Australian Government

Australian Social Inclusion Board

The Hon Mark Butler
Minister for Social Inclusion
Parliament House
CANBERRA ACT 2601

Dear Minister,

I am writing to provide advice on the outcomes of our first consultations as part of the Board's priority work on financial capability.

On 18 May 2012, the Board held a Roundtable on alternatives to payday lending. The Roundtable brought together key stakeholders to respond to the Treasury's discussion paper *Strategies for reducing reliance on high cost, small value, short-term loans,* released on 24 April 2012. The Board has drawn on this discussion to develop key recommendations for reform, which I have included at Attachment A. I would appreciate if you could provide a copy of this advice to the Minister for Financial Services and Superannuation for his consideration. The Board very much appreciates the opportunity to contribute to the Treasury consultation process.

The Board welcomes the introduction of a cap on credit costs and new disclosure requirements set out in the Consumer Credit and Corporations Legislation Amendment (Enhancements) Bill 2011. However, the Board recognises that to complement this change, a range of policies and initiatives are needed to reduce reliance on this type of loan, and to provide access to alternative loan and flexible finance options. This is the focus of the Treasury discussion paper and of the Board's attached submission.

Yours sincerely

P.M. Faulkner

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28 May 2012

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ATTACHMENT A

AUSTRALIAN SOCIAL INCLUSION BOARD

SUBMISSION TO THE TREASURY ON ALTERNATIVES TO HIGH COST, SMALL AMOUNT, SHORT-TERM LOANS.

The Australian Social Inclusion Board (the Board) is pleased to have the opportunity to provide the Minister for Financial Services and Superannuation, the Hon Bill Shorten MP, with its views on policy options for reducing the reliance on high cost, small amount, short-term lending. The Board welcomes the changes put forward in the Consumer Credit and Corporations Legislation Amendment (Enhancements) Bill 2011 to better protect vulnerable consumers from the detrimental impact of using payday lenders. This submission has been informed by the Board's consultations with representatives from the community finance, banking and consumer advocacy organisations, and outlines some recommendations for further protecting vulnerable consumers.

Information about people who use payday lenders

The Board understands that the level of information available on the payday loan industry and payday loan customers in Australia is limited. Robust evidence based policy responses need to reflect the nature of payday lending clientele and their circumstances, however while there is some survey data, there is a lack of systematic or representative information about this group.

The Board understands that there is also significant segmentation in the market. For example, many people who use payday loans are on very low incomes and do not have access to credit products from mainstream banks; however other clients are people who have credit cards and other mainstream debt products, and have reached their credit limits on those products.

There is also segmentation in terms of the frequency of loans, the size and repayment time of loans, and the level of financial literacy of the client. Some clients appear to be very aware of the cost of the loan and the repayment terms, whereas others do not fully understand the costs, and may feel they have been 'tricked' by lenders.

More data is needed about the client groups that use payday loans, the industry, and the consequences over the long term.

Recommendation

- *The Board recommends that further work be undertaken to identify gaps in existing data and that methods for data collection and reporting be instituted. This will enable a better understanding of the client groups that use payday loans, as well as collecting better data about the size and activities of the payday lending sector.*

Alternatives to payday lending

Approximately 70% of payday loans are used to meet everyday expenses such as utility bills, groceries and rent. Payday loans are generally approved and provided on the spot. Repayments are taken via direct debit from clients' bank accounts; ensuring repayments are prioritised over other expenses.

The mainstream banks are currently very limited in the small amount credit products they offer to low income Australians. There is some provision of programs such as No Interest Loan Scheme (NILS) and Low Interest Loan Scheme (LILS) in partnership with community organisations and government, and some provision of discounted loan capital to Community Development Financial Institutions (CDFIs) to support their programs.

The Board considers that community sector microfinance programs such as NILS and LILS are not currently operating as alternatives for payday loans. While important initiatives, they are generally available only for the purchase of assets (such as a washing machine or fridge) and they have much slower approval times due to the due diligence processes undertaken to ensure the client can afford the repayments.

The role of banks in servicing financially excluded groups, and in supporting the community finance sector, needs further consideration. The banks have substantial existing infrastructure and geographic reach which will never be matched by the nascent CDFI sector, and have access to more affordable loan capital than CDFIs can access.

Banks also have an important information and referral role. Many people when seeking credit will first approach a mainstream bank and if their application is rejected, frontline bank staff are in a prime position to refer applicants to appropriate alternative services. The Board heard concerns that banking staff are often unaware of existing community finance initiatives and in some instances were referring applicants to payday lenders.

In addition to the banks and their not-for-profit partners, there are a small number of CDFIs in Australia which provide alternative sources of credit and financial services. CDFIs provide low interest loans to individuals and small businesses for a range of purposes.

In 2011, the Australian Government launched a pilot study to examine the potential to establish a viable CDFI sector in Australia to meet the need for financial services and credit for financially excluded individuals.

The CDFI pilot project seeks to build the capacity and resilience of disadvantaged and financially excluded individuals by attracting investment and injecting funds into five community finance organisations that offer them financial services and products that they would otherwise not be able to access from mainstream sources.

The pilot is due to conclude in June 2012 after only 12 months of active lending. Initial assessment of the pilot shows that there is a need for a longer time in operation to fully test the model and draw conclusions from a mature service. The Board recommends that the pilot be extended.

The main challenge both for banks and CDFIs in providing credit products to low income Australians and those with a poor credit history is one of cost. Experience shows that with proper selection and support a very low default rate can be achieved with this group. However, there are costs associated with assessing a disadvantaged person's income, working with them to determine the loan type and repayment period, and possibly providing further training or mentoring. For a small amount loan with a low interest rate, the return on a loan is often too small to cover these administrative expenses. Stakeholders agreed that there would always be a need for a degree of public sector subsidy in order to make affordable small amount loans to disadvantaged applicants.

Recommendation

- *The Board notes that the current CDFI pilot has the potential to provide insight into the way CDFIs such as Fitzroy-Carlton Community Cooperative can provide an effective alternative to payday lending. The Board recommends that consideration be given, as a priority, to extending the CDFI pilot.*
- *The Board recommends that the Government considers what further support it can give to promoting growth in the CDFI sector, including what role the Government can have in encouraging the banking sector to provide increased funding for CDFIs.*
- *The Board recommends the Government undertake further work to determine the degree of public subsidy required for CDFIs to provide sustainable microfinance services to the most disadvantaged.*

- *The Board recommends the Government ask banks to consider better education for frontline staff about alternative services to which they should refer individuals who are rejected in applications for credit cards and other financial products.*

Regulation of payday lenders

Research suggests that the majority of clients of payday lenders take out many loans in a year, often back to back, or from multiple lenders at once. Stakeholders argued that this was part of the payday lenders' business model; the payday lenders main profits are made from repeat borrowers. This means that payday lenders have an incentive to encourage dependency and to engage in predatory lending.

One option canvassed by the Board for changing this business model, and breaking the cycle of debt that can occur, is to limit the number of pay day loans an individual can take out in a certain period of time. This would require the development of a national pay day loan register, so that the total number of loans to an individual could be monitored across multiple providers. The Board believes this cap would need to be coupled with significant support services to which people could be diverted when they reached their loan limit.

The state of Virginia in the US has introduced regulations that limited borrowers to one payday loan at a time and extended the length of time they have to repay it, effectively limiting the number of loans an individual can take out in a year. The reforms also introducing compulsory loan free periods once a loan is repaid. This has resulted in a significant drop in the number of payday loans made per year, and acts to prevent individuals getting trapped in a cycle of borrowing[1].

Recommendation:

- *The Board recommends that the Government consider introducing a cap on the number of payday loans that an individual can take out in a year, and that once this limit is reached they are diverted to alternative services such as financial counselling and support. The Board notes that this option would require significant development of infrastructure, further regulation of payday lenders, and increased resources for diversionary services.*

- *The Board recommends that the Government consider establishing a register of all payday lenders and all payday loans made. This would enable the introduction of a cap on loan numbers, as well as robust data collection.*

- *Alternatively, the Government could introduce a cap on the number of loans per year that a single provider could make to an individual, and this could be enforced through auditing arrangements as part of payday lenders' annual licensing process.*

Hardship Provisions

Through its consultations the Board found that many payday loans are used to pay bills for services where hardship provisions are available, for example nearly a quarter of payday loans are used to pay utility bills. The awareness and uptake of hardship programs provided by utility providers is very low. There is a need to better understand why there is so little uptake of hardship provisions for energy bills.

[1] See http://www.virginiafairloans.org/BorrowersGuide06_09.pdf and http://www2.newsvirginian.com/news/2008/dec/31/new_va_payday_lending_law_takes_effect_jan_1-ar-306718/

Recommendation

- *The Board recommends that further research is conducted to understand the low rate of uptake of hardship provisions available for delayed payment of utility and telephone bills.*
- *The Board recommends that the availability of hardship provisions be more widely advertised by providers and Centrelink.*
- *The Board notes the importance of the new compulsory disclosure requirements for payday lenders included in the Consumer Credit and Corporations Legislation Amendment (Enhancements) Bill 2011, for ensuring individuals are not using payday loans when alternative options such as hardship arrangements are available. The Board further notes the importance of getting the detail of the disclosure requirements right.*

<u>Centrelink Services</u>

Centrepay

Centrepay is an important service which helps people on low incomes to manage their finances.

Stakeholders advised the Board that a number of commonly used services, such as vehicle registration and motor insurance, which should be available on Centrepay are excluded because the payment systems and frequency of Centrepay payments are not consistent with those of state road and traffic authorities and insurers.

At the same time, Centrepay is being used by some companies which provide goods on lend leases where customers are unaware of the total cost of the contract, and the company receives payment deducted automatically through Centrepay. The Department of Human Services (DHS) is introducing some measures which will go some way to address this, preventing companies from suggesting that shoppers use Centrepay and requiring a 10 day cooling off period.

Recommendation

- *The Board recommends that all Centrelink clients should have access either to pay their vehicle registration and insurance through Centrepay, or through an Advance Payment which is repaid through their fortnightly income.*
- *The Board supports the ongoing work of the DHS to bring these payment types into the Centrepay model, as a simple and practical way to assist disadvantaged people to smooth their expenditure.*
- *The Board supports DHS' ongoing efforts to review and tighten which organisations can receive payments through Centrepay to ensure that organisations are not targeting vulnerable consumers with inappropriate lend lease products.*
- *The Board recommends that Centrelink clients who use Centrepay are provided with information about how they can cease Centrepay arrangements, and alternative options.*

Urgent and Advance Payments

Some Centrelink customers are able to borrow against their future income support payments through advance payments. The amounts and eligibility criteria for these payments are complex and not consistent as they are different for every pension type. Advance payments can range from $250 to $1100 and are interest free.

Centrelink also provides Urgent Payments, which are only available in exceptional and unforeseen circumstances, and must be repaid through deductions from future payments.

Recommendation

- *The Board recommends that DHS work to simplify the rules and increase consistency of Centrelink advance payments across different payment types. The Board notes that this may require legislative changes.*
- *The Board recommends that DHS review Centrelink's current arrangements and eligibility criteria for urgent and advance payments, and consider the expansion of circumstances in which urgent and advance payments are available, to make them a more available alternative to payday lending.*

Centrelink customers' information

Stakeholders raised concerns that Centrelink clients are often unaware of payments that are being deducted from their income support payments. This can lead to inappropriate prioritisation of payments for leased white goods payments for example, rather than groceries or medication.

Centrelink clients can currently set up Centrepay payments online, however there is no mechanism for clients to view all payments, deductions, and debts in one place in an easy-to-interpret medium. The Board is concerned that clients with poor financial literacy may be more disadvantaged by this.

The Board recommends that, to ensure clients are aware of the impact of any new Centrepay deduction on their fortnightly income received, DHS develop an online tool which displayed their full income and expenditure information. The screen would outline all of the forthcoming deductions: through Centrepay; pay in advance repayments; penalties for non-compliance and so on; and display the remaining income that would be deposited in the client's bank account.

Recommendation

- *The Board recommends that DHS explore the development of an online tool which enables a Centrelink customer to see their full income and expenditure information, and that this tool is displayed whenever a client establishes a new Centrepay or Pay in Advance arrangement*.
- *The Board supports the increased use of existing information on the Centrelink database to proactively identify customers who are likely to get into financial difficulty, and offer additional financial services or supports to these people.*