Submission to Consumer Affairs Victoria

Consumer Credit Code review

September 2005

1 Introduction

The Brotherhood of St Laurence and Good Shepherd Youth and Family Service welcome Consumer Affairs' review of the Consumer Credit Code. We particularly appreciate the interest in the impact of the Consumer Credit Code on vulnerable consumers as well as the role of microfinance in Victoria.

While there has been a dramatic expansion in the availability of credit in Australia, this has not been evenly distributed across society. There are many groups, including people on low incomes, who lack access to appropriate credit. However, the media and many consumer advocates primarily focus on low income earners who are over-committed. Although we recognise over-commitment-is a significant issue, our submission does not focus on this group. We believe it is important to consider that not everyone who is on a low income is over-committed and experiencing major financial difficulties. Many low income earners are extremely careful money managers who are determined to live within their means: they have stable income and housing. However many people are still unable to obtain access to the full the range of financial services including mainstream credit for necessary goods.

In this submission, we have endeavoured to respond to the issues raised by making reference to a number of pilot micro credit programmes. While we believe such programmes need to be further tested and evaluated for a more thorough understanding of customers' needs and barriers to microfinance, the No Interest Loans Scheme (NILS®) represents a long established micro credit programme with demonstrated success. The Brotherhood of St Laurence and Good Shepherd welcome the opportunity to work with Consumer Affairs Victoria to further develop this and the other micro credit options.

1.1 Brotherhood of St Laurence

The Brotherhood of St Laurence is a Melbourne-based community organisation that has been working to reduce poverty in Australia since the 1930s. This includes getting people into work; assisting people to access affordable credit, affordable housing and quality lifelong education; caring for older people; helping families with early childhood programmes and carrying out research and advocacy for change in services and government policies.

The Brotherhood operates a range of microfinance programmes:

- **Advance Personal Loan** – In partnership with Bendigo Bank, the Brotherhood of St Laurence provides personal loans of $500 to $2,000 to people on low incomes for necessary items such as household goods, car repairs and medical expenses. The programme was developed in response to the limited sustainability of earlier interest-free loans programmes. Access to the mainstream financial sector is also considered an important aspect of social inclusion and economic development.
- **Saver Plus** – In partnership with ANZ, the Brotherhood assists people on low incomes to save for their children's education. Each dollar saved is matched with a further two dollars by ANZ up to a combined limit of $3,000. The program also includes a financial literacy component.
- **Business Loans** – Studies have shown that self-employment is an important solution for people experiencing barriers to the labour market, such as mature job seekers and people from non-English speaking backgrounds. The Brotherhood of St Laurence and Fitzroy Carlton Community Credit Cooperative provide loans of around $2,000 to small businesses to promote employment.
- **Interest Free Loan programme** – The Brotherhood provides loans of up to $1,000 for household goods to people on low incomes. We have been accredited by Good Shepherd Youth and Family Service to operate a No Interest Loan Scheme.

1.2 Good Shepherd Youth and Family Service

Good Shepherd Youth and Family Service was founded in 1976 as a work of the Good Shepherd Sisters, a French Catholic order of nuns with the role of providing protection for socially disadvantaged women and children. Today the mission of Good Shepherd Youth and Family Service is to boldly challenge those structures and beliefs that diminish human dignity and to ensure the value of every human being and communities that enable people to thrive. In order to give effect to this mission, Good Shepherd Youth and Family Service is now present in four locations of metropolitan Melbourne: Collingwood, St. Kilda, St. Albans and the Mornington Peninsula. Its services include housing, financial counselling, family support and child and family counselling, women's programmes including family violence programmes and micro-credit programmes. These programmes are supported by a Social Policy Research Unit which seeks to bring about responsiveness in government and other institutions to those who are disadvantaged or excluded in any way. The microfinance programmes of Good Shepherd Youth and Family Service comprise:

- **NILS® (No Interest Loans Scheme)** – NILS® began in 1980–81 in Victoria with the introduction of loans to assist women to establish households on leaving care. NILS® has since expanded to 40 programmes across Victoria, all managed by community groups but coordinated and accredited by Good Shepherd. Each year in Victoria about $500,000 is lent for up to 850 loans. A default rate of 3.83% means that capital is largely maintained while a family's asset base improves and community connections are made.
- **Better Energy Loans** – This is a one-year, no interest pilot programme similar to NILS® to encourage appliance replacement with energy-efficient appliances. The pilot is funded by Origin Energy and includes the purchase of discounted energy-efficient appliances through Origin Energy stores, which provides an additional saving to the purchaser.
- **Good Shepherd Buying Service** – This free service is funded by Consumer Affairs Victoria and enables people on low incomes to purchase essential household items. Bulk purchase means that low income consumers who are often excluded from such purchases are able to make real savings on the cost of new household goods with effective warranties. The service is often used in conjunction with a NILS® loan. In 2003/04 there were 3,066 enquiries to the Buying Service with 769 purchases to the value of $634,886. An average saving of 22.58% was made for the items purchased.
- **Step Up Loans** – This is a low interest loans pilot programme funded by the National Bank for two years. Eligibility criteria are similar to those of NILS® but the loans may be for other than household goods. The pilot is being conducted in three locations in Melbourne and two in New South Wales. Step Up Loans are designed to be a bridge between the financial support services offered by the community service sector and the mainstream financial institutions of the banks but they retain the social capital investment of mentoring of the loan and assistance in moving into the relationship with the bank. Loans range from $800 to $3,000 with an interest rate approximately half the prevailing personal loan rate. There are no fees or charges with the Step Up Loan.
- **Financial counselling** – Staff provide general financial information and intervention in circumstances of financial hardship. This may include negotiation with creditors and assistance with debt consolidation. In addition, Good Shepherd financial counsellors run consumer cooperation groups and community information sessions including credit awareness and budgeting. This programme receives funding from Consumer Affairs Victoria and South East Water, with small grants from City West Water, the Magistrates Court and the International Order of Old Bastards Inc.

2 The efficiency and fairness of the operation of credit markets in Victoria

The current experiences of microfinance in Victoria

2.1.1 Definition of microfinance [i]

Microfinance refers to loans, savings, insurance, transfer services, and other financial products targeted at low-income clients with the objective of poverty alleviation. With access to a range of financial tools, families can invest according to their own priorities — school expenses, health care, business, nutrition or housing. Anyone who has access to savings, credit, insurance and other financial services is more resilient and better able to deal with everyday demands. While the small size of the loans is a key aspect of microfinance, there is a broader objective of improving the recipients' welfare.

Burkett (2003) identifies microfinance as 'one of many terms which have been developed around the world to describe financial services which focus on addressing various financial and social needs of people who are poor, financially excluded and disadvantaged'.

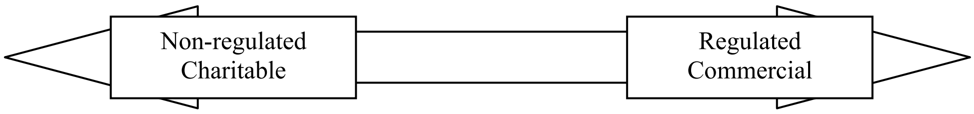
Burkett identifies the key features of microfinance:

- It is concerned with provision of financial services to people who are economically poor and who therefore experience financial exclusion, in that they do not have ready access to mainstream, commercial financial services;
- It is concerned with the provision of financial services to poor people using means which are as just, fair and sustainable as possible (therefore it excludes all exploitative financial services), with the underlying goal being that of poverty alleviation;
- It has a community and/or social agenda inherent in it purpose, mission and /or goals - and the provision of various financial services may be a means to achieving this purpose rather than an end in itself;
- The transactions are relatively small compared to the typical transactions dominant in mainstream financial services;
- It includes the full range of financial services to which poor people need access—it is not limited to the provision of credit.

While we understand that credit is the primary focus of this review, we believe it is important to recognise the other goals of microfinance. When these are taken into account, it becomes apparent that any definition of microfinance which includes pay day lenders (such as applied in the Consumer Credit Review Issues Paper) is incorrect as these lenders do not have a focus on poverty alleviation or indeed the other goals of microfinance which relate to a community strengthening approach.

While people living on low incomes might access the range of financial services described in the continuum below (Figure 1), it is the combination of accessibility to equitable services including credit which are best described by the term microfinance.

Figure 1: Financial services for people living on low incomes



No interest loans	Low interest loans	Fringe credit	Small credit providers	Nonbank lenders	Mainstream banking
Loan mentoring	Savings programmes	Pawnbrokers	Debt consolidators	Store credit	Credit cards
Financial literacy	Financial literacy	Pay day lenders		Credit cards	Financial literacy
					Insurance
					Concession accounts

2.1.2 Pilot programmes in microfinance in Victoria

Brotherhood of St Laurence and Bendigo Bank Advance Personal Loans programme

In partnership with Bendigo Bank, the Brotherhood of St Laurence has provided about 160 loans and disbursed around $100,000. Around $50,000 has been repaid and 15 loans have been finalised. To date there have been no defaults. The Brotherhood of St Laurence underwrites all loans, is the primary point of contact and recommends approval to the bank. Bendigo Bank and Community Sector Banking run credit checks, issue contracts and track payments. The programme has been piloted in five sites in greater Melbourne.

There have been varying levels of success in these areas and we are now focusing primarily on three of the sites. Success factors have included the profile of the Brotherhood in the local area, staff involved, prior existence of a no interest loan scheme and demographics of the area. The product is based on Bendigo Bank's standard personal loan, but amounts provided are smaller. Repayment rates are tailored to fit into a tight budget.

We have not profiled the business loan or Saver Plus programmes as these are not regulated by the Consumer Credit Code.

Good Shepherd National Bank Step Up Loans programme

This is a two-year pilot programme established through a $1 million line of credit facility provided by the National Bank. The pilot is operated in three locations in Victoria by Good Shepherd and in two locations in New South Wales, one each by Winmalee Community Centre and the Mercy Sisters. The pilots are operated alongside existing NILS® programmes and have very similar eligibility criteria. While inquiries are dealt with by the micro credit workers, the formal loans and loans application process are conducted by the National Bank, thereby bringing the loans into the mainstream credit provider regulation (and protection). The purposes of the loans extend beyond household appliances to enable the purchase of other items such as cars. Nearly 30 loans have been approved.

While an evaluation is in progress, some preliminary trends identified might lead to future adjustments to Step Up or indeed the development of other credit products. The take-up of the loans has been limited. It is believed that a community awareness campaign will address this by targeting referral sources other than the existing community service network which is generally the source of referrals for NILS®. This will more accurately reflect the nature of Step Up as a hybrid loans product set between the microfinance options provided under the community services framework and the mainstream financial services provided by the banking industry. A large number of inquiries have not translated into applications. While many enquirers live outside the pilot areas, the loans often do not meet their requirements: a very large number of inquirers are seeking loans for the purpose of consolidation of debt, but this need is outside the loans purposes of Step Up. Credit reporting has also been an obstacle in the take-up of the loans. While a household's current income and expenditure profile might indicate a capacity to pay the loan, credit history can often reveal a negative credit report which is unknown to the applicant or of a minor or historic nature. Under traditional loan assessments, loans would be refused but procedures have been set in place to ensure that where possible these issues are addressed and a loan issued. The evaluation currently underway for Step Up will address these and other issues.

2.1.3 Growth rate

Both Brotherhood and Good Shepherd programmes have grown at a slower rate than expected. Reasons for this include a desire to lend in a responsible manner and understand credit risk prior to endeavouring to expand. There has also been considerable ground work in developing an appropriate application process and for staff to learn about issues in lending to low income earners.

In addition, it has been difficult to identify appropriate customers. Referrals from other community organisations or Centrelink are standard ways for a welfare agency to recruit participants for a new programme. However, these sources often yielded people wanting cash rather than a loan, or people in such a dire situation that they would be unable to repay a loan.

Our view is that many of the most appropriate customers for microfinance are only minimal users of both banks and community organisations. Many people on low incomes do not use welfare services as they find it embarrassing or stigmatising. Despite the relatively small scale of these pilots, we do believe there is a market for microfinance in Australia. There are 4.4 million direct beneficiaries of government income support who are likely to have limited access to financial services[ii].

2.2 Options for provision of microfinance in Victoria?

We believe that microfinance needs to be jointly promoted by community, business and government sectors. The best option for the provision of microfinance may bring together banks' systems, expertise in credit analysis, and branch network and community organisations' expertise in engaging with people's welfare, trust and advocacy. Such an approach retains social capital built through the relationship of credit provider and borrower. Government also has an important role in creating a regulatory environment conducive to microfinance, as well as providing significant capitalisation to ensure accessibility.

An advantage of community organisations such as the Brotherhood of St Laurence and Good Shepherd playing a role is that they have much experience in understanding the plight of people on a low income and in developing solutions. They are visible and trusted by people on limited incomes. However, a challenge is that loan assessment is very different from assessment for some other services provided by a community organisation. In particular, many other services are provided on a needs basis, whereas loans should be provided according to a capacity and willingness to repay. Declining the neediest people can be difficult for many staff, but they can be trained in different approaches and most acknowledge that approving loans with low prospects of repayment is likely to cause harm in the long term to the borrower.

An advantage of bank involvement is that they have the potential to achieve participation in mainstream financial services for people living on low incomes. Banks have much larger balance sheets than any community organisation and a capacity to diversify lending risks. This is an important element in sustainability of transitional programmes aimed at assisting borrowers into the mainstream. Banks also bring expertise with the compliance requirements in relation to regulation of credit providers and the taking of deposits. Bank staff are also experienced with the principles of lending. Responsible lending and the welfare of the customer must be a priority in this market: there is a fine line between helping and harming. On the other hand, a profit rather than a welfare motive may also discourage bank staff from investing the time to understand the customer's needs and ensure the applicant recognises their rights and responsibilities. In addition, while bank staff have the strongest skills in credit analysis, they are often constrained by credit scoring models which usually exclude the microfinance target market and many staff do not have the discretion to over-ride computerised decisions. The associated bank policies may also create inflexibility, leading to staff ignoring important information that falls outside standard processes.

A key role for government in the provision of microfinance is to ensure equity of access for those on low incomes requiring microfinance. Adequate capital funding could ensure that poor households are not excluded from microfinance on the basis of their geographic location. The Governments of Western Australia and Tasmania have recognised the importance of adequate capitalisation to ensuring access.[iii] [iv]

Governments also have the key role of ensuring a regulatory environment conducive to microfinance and other financial services for people living on low incomes. Ideally, this regulation balances the fostering of social capital in community based schemes with ensuring adequate consumer protections particularly in for-profit credit provision. (We discuss some of the regulatory barriers later in the paper.) Overall, the Brotherhood of St Laurence and Good Shepherd believe that active participation is required from all three sectors (banks, community organisations, government) to ensure accessibility, equity and inclusion.

At both federal and state levels, regulatory requirements could ensure that mainstream financial institutions address issues of financial exclusion in the way they operate and in the range of products and services provided. An example of this is the $30 million community fund proposed by the Opposition as part of its last federal election policy statement. At the state level, the role of government in influencing financial institutions' approach to corporate social responsibility can be critical. An example of this is the partnerships approach of the Victorian Department of Communities where financial institutions and community organisations are encouraged to develop new responses to inclusion. These may be by promotion, sponsorship or direct funding of micro credit and other microfinance initiatives.

2.3 Barriers to the provision of microfinance in Victoria

There are barriers to the provision of microfinance across the continuum from the non-regulated charitable sector to the regulated commercial providers. Some of these barriers are detailed below.

2.3.1 Low margins and small loans

Banks are generally reluctant to lend small amounts. Part of the reason for this is the low margins in the provision of small loans. Minimum personal loan amounts range from $3000 to $5000, which is often more than people on low incomes need, and repayments for that amount may also be unaffordable based on their income and expenses. This means that if eligible, people on low incomes are encouraged to use credit cards, but this unstructured form of credit can exacerbate financial difficulties. Alternatively some people opt for the services of the fringe credit providers such as payday lenders and finance companies which can exacerbate debt-related problems (e.g. by advancing another loan to repay existing debts) and harm the financial stability of the family.

2.3.2 Regulations

Although it is often argued that information empowers consumers, we feel that existing consumer credit contracts are confusing. For the Brotherhood / Bendigo product, the personal loan contract is five pages long and uses quite technical language. In addition to the contract itself, there are three other places for the customer to sign (direct debit authorisation, etc.). There is also a long booklet on terms and conditions of the loan, which few people appear to read. The complexity of this documentation and unfamiliarity with mainstream banking processes may be contribute to financial exclusion. For the Brotherhood/Bendigo Bank loans, staff advise they spend around half an hour preparing this documentation for each customer. A considerable minority (10–20%) of our customers are semi-literate or have very limited English skills. Good Shepherd estimates that one and a half hours are required to complete the initial loans application process. We believe that the amount of paperwork brings about more confusion than empowerment. Those customers who are literate and native English speakers usually have limited education and the supported microfinance loan is often their first loan. While the Brotherhood and Good Shepherd believe that consumer protection is critical, paperwork should be simplified so that vulnerable consumers can easily understand their rights and responsibilities.

2.3.3 The current community service sector dominance of microfinance

The welfare system itself can be considered a barrier to the use of microfinance. Many people on a low income are not aware of the availability of NILS® loans through the community service sector. The difficulties of making people aware of the pilot loans programmes run by the Brotherhood of St Laurence and Good Shepherd have already been noted. Once they are engaged, loans recipients enthusiastically endorse the notion of a lending relationship based on reciprocity, trust and commitment.[v] However, many families living on low incomes do not require services from the traditional community service sector and do not use the existing microfinance options. An increased profile for microfinance developed in partnership with financial institutions, government and community services could see better targeting and improved uptake of microfinance options.

A more sophisticated understanding of microfinance options and the target population segment is required. It is important to acknowledge that microfinance is limited in the Australian context in what it can do to address the needs of destitute families and families in financial crises. The articulation of microfinance with other major systems needs to be understood. For instance ensuring adequate income to live with dignity is a function of federal government through the social security system. At the state level, the importance of government concessions for families living on low incomes needs to be recognised as does the regulation and pricing of both government and commercial sector goods and services.[vi]

Financial stabilisation is necessary before families can utilise microfinance options to secure basic family assets and before they can utilise microfinance options to secure protection against future financial stress. The expansion of financial counselling services in Victoria is important to this end. It is pleasing that the recent Review of Hardship Provision in utilities has investigated expansion of financial counselling services to ensure geographic coverage of Victoria and to reduce the long waiting lists for people in crisis.

2.3.4 Computerised assessment of capacity to repay

Improved technology has brought about improved efficiencies, but also an impersonal and inflexible service, whereby people such as low-income consumers, who do not fit computerised models, are denied access to services. For instance, the credit scoring models used by banks and the accompanying policies are unable to recognise the complex needs of people on a low income. As a result, they generally exclude these people due to the models' assumptions about capacity to repay loans. For instance, standard loan calculators that assess affordability based on income bracket, number of dependent children, marital status and car ownership status, calculate a level of expenditure that is generally higher than Centrelink income. These calculators thus usually assess that people on low incomes cannot afford loan repayments regardless of the individual's actual expenditure, capacity to budget and commitment to repaying a loan. The recent development of the Step Up Loan by Good Shepherd and the National Bank has demonstrated that the existing financial services processes can be sensitised to take adequate account of the capacity of people living on low incomes to repay a loan and to ensure that they are not automatically excluded. The bank has ensured it can undertake this assessment by centralising management of the Step Up Loans Programme processes.

2.3.5 Credit records

A common difficulty in expanding microfinance programmes is adverse credit records. Workers in existing microfinance programmes need to do considerable work to ensure that issues arising from credit records are dealt with preparatory to applications for a micro credit loan. About half of the people on low incomes that inquire about our programmes have items on their credit records. Most credit scoring systems lead to an automatic decline if there is an item on a credit record regardless of the amount, whether the item has been subsequently repaid, or whether the applicant can demonstrate their circumstances have changed. Common items include unpaid mobile phone contracts and utility bills.

The Brotherhood of St. Laurence and Good Shepherd are cautious about the current lobbying by existing credit reporting providers to move to a model of positive credit reporting (that is providing access to records of payments as well as failures to pay). We think that the flaws in the existing system (including the difficulty of correcting errors) need to be addressed before adding complexity to the credit reporting system.

2.4 Government facilitation of the provision of microfinance

2.4.1 Funding

Funding for capital preservation in microfinance has been identified as a key action for government. This would be consistent with the Victorian Government's broad policy agenda 'Growing Victoria Together'[vii] and the recent social policy statement 'Addressing Disadvantage in Victoria'.[viii] The NILS® network in Victoria is the most highly developed microfinance option. Further capitalisation with modest recurrent operational support would enable statewide coverage as well as recapitalisation of existing programmes which have slowly run down over the years.

Consumer Affairs supported the operating costs for loans programmes up to the early 1990s. We feel microfinance fits in with the spirit of the Consumer Credit Fund. Given there are considerable funds available, we feel low income earners could benefit through better development of microfinance services. Options which could be developed through the Fund include provision of loan capital, operating expenses and the piloting of financial literacy training for people living on very low incomes.

2.4.2 Disclosure and regulations

Consumer Affairs should be encouraged to review disclosure regulations to ensure clear language is used so that consumers are protected but are also able to understand their rights and responsibilities in signing a contract. As discussed previously, we consider the amount of paperwork needed for one loan is a barrier to sustainability and does little to enhance customers' understanding of rights and responsibilities.

2.4.3 Credit unions

The credit union movement previously played a key role in the provision of appropriate financial services to low income earners. However, there are now only a few credit unions in Australia that providing microfinance as understood in this submission. These include the Fitzroy Carlton Community Credit Cooperative, Maleny Credit Union[ix], First Nations Credit Union and Traditional Credit Union. We believe Government should to encourage the revitalisation of credit unions' original mission, given the powerful nature of mutual help.
While regulation of credit unions may have brought some benefits in increased consistency and prudential safety, we believe it has resulted in a drift away from the movement's traditional ethos

of mutual help. This has reduced the opportunities for people on low incomes to participate in the market for financial services. Currently, problems for credit unions providing microfinance services include a reliance on volunteers due to the high transactional costs and the low income earned from small loans. Therefore, there is a considerable burden for the few paid staff in complying with regulations. Many credit union staff consider that structured loans with principal and interest payments are best for their customers' welfare and continue to provide these, despite the administrative burden. Most credit unions do not provide credit cards, despite low-limit cards being an option sought by people living on low incomes[x] and despite the fact that the preparation of one contract only for the life of the credit card is less work than a structured personal loan with interest and principal payments.

In addition, many of these credit unions do not break even by providing microfinance. Fee and interest income is inadequate given the low value of loans. They are also unable to achieve economies of scale. As a result, microfinance services need to be subsidised through grants and other activities. The Fitzroy Carlton Community Credit Cooperative subsidises its operational costs through the provision of bookkeeping services to local community groups and deposits from local community groups at low interest rates, reinvested in higher yielding accounts.[xi] The Brotherhood of St Laurence also provides an annual grant for operating expenses. The Traditional Credit Union has been supported by ATSIC, Northern Territory Government, the Australian Government, Rural Transaction Centre funding and assistance from Westpac for marketing and training strategies.

The Brotherhood and Good Shepherd believe that governments must look at ways of reinvigorating the traditional goals of the credit union movement. This may be achieved by providing additional tax breaks for credit unions demonstrating commitment to services for people living on low incomes, in combination with regulatory breaks around certain financial services and products.

2.4.4 Community Reinvestment Act

In the United States, the Community Reinvestment Act of 1977 (CRA) encourages banks to meet the credit needs of the communities which they serve. Regulators consider a bank's CRA record in determining whether to approve a merger application, allow the institution to engage in newly authorised financial activities (such as insurance) or open or close a branch.

The US Government has a formula for rating banks' performance under CRA. This is mainly based on the number and amount of loans to low-income borrowers, as well as banks' investment and availability of retail banking services in low-income communities. Given that Australian banks currently undertake self-reporting of community programs, similar clear and consistent benchmarks may better assist in comparing servicing and evaluating impact.

There has been considerable debate in the United States about the effectiveness of the CRA.[xii.] Critics argue that it is trying to address a non-existent problem, and that even if intervention was warranted, the CRA is an inappropriate tool. They also suggest that CRA is having little if any benefit, at a high cost.

In contrast, there are many others that argue that CRA has had a significant impact on the financial well-being of low income communities. By fostering competition amongst banks in low-income communities, CRA generates larger volumes of lending from diverse sources and adds liquidity to the market. Banks have developed expertise in serving low-income communities. Many have created departments focusing on lending to people with low incomes. Others have partnered with community organisations that provide expertise, financial education and assume portions of risk that banks do not want to bear. Supporters argue there has increased lending in low income communities and it has not led to the kind or the extent of unprofitable, excessively risky activity predicted by critics.

While there are some important lessons for us from the CRA, the Australian financial sector is very different from that in the United States. Whereas there are smaller, state-based banks in the United

States, the Australian market is dominated by the four major banks. In addition, the threat of mergers being denied is considerably weaker in Australia, given the current 'four pillars policy'. Despite this, we do feel there is currently minimal competition amongst banks in servicing low-income Australians and legislation similar to the CRA could assist in changing this. We believe the philosophy of the CRA is important, as it recognises that banks have a broader purpose than just making profits for shareholders, that they have a social responsibility and that financial services are vital for all citizens.

Implementing similar legislation in Australia would not necessarily be straightforward or the most appropriate solution. For example, anecdotal evidence from the USA experience suggests that investment has focused on redlining on a geographical basis. Given that many areas in Victoria, for instance Melbourne's inner suburbs, are a mixture of high and low incomes, this could result in little net improvement in ensuring access to equitable financial services. We would suggest assessment be based on the number of low income people serviced and the range and equity of services offered, rather than servicing in a particular geographical area.

Moreover, there have been changes to the US financial system since the CRA was introduced. In particular, the CRA emphasises branch-based deposit gathering for home lending. As new home lending products have emerged and global capital markets have replaced individual depositors as a source of lending funds, the scope of the CRA has been eroded. Today less than 30 per cent of home loans are subject to intensive review under CRA.[xiii] In Australia the financial services industry is also experiencing tremendous change, related to technology, globalisation, and competition from non-bank lenders. Any legislation similar to CRA would need to be flexible enough to respond to industry change.

While we believe that self-regulation around social investment is preferable to government intervention. it does not always ensure consistency or indeed access for the most marginalised consumers. We consider it is positive that ANZ Bank, National Australia Bank and Bendigo Bank have all been willing to experiment in the area of microfinance without government intervention and believe this is a better solution for innovation and development than compulsion. An approach of using the 'carrot' rather than the 'stick' is preferable in encouraging banks to undertake new ways of social investment.

We recommend additional research be undertaken to better understand how the government can encourage banks to further improve services to people on low incomes and to investigate ways of ensuring equity of access for those needing financial services.

2.4.5 Credit reporting system

Given the extension of the credit reporting system to utility companies, mobile phone providers and other organisations, about half of the people enquiring about our microfinance programmes have items on their credit records. Some items, however, do not necessarily indicate lack of creditworthiness. For instance, the Brotherhood of St Laurence and Good Shepherd consider it is unclear to customers that an unpaid utility bill would be listed on their credit record. Furthermore, it appears that some utility companies often choose to write off unpaid bills and list them on credit records rather than incur the cost involved in collections of small amounts. However, this lack of follow up may be harmful and unfair to the customer. We believe the government should consider reforming the credit reporting system so it is a better indicator of creditworthiness. Suggested reforms include a higher threshold for listing unpaid bills (say minimum of $500); requiring utility companies to disclose to customers at the outset that unpaid bills could be listed on their credit records; and requiring utility companies to undertake more follow-up of payment prior to listing items on a credit record. Utility companies in Victoria now have well developed hardship processes to ensure consumers do not fall though the safety net protections. They should be required to demonstrate that these have been complied with before listing the debt. This could be extended to other companies such as banks which are considered an essential service.

The Brotherhood and Good Shepherd reiterate our concern with the current proposal for positive credit reporting. We have found many inaccuracies, inconsistencies and injustices for clients under the current system. The difficulty of ensuring adequate knowledge about the system and the means of rectification do not appear to be addressed by a shift to positive credit reporting.

2.4.6 The need to make a satisfactory assessment of capacity to repay

The Brotherhood of St. Laurence and Good Shepherd are very concerned about unsolicited offers of credit cards and extension of credit limits based only on customer selection. It is our experience that consumers prioritise payments of the monthly minimum limit on their credit card over other household payments because the credit is a lifeline to 'making ends meet' in the short term. While the major banking institutions report a default rate of less than 1% on credit cards, the reality for financial counsellors is that the financial difficulties of many consumers are exacerbated when additional offers of credit are made based simply on the payments history. We therefore support action by the Victorian Government in legislating to ensure that lenders carry out 'a satisfactory assessment process'.

The Brotherhood and Good Shepherd support the introduction of legislation similar to that of the ACT to encourage satisfactory assessment of the capacity to repay in extension of credit or credit card offers.

2.5 The need to further assist consumer decision making

2.5.1 Need to assist in consumer decision making

There is a need to further assist consumer decision making, but this is a complex task. While research indicates that low levels of financial literacy are prevalent amongst people of low socioeconomic status, the low financial literacy may be a result of a range of other related social factors. These factors include family breakdown and a lack of role models for managing money well, or resolving household disputes over money. Unemployment is another significant problem, as it is difficult for people on low-incomes to access financial services. Other factors such as drug addiction, consumerism and gambling reflect much greater social problems than a lack of education about money management. People may also be capable of managing their finances, but arrears or other financial problems may be due to inadequate income. A BSL client supported this: 'I've tried financial counselling, I've tried a budgeter, it's the lack of money that's the problem'. These experiences suggest that poor consumer decisions are due to a range of factors, and that while education can play a role in combating these, the wider social factors need to be taken into account.

Financial literacy strategies need to be relevant and take into account the social issues affecting people's choices and decision making. People's general approaches to life have a significant impact on consumer decision making. Kliger (2004) sets out three interacting factors that drive the use of credit. These are Identity and Society (a society with a collective ideal that links personal well-being to consumption and possession of material goods), Personal Attributes and Credit Industry Practices.[xiv] The Brotherhood and Good Shepherd believe that greater targeting of financial literacy strategies is needed to take into account the links between human behaviour and consumer and financial literacy and the different personal characteristics of people in the community. Thus, special programmes for women who are supporting parents or recently exiting prison require a different approach from general community education strategies.

Despite difficulties in understanding consumer decision making, we still feel this is important as adverse decisions are more acutely felt by people on a low income. For instance, many people do not have a network of friends and family to help out in a difficult time, they may struggle to find alternative employment if a job is lost and they are unlikely to have a buffer of savings or income from assets to fall back on. One Brotherhood client recently commented, 'I get it [money] in my hand and it's gone after rent and food', supporting the view that people on low-incomes are on such a tight budget that they are vulnerable if there is an unexpected expense or loss in income. In the event of a car accident, illness, relationship breakdown or unemployment, people on a low income may be unable to cope with this shock to their household budget. For instance, relationship breakdown often results in people being unable to pay rent expense or bills, which can cause a downward spiral in falling into arrears and unpaid bills being listed on a credit record. A client recently advised she understood the implications of going bankrupt due to unpaid debt from a previous relationship, but felt she had no other option as she could not afford repayments. Overall, it is important to consider the vulnerability of people on a low-income and the role financial services can play in managing this. Financial literacy training or advice, coupled with improved access to savings, credit and insurance products could have a powerful impact on reducing vulnerability, especially if the training and advice is developed by consumers themselves based on their lived experience of what is important to financial participation in the community.

2.5.2 Assisting consumer decision making

While we argue that decisions are not only a product of consumer skills, but a more complex range of emotions and individuals' previous life events, improved education is still important. Maths and literacy are critical areas. We also believe that planning and budgeting are important, however these skills are not easily taught and are more likely to be developed by trial and error or exposure to a parent's money management strategies. This view is supported by a Brotherhood client who had declared bankruptcy and felt part of the reason was that her mother died when she was aged twelve and that no-body else taught her to be careful with money. This experience demonstrates that it is difficult for some people to develop money management skills without exposure to a parent or mentor. Another client supports this, commenting 'My kids are used to getting what is given so they are appreciative when they get new things', suggesting that the children may also grow up to appreciate the importance of living to a budget. These views suggest a parent or other mentor could play a significant role in building capacity to develop good consumer and financial skills. All skills could be benchmarked over time in a similar way to ANZ's study of financial literacy, but solutions to poor budgeting and planning may be complex.

Good quality advice can also promote better decision making. However, we believe there is a lack of access to proactive financial advice for people on low incomes. They are not a target group for bank financial advisers and people seem to consult other financial counselling services mainly when they are being pursued by debt collectors, considering filing for bankruptcy, or facing some other form of financial crisis. While many people on low incomes have strong skills in budgeting for day-to-day expenses, they have difficulties in engaging in more sophisticated financial activity. Re-introducing banking through schools and building familiarity with key financial concepts at an early age could thereby promote greater financial participation.

It is important to develop appropriate channels for improving decision making. The Brotherhood of St Laurence and Good Shepherd believe that low-income consumers mistrust many information sources. This means people accept information from friends or family members who are trusted, but not necessarily expert in dealing with financial matters. In preparing our financial literacy course, the Brotherhood obtained feedback that supports this – people stated they 'don't want to hear from so called 'experts' or people in ties and suits, want real people who we relate to their situation, who are independent, neutral, able to listen.' This suggest that whilst it is important for formal information providers to clearly explain terms and conditions, many of the most disadvantaged consumers will fall through the gaps if this is the primary means of communication.

It would be useful to increase parents' awareness of ways that they can assist their children to develop good habits, for instance through managing pocket money. However, many people have not had proper role models to assist them through difficult financial decisions and it would be important that unbiased and trustworthy mentors or coaches are available for advice at these times.

The Brotherhood and Good Shepherd also believe that the teaching of financial concepts is important in a school environment and can build greater awareness and confidence with finances later in life. Recent Victorian Government initiatives in consumer education are to be applauded. Yet, there is the difficulty of an already overcrowded curriculum. We would thus support consumer and financial literacy being allocated to existing subjects, such as English and maths. However, there should be acknowledgement that for some people, school is not a successful learning experience. Many people fall through the gaps at school and leave early with sometimes poor literacy. Therefore, the Brotherhood and Good Shepherd would support introducing consumer and financial issues in schools, but not solely relying on this avenue.

Centrelink may not be an appropriate body for information to be channelled to people on low incomes, as many of these people do not trust Centrelink. Many find their experience with Centrelink degrading and try to minimise their dealings with the agency.

2.6 Access to credit

We believe that undue emphasis on low income consumers who have difficulties with repayments serves to disadvantage all on low incomes. Attention needs to be paid to people who are unable to access appropriate banking services, but are managing their money well.

2.6.1 Indebtedness of low income earners

The following provides an overview of the experiences of low income people’s experiences and management of credit. The data used comes from the Household, Income and Labour Dynamics in Australia (HILDA) survey, a nationally representative survey of Australian households occupying private dwellings. The 2002 survey included the topic of household wealth and provides information on asset and debt levels of households. The analysis has been conducted by the Brotherhood of St Laurence.

In the following discussion, low-income individuals include the population of people with household income per equivalent adult in the bottom income quintile. Differences in needs across households of different sizes and composition are accounted for. Of the total population estimate of 15,325,803 people aged 15 years plus, 2,941,273 people are estimated to be in the bottom income quintile and thus comprise our low-income group.

As Table 1 shows, Compared with all other income brackets, those on low incomes are least likely to have a credit card, with 38% of people surveyed indicating ownership. There is a marked jump to 50% of people having a credit card in the second lowest income group. Part of the reason for this difference may relate to banks’ reluctance to lend to people on Centrelink benefits and the second lowest income group may be more representative of people on low wages. Another reason is that the lowest income quintile has a large representation of older people who are less likely to have credit cards in general. A similar pattern is evident for those with personal loans: only 13% in the lowest income group had a personal loan compared with the overall average of 22%.

Table 1 Percentage of people with a credit card or personal loan, by income group

Income group	With credit card or personal loan	With credit card	With personal loan
Bottom 20% (lowest income)	44.0	37.6	13.0
Quintile 2	57.2	49.6	18.2
Quintile 3	67.0	59.1	24.0
Quintile 4	73.6	66.5	28.1
Top 20% (highest income)	78.5	73.9	26.8
All	64.5	57.8	22.2

Note – the personal loan category includes car loans, overdraft, hire purchase as well as personal loans.
Data source: HILDA survey 2002

Thus while commentators may be correct in expressing concern about certain individuals' overuse of credit cards, this is not uniform across the community. HILDA data shows that people on higher incomes are more likely to use credit cards and personal loans, while the majority of people on low incomes do not use credit. Further research is required to understand the nature of risk for those people living on low incomes who do have substantial debt.

2.6.2 Outstanding balance on credit cards and personal loans

Perhaps of more significance is the outstanding balance on people's credit cards and personal loans, shown in Table 2. The average credit card balance for low income earners is $304, compared with an average of $544. The average debt from a personal loan was $1,599 for the lowest income group compared with an average of $4,142. As noted above the lower income groups are less likely to have credit cards or personal loans, and thus less likely to incur debt from these credit products.

Table 2 Outstanding balance on various debts, by income group

	Average credit card debt	Average debt from personal loan	Average combined debt	Average combined debt (those with debt)
Bottom 20%, (lowest income)	$304	$1,599	$1,903	$8,201
Quintile 2	$436	$1,989	$2,425	$7,841
Quintile 3	$550	$3,902	$4,452	$11,541
Quintile 4	$669	$4,011	$4,680	$11,280
Top 20% (highest income)	$731	$8,744	$9,475	$24,497
All	$544	$4,142	$4,685	$13,481

We consider that these average figures of debt are manageable for many low income earners. However, there are clearly some people in the low income group (as in other groups) that are over-committed. Indeed, the average level of credit card and personal loan debt for only those people in the bottom quintile that reported outstanding debt is $8,201, still lower than the overall average but relatively closer to the higher income quintile debts.

So for those low-income people who do have debt from credit cards and personal loans, this debt does seem to be quite high. This cannot be ignored. However, it is important to consider that those people on low incomes who appear to be overcommitted and possibly experiencing financial difficulties may not be representative of an entire income group.

As Table 3 shows, 55% of the lowest income group with a credit card pay off their credit card every month 'always or almost always'. This proportion falls to the middle income group (Quintile 3) and then rises again for higher income quintiles. However, there are also a relatively high proportion of those in the low income group who pay off their credit card monthly 'hardly ever or never' or 'not very often' (32.5% compared with an overall average of 27.8%). This is a group that we should be concerned by, but we should also consider the needs of others on low incomes. Measures such as a health check on credit card statements, less automatic limit increases and proactive financial education could assist in this area of reducing the risk of overcommitment.

Table 3 Payment patterns for those with credit cards, by income group

Percentage of credit card holders who pay off debt monthly				
Income group	**Always or almost always**	**Most months**	**About half of the time'**	**Hardly ever or never, or not very often**
Bottom 20% (lowest income)	55.3	7.7	4.5	32.5
Quintile 2	53.6	9.2	6.1	31.0
Quintile 3	51.0	9.2	6.9	32.9
Quintile 4	54.0	11.2	7.9	26.9
Top 20% (highest income)	61.7	11.1	6.7	20.6
All	55.6	10.0	6.6	27.8

It should be noted that this data is self-reported and there may be a difference between a philosophy of paying off a credit card each month and actual practice. It is felt that this may lead to an over-estimation of the proportion of the time that a credit card balance is paid off in full.

2.6.3 Respecting cultural differences

The Brotherhood of St Laurence discussed access to credit with a group of Islamic women from the Horn of Africa. Few of the women had loans and they attributed this to concerns about interest as well as being on a low income. They noted that the Arabic word for interest is 'riba', which literally means charging more than needs to be charged. They advised the notion of being over-charged is part of the difficulty that Islamic people have in paying interest. They believe that when a profit is earned, some should be given to people on low incomes. However, many women said they would be willing to pay for a service and understood the concept of a bank needing to cover expenses. These women felt their inability to access credit keeps them from improving themselves. Without credit, they are unable to easily purchase, for instance, a new sewing machine to develop a livelihood, or larger items such as a car or a house.

However, they had developed some other creative solutions. A group of women were saving together and then lending money to each in turn. It had been suggested that a $10 membership fee be charged each year although there had been some debate over whether this was 'haram' (not accepted). One woman also had a loan with an Islamic bank. She had purchased a car for $14,000 and the loan was for $17, 000 which included a fee. Other women took advantage of the interest-free $500 Centrelink advance available once a year.

There are also barriers for Indigenous people in accessing credit. In remote areas, difficulties include lack of branch access and acceptable identification. Another barrier is the cultural practice that encourages sharing money amongst all community members. This means that it is socially awkward to save if another community member needs money. Anecdotal evidence also suggests that a high proportion of Indigenous people have items on their credit records, particularly unpaid bills due to moving house regularly and not paying the final bill. Furthermore, repayment rates can be compromised if Indigenous customers consider funds to be 'whitefellas' money' and this can then reduce commitment to repaying.

3 Conclusion

While we acknowledge that inappropriate finance can perpetuate poverty, we believe that when provided in a responsible manner, access to equitable financial services can also assist in alleviating poverty. Although there are many challenges involved in the provision of microfinance, including micro credit, it is still considered important and possible. The considerable returns for society in promoting microfinance include:

- reduced use of emergency relief through appropriate financial tools to assist people reduce their vulnerability
- reduced hardship and family stress
- addressing the problem of asset-based poverty and promoting wealth creation through appropriate financial services

and

- creating a solution to exploitation by fringe lenders.

While asserting the value of microfinance, we acknowledge that indebtedness is a serious problem for some people on low incomes. In this connection, we see a key role for organisations like the Consumer Law Centre of Victoria, the Consumer Credit Legal Service and the Financial and Consumer Rights Council, which have expertise in protecting consumer rights.

The Brotherhood of St Laurence and Good Shepherd appreciate Consumer Affairs interest in microfinance. We also welcome the commitment of National Australia Bank, Bendigo Bank and ANZ to working in this area.

Endnotes

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