Brotherhood of St Laurence

Working for an Australia free of poverty

Response to Community Development Finance in Australia – A Discussion Paper

Provided to ANZ

July 2004

Introduction

The Brotherhood of St Laurence welcomes the ANZ's interest in Community Development Finance in Australia. We have endeavoured to respond to issues raised, however believe programs need to be tested and evaluated for a more thorough understanding of customers' needs and their barriers to accessing CDF. The Brotherhood of St Laurence would welcome the opportunity to work with ANZ to further develop an understanding of this sector.

The Brotherhood of St Laurence was established during the Great Depression and has experience across a broad range of services. 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 programs and carrying out research and advocacy for change in service and government policies.

The Brotherhood values the partnership with ANZ in the provision of Saver Plus. We also operate a range of other community development finance programs. These are detailed as follows:

- Interest Free Loan program – The Brotherhood provides loans of up to $1,000 for household goods to people on low incomes.
- 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. The program was developed in response to the limited sustainability of earlier interest-free loans programs. Access to the mainstream financial sector is also considered an important aspect of social inclusion and economic development.
- 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 a non-English speaking background. The Brotherhood of St Laurence and Fitzroy Carlton Community Credit Cooperative provide loans of around $2,000 to small businesses to promote employment.

We would be happy to further share specific details and lessons regarding the above programs.

1. WHAT IS THE NEED IN AUSTRALIA?

ANZ seeks comment on the extent of the problem of 'underbanking' or financial exclusion in Australia. In particular, which groups in the community are most affected by this problem? What are the main causes of the problem?

Overall, the Brotherhood believes further research is needed to understand the extent of financial exclusion in Australia. However, we generally find people on low incomes have difficulty accessing mainstream finance for the following reasons:

- Loan calculators that assess affordability based on factors such as 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 capacity to budget and commitment to repaying a loan.
- Banks are generally reluctant to lend small amounts. Minimum personal loan amounts range from $3K - $5K, 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, which due to their unstructured nature can exacerbate financial difficulties.
- About 50% of the people on low incomes that inquire about our programs 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 if the applicant can demonstrate their circumstances have changed. Common items include:
    - Mobile phone contracts - often due to misinterpretation of the contract and not understanding that the plan needs to be paid out if terminated early.
    - Unpaid bills - usually when they have left a residence and not understood it is their responsibility to provide a forwarding address for bills.
    - Unpaid credit cards - particularly if a former partner was issued a subsidiary card.
    - Personal loans from finance companies such as GE - Common reasons for having accessed credit and being unable to repay it are loss of income through unemployment or illness or shock to household budget through relationship breakdown.
- Many people on low incomes have self-selected out of mainstream banking. Much of this results from their belief that banks do not want to deal with people receiving Centrelink payments. A participant from Brotherhood research supported this, saying "When I go into a bank I sense the feeling of 'what are *you* doing here?' "

We find that many small businesses have difficulty accessing mainstream finance for the following reasons:

- Banks generally do not lend to small business owners without collateral, which eliminates many potentially reliable customers who do not come from a wealthy background. It also reduces the credit analysis needed so that one bank employee can manage many more small business customers.
- Banks are also unwilling to lend less than around $10-$50K for businesses, which is greater than the need of many small businesses, and beyond their repayment capacity over the short term.
- Banks also require audited accounts and a track record of at least 2 years. Many small business owners would not consider obtaining the services of an auditor and do not keep formal accounts.
- Many small business owners have self-selected out of mainstream banking. Much of this results from their belief that banks do not want to deal with businesses of their size or type.

Is this a problem for most people on low incomes or is it concentrated amongst some groups in particular, such as women, people with disabilities and people from Non English Speaking Backgrounds? Is it especially a problem in particular areas or communities?

About 80%-90% of inquiries for our loan programs are from women, mainly sole parents. This may indicate higher need amongst women and be representative of poverty amongst sole parents. Alternatively, it may suggest that women are more comfortable contacting community organisations, that our promotional material appeals more to women, or that women take more responsibility over financial matters. About 20%-30% of people applying for our personal loans programs were born overseas, compared to the Melbourne average of 6% in the 2001 census, which suggests access to banking services could be a particular problem for people from a non-English speaking background.

There is a more even gender balance for people inquiring about our small business loan program. People from a non-English speaking background are considered a good prospect for small business creation, as many have skills and experience from their home country, as well as a niche market amongst their immigrant community. However, they may experience barriers in accessing credit or obtaining employment, due to difficulties such as poor English or discrimination.

There are also barriers for Indigenous people in accessing banking services. In remote areas, difficulties include lack of branch access and acceptable identification. Another barrier is the cultural practise 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, quality of repayment rates can be compromised if Indigenous customers consider funds to be "whitefellas money" and this can then reduce commitment to repaying.

ANZ seeks comment on which aspects of 'underbanking' are most prevalent: lack of access to credit, financial advice, insurance, savings products?

Lack of access to credit is prevalent and discussed as follows:

- Credit card use does not seem as common amongst people on low incomes, as with the rest of the community. Whilst the ANZ survey of financial literacy showed about 64% of Australians used credit cards, our estimation is that only about 20%-40% of people on low incomes use credit cards, depending on access to paid employment. Many people trying to manage on a tight budget are cautious of incurring debt. Some see their income as unlikely to increase and thus repayments must come from the same low income. In addition, many would not qualify for credit cards.
- Based on our experience, it seems that people on a low income would be about 2-3 times more likely to approach family and friends, a community organisation, Centrelink or a fringe lender, than a bank if they were in need of funds. This is probably due to their expectations of rejection from a bank, as well as reluctance to incur debt that they may not be able to repay. Depending on the amount required, it seems that the most common strategies would be to cut down on expenditure or go without the proposed purchase, rather than take out a loan. However, for some items, like a washing machine, people realise it is cheaper in the long term to repay a loan, rather than rent or visit a Laundromat. In addition to this, many customers believe that saving for the loan amount is not a viable option for them, given the lack of discretionary income on pensions or benefits. As a result, they see loan repayments as forced saving and the best way to manage the necessary sacrifice of some area of personal expense.
- There is a lack of access to credit from banks amongst people on low incomes, however some use organisations such as GE Finance or City Finance. These organisations have marketed in a way that addresses some of the concerns and difficulties experienced by people on low incomes in accessing banking services.

There is a lack of access to proactive financial advice for people on low incomes. They are not a target group for bank employed financial advisers and although financial counselling services exist, people seem to use them when they are being pursued by debt collectors, considering filing for bankruptcy, or in some other form of financial crisis. Whilst many people on low incomes have strong skills in budgeting to ensure they can pay for day to day expenses, they have difficulties in engaging in more sophisticated financial activity. Re-introducing banking through schools and building familiarity with these concepts at an early age could thereby promote greater financial awareness.

Whilst ANZ's survey of financial literacy found that 80% of all adults used car insurance, based on our experiences, only about 30% of people on low incomes insure their cars. Part of the reason may be the expense of the insurance premium; that insurance products are not payable on a fortnightly basis (which would best coincide with pension payments); or that the excess is so expensive that it would be considered almost as unmanageable as the loss of the car. Another reason may be a tendency to live on a day to day basis and not consider longer term risks. We are unsure of the gaps in the market for insurance to business, as we target participants in the government funded New Enterprise Incentive Scheme whereby insurance is compulsory to obtain the allowance. However, a difficulty of insurance for businesses is that premiums are often not tailored to match cashflow movements and participants thus find it difficult to obtain the lump sum required for an annual insurance premium.

Although most people on low incomes receive their pension payment electronically and thus have a bank account, few seem to use these accounts to assist in budgeting, saving or creating their own safety net. Most people on low incomes seem to withdraw all their income every pay period. Part of the reason for this is many bank accounts are structured so that fees penalise several small withdrawals. Whilst another reason could be that the pension is insufficient to cover daily expenses, it is considered some would appreciate the value of savings and thus be willing to make some sacrifices if an account was well structured for their needs and risks. A split account structure could assist people in better managing their finances. If there were sub accounts for rent, bills, a longer-term savings goal and daily expenses, people would have a better capacity to reduce their vulnerability.

2. WHAT CAN WE LEARN FROM OVERSEAS?

ANZ seeks comment on which features of CDF programs in other countries are likely to be most readily applicable in Australia.

Group lending is one of the most distinctive features of programs overseas. The rationale for this is that:

- It reduces the analysis needed for a credit decision, as lenders assume people would only be a guarantor for a business they consider viable.
- Other group members can provide support in difficult times.
- Agreeing to a cross guarantee could be considered to be "emotional collateral", whereby the borrower feels there is a lot to loose in terms of reputation and relationships if they default, as well as the notion of dishonouring a contract.
- It results in a diversified risk pool.

Whilst group lending may not be replicable in Australia, lenders should consider some of the above features. For instance, for business customers a lender could seek references from suppliers, landlords and customers to reduce the need for analysis. Mentoring services could also be developed for support in difficult times. Banks already create an emotional link to loans by endeavouring to take a personal guarantee from company directors. Credit unions create this emotional link by emphasising that loan funds are the savings of other members and repayment will ensure funds can be lent out to others in need.

Interest rates are priced to reflect the risk of default in most developing country CDF programs. Many studies suggest that low income borrows have an inelastic demand for loans: that is, the price of the loan (interest charged) has little or no effect on their demand for this service. This view has also been supported to some extent in Australian studies. A survey undertaken by the Brotherhood of St Laurence in "Credit to the Community" found that twice the number of respondents were concerned with issues of access to loans than were with the price of the loans. The existence of payday lenders and pawnbrokers also suggests that there is still a demand for loans at a high price. The Brotherhood of St Laurence believes there is a place for people to make some contribution to the risk of default, but this needs to be balanced with affordability and reputation. In terms of reputation, it is difficult to price interest to cover the risk of default, as many government bureaucrats, consumer and welfare advocates believe people on low incomes should not pay high interest rates.

Whilst it could be argued the market for CDF services is narrow, the impact of strategies for targeting and promotion should also be considered. We believe the question of a genuine need for these services in developed countries has not yet been fully explored. Some statistics of businesses and individuals often financially excluded are as follows:

- Australian Bureau of Statistics (2000-2001) showed small businesses account for 97% of all businesses and 46% of employees in Australia (whereby small businesses are defined as those with less than 20 employees). The CPA Microbusiness Study (1999) showed that 66% of small businesses use their own savings and 48% of respondents advised set-up costs were less than $5000. Whilst it is acknowledged that small business lending is risky, these figures suggest there could be a considerable volume of small businesses to be able to access mainstream banking services, but with a demand for these services.

- ABS data shows that the proportion of people of workforce-age receiving income support was 21% in 1999. Many of these people would be able to access banking services if they also worked casually. Others may not be able or willing to service a loan. However, there is still a high proportion of Australia's population that could be excluded due to their low income who could be a reasonable credit risk. The prevalence of pawn brokers and pay day lenders also indicates a demand for credit amongst people on low incomes.

Because CDF services are unique and marketing budgets are often small, standard principals for businesses, such as market research and product development are often ignored in the provision of CDF. This could be part of the reason for low volumes overseas. Processes can be viewed by customers as intrusive and more like those pertaining to welfare services than a banking relationship. Products developed can often end up looking more like what staff in a head office think people need, rather than the views of the customers themselves. This may result in people who would have initially asked for a grant rather than a loan inquiring and the most appropriate customers either not knowing about the service, or feeling too embarrassed to apply. If an organisation such as ANZ was involved, and there was access to professional market research, existing knowledge on appropriate processes and product design, a broad branch network and well-established branding, demand could be stimulated to a greater extent than the examples given in the discussion paper.

Conversely, which features of CDF programs in other countries will be least applicable?

There could be regulatory and ethical issues in taking a cross guarantee, particularly as a default would be listed on a guarantor's credit record. In addition, the guarantor would need to prove a capacity to repay, but few people on low incomes would have networks of friends or family with the capacity to be guarantor. Calmeadow in Canada trialled a group lending scheme and results indicated it was difficult for customers to find other people willing to participate in a cross guarantee. Street UK also found the cross guarantee structure failed to diversify risk as people facing similar risks (such as market stall holders) tended to group together.

There is strong emphasis on lending for small business creation in developing countries. However, given the provision of pensions and benefits from the government in Australia, everyone has an income and self employment is not the only option. Therefore, other services such as personal loans, advice, saving and insurance should also be considered.

3. WHICH ORGANISATIONS CAN PLAY A ROLE?

ANZ seeks comment on the appropriate roles of business, community organisations and government in the development of CDF programs. Who is best placed to assess the needs of low-income communities and low-income individuals or families, for CDF?

It is difficult to make a firm statement about appropriate roles for each of business, community organisations and government. There are strengths and weaknesses in each organisation.

An advantage of community organisations playing a role is that they have much experience in understanding the plight of people on a low income and solutions to problems. Community organisations are visible and trusted in this sector of the community. The Brotherhood's research, "Credit to the Community", also indicated that customers felt community organisations provided a more personalised or appropriate service. However, a challenge is that loan assessment is very different to 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 based on a capacity and willingness to repay. Declining the neediest people can be difficult for many people, including community workers. Despite this, staff can be trained in different processes and most would be capable of seeing the harm over the long term of approving loans with low prospects of repayment.

An advantage of bank involvement is that they have much larger balance sheets than any community organisation and a capacity to diversify lending risks. Bank staff are also experienced with the principals of lending, saving and provision of advice. However, it could be a disadvantage that many front-line bank employees are incentivised by profits, as this could skew motives in dealing with CDF customers. Responsible lending and the welfare of the customer must be a priority in this market and there is a fine line between helping and harming these people. A profit motive may also discourage bank staff from investing the time needed to understand the customers' needs and ensure the applicant recognises their rights and responsibilities. In addition, whilst bank staff would be considered to have the strongest skills in credit analysis, they are often constrained by credit scoring models. These models usually exclude the CDF target market and many bank staff do not have the discretion to over-ride computerised decisions. The policies that accompany these models can also create inflexibility which potentially leads to staff ignoring important information that falls outside of standard processes.

The government could analyse needs of communities on a macro basis. They could also oversee efforts of community groups and banks and create a conducive regulatory environment for CDF. Overall, the Brotherhood of St Laurence believes participation would be required from all three sectors.

Who is best placed to be the point of contact for people in need of CDF?

Given that many people on low incomes have self selected out of mainstream banking services, it could be difficult for a bank to publicise CDF. Despite this, banks have access to a large CDF customer group through their existing base of customers with transactional accounts. Bank systems would be able to identify customers receiving pensions or running a small business and standard targeting strategies such as mail-outs could be considered.

Many people on low incomes do not use welfare services as they find it embarrassing or stigmatising. These people are often those most likely to benefit from CDF. However, it is considered that community groups have a significant level of goodwill which is important for building trust from the CDF customer group. Other non-welfare organisations such as sporting clubs and schools could play a role in outreach to the CDF customer group. As a result, a mixture of banking and community approaches may be needed.

ANZ seeks comment on the extent to which small-scale lenders like credit unions can be seen as providing community development finance and conversely, what the limitations may be for these existing lenders in Australia.

There are only a few credit unions in Australia that could be seen as providing CDF. These include the Fitzroy Carlton Community Credit Cooperative, Maleny Credit Union, Foresters ANA, First Nations Credit Union and Traditional Credit Union. However, problems for these organisations include a reliance on volunteers given the high transactional costs and the low income earned for small loans. Therefore, there is a considerable burden for the few paid staff at these organisations in complying with regulations. Most credit unions do not provide credit cards, 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. However, many credit union staff consider structured loans with principal and interest payments are best for their customers' welfare and continue to provide these, despite the administrative burden.

In addition, many of these credit unions do not break even by providing community development finance. Fee and interest income is inadequate given the low value of loans. They are also unable to achieve economies of scale. As a result, CDF 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. 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 Federal government, Rural Transaction Centre funding and assistance from Westpac for marketing and training strategies.

Given these difficulties in providing community development finance, many credit unions have merged, experienced a mission drift, or closed down. Many others are loosing market share to banks that are now promoting a community image. Overall, it is considered there is limited volume of CDF currently delivered through credit unions and great difficulties in expanding services.

4. WHAT REGULATION, TAX AND WELFARE ASPECTS NEED TO BE ADDRESSED?

ANZ seeks comment on how the existing regulatory tax and welfare systems may be likely to interact with CDF programs and what changes to those systems may be required to enhance the effectiveness of those programs. In particular are there aspects of banking and credit regulation that may limit the development of CDF programs?

Given the expansion of the credit reporting system so that utility companies, mobile phone providers and a broad range of other organisations have access, there is a high proportion of people with items on their credit records. Some items are not necessarily an indicator of lack of creditworthiness. For instance, the Brotherhood of St Laurence considers it is unclear to customers that an unpaid utility bill would be listed on their credit record. Furthermore, due to the usually small amounts, it appears that utility companies often choose to write off unpaid bills and list them on credit records rather than incur the cost involved in collections. However, this lack of follow up is considered harmful and unfair to the customer. As a result, we believe the government should consider reforming the credit reporting system so it is a better indicator of creditworthiness. Suggested reforms include a lower threshold for unpaid bills listed (say minimum of $500); that utility companies must disclose to customers at the outset that unpaid bills could be listed on their credit records; or that utility companies need to undertake more investigation in following up payment prior to listing items on a credit record.

One of the greatest difficulties for small organisations in providing community development finance is the APS 221 regulation. This limits individual exposure to 25% of an organisations' capital base. For instance, the maximum loan the Fitzroy Carlton Community Credit

Cooperative can issue is $125K. This means that they cannot easily subsidise their services through the provision of larger loans or adequately service their existing member base.

Consumer credit code regulations are also considered cumbersome for small organisations to administer. Consumer credit regulations were developed principally to protect consumers from organisations with a profit motive whereby there is the potential to exploit. However, this code has been applied to credit unions as well as banks, despite the movement's motive of mutual help. Part of the reason for credit unions and banks having the same level of regulations could stem from the collapse of the Pyramid Building Society, which bought about a perception that money was not safe with these organisations.

Are there regulatory approaches overseas that assist the development of CDF programs, which could be useful in the Australian context?

The Community Reinvestment Act from USA could be considered for Australia; however it may be more appropriate for this to be linked to income or some other social indicator rather than a geographic location. The approach of Kiwibank, sponsored by New Zealand Post, could also be explored.

What aspects, if any, of small business tax regulations need to be addressed?

The high marginal tax rates for moving from welfare to work are a disincentive and need to be addressed.

Is refinement of current welfare policy and income tax policy needed to accommodate CDF programs?

Whilst the welfare system provides income that leads to a potential to afford loan repayments, it is also considered an impediment to some ideas of mutual help, such as CDF. Many people on a low income have only ever had an experience as a passive recipient of welfare. As a result, the idea of a loan can be foreign, particularly the notion of a lending relationship based on reciprocity, trust and commitment. Some people inquiring about our programs resist the idea of paying back a loan and note that they hoped the funds would be given to them. Because of this demand for loans could be considered latent due to the culture of welfare provision. We believe that if there was a growth in the profile of CDF and people were better able to appreciate its benefits, this could contribute to a change in culture and lead to an increase in demand. One participant in the Brotherhood's research, "Credit to the Community" commented "It makes me feel as though I'm looking after myself and the children without anyone else doing that for me." As people experience CDF, or observe friends and family's experience, they may also start to share the above participants' view and choose CDF. To develop a better understanding of how an increased profile of CDF could stimulate demand, we would need to trial and evaluate programs.

5. HOW DO WE MANAGE CDF PROGRAMS COMMERCIALLY?

ANZ seeks comment on how the commercial risks of a CDF program can be best managed. To what extent can a business partner in these programs expect to gain a normal commercial return on its investment?

If ANZ were to provide a loan in the same way as the Deutsche Bank Microcredit Development Fund with an interest rate of 1-3%, there would be a lower than normal commercial return on this investment. However, there would be returns to ANZ in terms of improved brand image, goodwill and greater levels of trust from the broader community. Retention of staff could also improve with people finding more meaning and integrity in their jobs. The rise of regional banks with a community focus suggests that the average person is increasingly interested in dealing with a bank that has a genuine commitment to customers, staff and the communities they work in, rather than solely profits and shareholder value. We would like to see banks working on CDF themselves and are pleased ANZ is analysing this issue. If banks did not address this issue, this would increase pressure on the government to intervene in the market for financial services. Returns such as improved branding, staff retention, community and government relations are more difficult to measure than an interest rate. However, these returns are still of significant value for a bank, particularly given the level of "bank bashing" and loss of faith in the banking system.

There are also returns to the whole of society from CDF in:

- a reduction in use of material aid through appropriate financial tools to assist people reduce their vulnerability
- reduced hardship and family stress
- addressing the problem of asset based poverty and promote wealth creation through appropriate financial services
- creating a solution to exploitation by fringe lenders and
- improved participation in labour market through lending for enterprise creation.

The Brotherhood of St Laurence has contributed to the Fitzroy Carlton Community Credit Cooperative in a similar way to the Deutsche Bank model. The cooperative has $50,000 in subordinated debt from the Brotherhood and around 5% per annum is paid in interest. This has assisted the cooperative manage its liquidity. This has proved a relatively easy way for the Brotherhood to support the cooperative and minimal involvement has been required – it is still the cooperative that bears the responsibility of dealing with customers, complying with regulations and administering financial products.

It is considered that the provision of loans, like the Deutsche Bank model could prove difficult in Australia. There are few credit unions that have the capacity or inclination to provide small loans to micro-businesses or people on low incomes. A Deutsche Bank type model would still not address the high costs, low income, inadequate marketing and product development, or the regulatory burden and welfare culture. Thus, there may be few credit unions that would be able to use this support in the way intended.

Furthermore, by ANZ providing a loan to CDFs, the bank is not bearing any of the risk in lending to small businesses or people on low incomes. If Australia's largest banks are unwilling to bear any risk themselves in the provision of community development finance, then solutions are likely to remain piecemeal and unable to impact on a large scale. We believe banks have over-estimated the risks of lending to people on a low income due to the assumptions of credit scoring models and the accompanying policies. In addition, overseas banks operate at a profit at higher levels of risk. We believe it is possible for banks (potentially shared with government and community sectors) to bear the risk in lending to this sector of the community, and also a social obligation. Given banks have an implicit guarantee from the Reserve Bank, access to the payments system and a relatively unregulated market, the Brotherhood of St Laurence believes that banks have a social contract. Because of this, the Brotherhood of St Laurence welcomes ANZ's interest in contributing to community development finance.

We believe it would be reasonable to expect loan loss rates similar to those currently experienced, such as around 0.70% for small and medium business and 1.25% for personal loans. There have been no losses so far in the Brotherhood's program in partnership with Bendigo Bank. Fitzroy Carlton Community Credit Cooperative experiences a loan loss rate of around 1% per annum. The Brotherhood's interest free loan scheme currently experiences a loan loss rate of 2%, and there is room for improvement in access to bank arrears management systems, the motivation of unpaid loans being listed on the credit reporting system and access to bank staff experienced in collections.

If risk of default was calculated to be higher than the current market average, the Brotherhood of St Laurence would consider it reasonable to charge a higher interest rate for this product. However, it is noted that the loan loss rates for Australian banks are lower than global averages, which could suggest greater financial exclusion locally than overseas in terms of credit products.

The Brotherhood of St Laurence would also encourage consideration of means to obtain returns from administration costs. ANZ's standard application fee of $125 for a personal loan or $600 for a business loan would seem disproportionately high, given the lower values of loans, of around $500-$2,000. If this did reflect the true cost of providing the service, it could be amortised over the term of the loan and combined with the $25 administration fee per quarter attached to the personal loan. For instance, $5-$10 per month could be charged over 1-2 years and this would be more affordable for people on low incomes and potentially recoup banks' administration expenses. Market research would need to be undertaken to determine people's willingness or capacity to pay these fees. However, studies of microfinance have found that finance that is provided quickly and in a non-stigmatising way is more important to CDF customers than discounted interest and fees.

Given the current state of credit unions, and young nature of community development finance, the Brotherhood of St Laurence does not believe the Deutsche Bank Microcredit Development Fund is appropriate for the current Australian market. We believe a structure would need to be developed that shared expenses, risks and responsibilities between government, community and business. The Brotherhood of St Laurence would welcome the opportunity to work with ANZ to further analyse the potential of CDF.

What are the elements of program design that will best aid in the management of those risks?

Given the market power of the big four banks in Australia, many analysts consider there has been a lack of innovation in product development. The Brotherhood of St Laurence considers that if the product is well designed, then low loan loss rates are achievable. For instance, repayments should be small and regular to coincide with pension day. For personal loans, ANZ could negotiate with Centrelink for payments to be directly credited to the loan account. Seasonality factors such as Christmas and the beginning of the school year could be considered for personal loans. Standard business seasonality, such as retail sales peaks and troughs, should be considered for business loans. It is recommended that the application process be non-stigmatising, transparent and fast. Affordability could be promoted in terms of the fortnightly repayment rate, rather than total interest and fees. To promote a willingness to repay, customers would need to understand:

- the impact of the credit reporting system on non-payment
- that non-payment will impact other people in their situation as it could lead to programs being discontinued
- that full repayment may lead to the opportunity to borrow to fund other items.

Arrears management should be consistent with standard bank procedures. Given that banks have invested considerable capital into systems for tracking payments and arrears, CDF could leverage off these systems. Banks also have expertise in the preparation of contracts, a branch network to accept deposits, internet and phone banking facilities, and other crucial aspects of credit provision. These systems should all be available for CDF.

What is the best way of achieving the social objectives of a CDF program consistent with the management of those risks?

Banks' systems, expertise in credit analysis, and branch network combined with a community organisations' motive in improving people's welfare, trust and visibility may be the best way of achieving these goals. It is considered that banks could maintain a high expectation towards repayment and risk management, but may need to modify some expectations regarding the return on capital. Operating costs may need to be subsidised, but some income could be generated through fees, interest or margin on the sale of goods. Although it is suggested in the discussion paper that CDF programs could be a relatively inefficient social welfare tool, the alternatives of material aid or unemployment benefits are likely to be more inefficient from the whole of society's perspective. In particular, there is the ongoing opportunity cost of fundraising and charging taxes compared to a revolving loan fund. There is also no fee income to subsidise any operating costs in the provision of material aid or benefits. Furthermore, there are costs to society through inequality and poverty. Whilst there are many challenges involved in the provision of CDF, it is still considered important and possible.

Future Directions

ANZ's discussion paper is a good starting point, however we believe a range of options and models should be developed to contribute to community development finance. We recommend analysis of a full range of banking services, including personal and business loans, insurance, savings and advice. In order to develop a model, research should be undertaken and programs trialled to determine the appropriate means to balance risks and contributions from various parties. We recommend the following key research questions to be explored:

1. How would a program operate? What are the credit options currently available for people on low incomes? Existing programs in Australia could be analysed to determine:
    - characteristics of applicants, both successful and unsuccessful
    - eligibility criteria, targeting and promotion undertaken
    - referral in and out of the program.
2. How effective are existing programs in meeting the needs of participants? There are two main aspects of this question. The first is the perspective of participants in existing CDF programs about the extent to which the project is meeting their goals. This could be assessed by structured interviews with participants. Questions would cover the operation of the program, affordability of repayments, the impact on their lives of having access to credit, benefits and limitations of the program and how the program could be improved. We would also endeavour to develop a better understanding of the products and services that people on low incomes want and what they are willing to pay. In addition, this question would analyse the extent of people on low incomes' ability to repay loans not currently understood by mainstream banks due to the use of credit scoring models.
3. Can a program be financially sustainable? This question could be explored through a cost/benefit analysis of:
    - costs of program delivery (including promotion and operational costs such as administration and processing time)
    - revenue from loan interest and margin on the cost of goods sold
    - repayment and default rates
    - strategies for improved sustainability, including geographic expansion, increased product range, fee and interest structure.

The Brotherhood of St Laurence believes CDF is a shared responsibility between banks, community organisations and the government. We believe financial inclusion is a key aspect of poverty alleviation and would appreciate the opportunity to work with ANZ to further promote this concept.