in the Gold Coast and greater Brisbane area. The Queensland Office of Fair Trading ("OFT") investigated the phenomenon, which included a public information-seeking phone-in, and which resulted in a public report.[iii] The Report considered the experiences reported by 59 borrowers. It is likely that those people who spoke to the OFT were only a small proportion of the total, and that many hundreds of people in varying financial and personal circumstances borrowed money from the loan sharks. Many of the people who borrowed from these lenders were problem gamblers, although the exact proportion of borrowers who were problem gamblers was not identifiable in the OFT Report.

Critical common features of the loans include the following:

- loans usually of between $500 and $2000;
- interest rates described as 3% or 4% per week;
- weekly "interest only" repayments;
- the terms of loans were open-ended;
- payments to reduce the principal could only be made in lump sum unit amounts of $500;
- loans were conditional on borrowers signing “declarations” to the effect that the loans were for business purposes, irrespective of the actual purpose, and despite the overwhelming majority being personal loans[iv]. These declarations were intended to circumvent the *Consumer Credit Code* which does not regulate business or investment loans.[v]

Issues of concern for borrowers include:

- *Extremely high cost of the loan*: a weekly interest rate of 4% amounts to a flat annual percentage rate of 208%. A $2000 loan would cost $4160 in interest payments over a year, or calendar monthly payments of $347.00. As a raw regular monthly financial commitment which has no effect on the principal this is sizeable. Administration fees and in-advance interest were also taken out of the loan funds before the proceeds were given to the borrower. A $5 per day “late fee” was charged on late repayments.

- *Long-Term Relationship:* The fact that borrowers were only able to pay off the loan’s principal in $500 lump sums meant that the term of the loan was indefinite – terminated only by the borrower’s ability to access the lump sums from another source. It was not to the advantage of these loan sharks for the principal to be reduced. Low-income borrowers faced a real risk of literally being trapped into these loans without any real prospect of paying them off. One man who had borrowed $2000 in May 1997 paid off $8000 without any reduction in the principal, while a woman who had borrowed $6000 in June 1996 repaid almost $30,000 without any principal reduction.

- *Enforcement*: Borrowers who participated in the Office of Fair Trading Inquiry reported that the loan sharks adopted enforcement practices which included:
  - death threats and 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 usually described by borrowers as being large, extremely muscular and physically intimidating and who might attend a borrower’s home in groups to collect payments.

3.4 Casino Loan Sharks

The loan sharks who frequent casinos reconnoitring for losing gamblers are lenders who actively target problem gamblers. These loan sharks are, in my experience and that of many financial counsellors who work in the field, often associated with ethnic communities, although the lender and borrower may not necessarily know each other beforehand. These lenders are barley visible. Consumer credit laws are irrelevant to their practices. These high interest, and sometimes large loans, are commonly reported as being enforced by threats of violence. Fear of the loan sharks commonly prevents borrowers from reporting these activities to police.

4. FRINGE LOANS AND CONSUMER PROTECTION LAWS

The primary legislation designed to regulate consumer credit loans – including fringe credit – is the *Uniform Consumer Credit Code* which in every state applies to all credit for "personal, domestic and household purposes". A passing issue – not to my knowledge tested in court – is whether a loan to finance a gambling habit is for "personal, domestic, our household" purposes, or is rather an investment, given the potential financial returns. The argument that it might be better described by its nature as an investment belies the true nature of gambling and clashes sharply with gaming industry advertising and promotion which depicts it as a personal entertainment activity. It is an argument which is likely to fail.

As already identified, many of these fringe lenders do not comply with the provisions of the *Consumer Credit Code*. The South-East Queensland loan sharks sought to evade the Code by obtaining from borrowers a signed declaration that the loan was for some unspecified business purpose, pay-day lenders usually have loan terms of less than 62 days, thereby falling outside the Code, while casino loan sharks simply ignore the Code entirely.

The consequences of not being regulated by the Code include the loss to borrowers of fundamental protective rights which provide for:

- a copy of the contract,
- disclosure on the contract of sufficient information for the borrower to make an informed choice about taking out the loan including the annual percentage rate of the loan;
- statements of amounts paid,
- notice of default, and a reasonable time in which to remedy the default;
- the right to apply to a court to have contracts set aside on the grounds that they are unjust (s70 of the Code), taking into account factors which include whether the loan would inevitably lead to the borrower being financially overcommitted.

The "overcommitment" provision of the Code is important in the context of lenders deliberately exploiting a problem gambler's compulsion. It allows a borrower to apply to a court for an order "re-opening" the contract where:

> "at the time the contract […] was entered into or changed, the credit provider knew, or could have ascertained by reasonable inquiry of the debtor at the time, that the debtor could not pay in accordance with its terms or not without substantial hardship" (s70(2)(l) of the Code).

Non-regulation by the Code also has the effect of "side-lining" the state government consumer agency with the responsibility for consumer credit. If the loans are not regulated by the Code, those agencies have much reduced powers to investigate or prosecute lenders for practices in contravention of the Code.

Other consumer protection laws which might apply to the loans include the *Australian Securities and Investments Commission Act (Cth) 1989* which prohibits unconscionable, and misleading and deceptive conduct in the provision of financial services where the lender is a corporation and the Code does not apply[vi], and the various corresponding provisions of state *Fair Trading Acts.* New South Wales has the added protection of an over-arching *Contracts Review Act 1980* which may be used to seek court orders reviewing the fairness of a fringe lender's contracts.

Otherwise it is the general law of contract which regulates the loan and which seeks to give effect to the terms of the loan agreement - terms which because of what will commonly be a borrower's extremely weak bargaining position vis-à-vis a fringe lender, may well be inherently unfair.

The laws of equity and in particular the principles of unconscionability are often described as ameliorating the effects of the law of contract. There is a line of case-law which enunciates the circumstances in which a court may strike down a contract (including loan contracts) as unconscionable[vii], and which apply not only to the circumstances in which the contract was entered into which may make it unconscionable, but to the terms of the loan itself[viii]. There are some very significant hurdles to the practical use of these protections however, including that many lower courts do not have jurisdiction to hear equitable arguments. This means that borrowers wishing to rely on equitable protections must go to the more expensive jurisdictions of the higher courts. For small loans the costs of doing so are prohibitive, and justice accordingly illusory.

5. REGULATORY RESPONSES.

5.1 Enforcement Responses

Given the type of experiences borrowers from some fringe credit providers report, it is important that regulatory agencies are prepared and capable of appropriately addressing complaints by borrowers against fringe lenders. The first question might be: is a police response or a consumer credit one more appropriate? The answer will inevitably depend on the nature of the particular complaint made about the fringe lender. The South-East Queensland loan shark phenomenon provides an interesting example of the overlap between the responsibilities of the police and those of the government consumer agency .

In 1998/99 the Queensland Police Service ("QPS") commenced an investigation, known as *Operation Hibiscus*, into the loan shark network. The investigation focused on suspected organised criminal activity overlapping the fields of loan sharking, extortion and associated money laundering, drug production and distribution. The QPS requested the assistance of the Queensland Crime Commission ("QCC") in its investigation[ix]. The QCC was established in 1997 as an agency with a brief to investigate instances of suspected organised criminal activity. It has significantly greater evidence-gathering powers than the police.

As a result of the QPS/QCC investigation, 24 people were arrested on a range of charges including production and possession of a trafficable amount of cannabis, extortion and firearms offences. A further 10 people were arrested on charges including grievous bodily harm, deprivation of liberty, extortion, housebreaking and burglary and weapons offences.

Evidence obtained during the QCC hearings was provided to the Queensland Office of Fair Trading ("OFT"). The OFT has commenced Supreme Court proceedings against a dozen fringe lenders alleging widespread contraventions of the *Consumer Credit Code.* The OFT has sought, among others things, orders from the court that each of the lenders pay amounts of $500,000 as penalties for their conduct, and injunctions restraining them from future lending. In the course of those proceedings, the OFT has already obtained injunctions restraining some of the lenders from disposing of certain of their assets.

Both the OFT and the QPS prosecutions are continuing. While it is not possible to comment on the likely success or failure of either of those rafts of prosecutions at this stage, it is possible to

make some observations about the regulatory responses required to address fringe lending excesses:

- there may be an overlap between serious criminal conduct in which the police ought to be involved, and contraventions of the consumer protection laws for which consumer protection authorities are responsible;

- serious criminal conduct can only be dealt with effectively by the police;

- many fringe lenders are not highly visible lenders which may require the commitment of surveillance resources as part of any meaningful investigation;

- the investigation and prosecution of fringe lenders, or fringe lending networks, requires a significant commitment of regulatory resources and will. State government consumer agencies have in the past been notorious for their reluctance to actively investigate and prosecute contraventions of consumer credit legislation, often by virtue of resource restrictions. (The Queensland OFT's current actions against the South-East Queensland loan shark network are notable and commendable exceptions);

- borrowers are commonly extremely reluctant to report problematic fringe lender behaviour for reasons which include:
  (a) fear of reprisals from lenders threatening violence;
  (b) lack of awareness of their rights;
  (c) lack of faith in the ability of regulatory authorities to respond adequately and in a timely way to complaints;
  (d) problem gamblers feeling guilty about their own involvement in the loan.

5.2 Legislative Response

The Queensland Office of Fair Trading has moved to address the issue of regulatory failure in relation to the pay-day lenders by convening a working party of consumer and industry members to report to it on how those lenders ought to be regulated. That working party must produce fruit. It remains to be seen whether it can come up with an appropriate and effective regulatory model, and if so whether it can co-ordinate all the states to support that proposal into legislation.

6. CONCLUSION

Issues arising out of the loan shark/problem gambler relationship are challenges not just to gamblers and the gambling industry, but also to fair trading authorities and police.

Strategies for addressing loan shark problems and those of other excessive fringe lending must, therefore, be multi-dimensional.

The *Consumer Credit Code* must be amended to effectively capture all consumer credit loans – as it was intended to do. Problem gamblers must be given every opportunity to report excessive lending conduct to appropriate regulatory authorities, and be represented in disputes with the lenders. This means an appropriately targeted education campaign, agency commitment to fringe-lending monitoring strategies, and adequate funding to consumer credit legal services and legal aid offices. Police and fair trading agencies must have the capacity to receive complaints, identify them appropriately, and act swiftly. They must have workable protocols for referral of

complaints between them and which recognise the strengths and limitations of their respective powers.

The act of taking out a loan should never be the end result of an exploitative relationship between borrower and lender, or in the case of some loan sharks, an entryway to a life of fear.

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[i] Productivity Commission, Australia's Gambling Industries, Inquiry Report , 26 November 1999, p 7.1
[ii] See for example, *The Pawnbrokers Act (Qld) 1984*
[iii] Fringe Credit Provider – A Report and Issues Paper", Queensland Office of Fair Trading, May 1999
[iv] ibid, p 8
[v] The declaration will, however, be ineffective if the lender "knew or had reason to believe" at the time that the declaration was made that the credit was in fact to be applied wholly or predominantly for personal, domestic or household purposes (s11 of the Code). See also *Brown v BE Finance Pty Ltd*, in the Magistrates Court in Brisbane, June 1999, unreported.
[vi] ss 12CA, 12CB and 12 DA *Australian Securities and Investments Commission Act (Cth) 1989*
[vii] see Commercial Bank of Australia Ltd v Amadio (1983) 151 CLR 447
[viii] West v AGC (Advances) Ltd (1986) 5 NSWLR 610 @ 620-1 in relation to the *Contracts Review Act (NSW) 1980*
[ix] Queensland Crime Commission, 1998/99 Annual report, p 27