Strategies for reducing reliance on high-cost, short-term, small amount lending

Discussion Paper

April 2012

ISBN 978-0-642-74792-1

Manager
Communications
The Treasury
Langton Crescent Parkes ACT 2600
Email: medialiaison@treasury.gov.au

Consultation Process

Request for feedback and comments

The Government is seeking your feedback and comments on the strategies and options discussed in this paper looking into offering alternative means of assistance for those who may otherwise use payday or high cost, short-term, small amount lending as a source of finance. Specific questions have also been included to focus your feedback.

While submissions may be lodged electronically, by post or by facsimile, electronic lodgement is preferred.

All information (including name and address details) contained in submissions will be made available to the public on the Treasury website unless respondents indicate that they would like all or part of their submission to remain in confidence. Automatically generated confidentiality statements in emails do not suffice for this purpose. Respondents who would like part of their submission to remain in confidence should provide this information marked as such in a separate attachment. A request made under the *Freedom of Information Act 1982* to make available a submission marked 'confidential' will be determined in accordance with that Act.

Closing date for submissions: Monday, 4 June 2012

Email: SALpaper@treasury.gov.au

Mail: General Manager
Retail Investor Division
The Treasury
Langton Crescent
PARKES ACT 2600

Enquiries:

(1) Mr Christian Mikula, Manager, Consumer Credit Unit, The Treasury

Phone: 02 6263 2046

Or

(2) Ms Paula Mance, Section Manager, Money Management Branch, Department of Families, Housing, Community Services and Indigenous Affairs

Phone: 02 6146 2220

TABLE OF CONTENTS

FOREWORD

 

We are pleased to release this paper which canvasses a number of options and strategies that aim to provide more affordable, fair and readily accessible alternative lending or other assistance for those consumers who would normally access high-cost, short-term, small amount lending, particularly those products referred to as payday loans.

The Government recognises the value of this small amount lending sector as it fills an important gap in the market place. However, the cost of these loans can be very high due to their short-term nature and high risk, so that this type of borrowing by the financially disadvantaged can perpetuate their debt problems as they need to spend a relatively high percentage of their income to service the debt. The Government wants to see improved outcomes for this sector by ensuring the availability of a range of affordable and fair alternatives. This paper canvasses a number of possible strategies to achieve this.

Small amount lenders are already subject to the licensing and responsible lending obligations contained in the National Credit Legislation. More recently, the Consumer Credit and Corporations Legislation Amendment (Enhancements) Bill 2011, which is due to be made into law early this year, introduced caps on interest rates, fees and charges to small amount lenders which will reduce the costs for consumers taking out these loans. These changes will go some way towards protecting the interests of more vulnerable consumers.

The options discussed in this paper seek primarily to enhance access to alternative lower cost financial or other assistance to ultimately improve vulnerable consumers' financial situations leading to improved financial health and capability for the long term. The Government considers that improving financial capability should be addressed in many varied ways to assist as broad a spectrum of consumers as possible, all with different financial positions, needs and objectives.

Your input is important to the Government in deciding how best to proceed on this important issue.

We encourage you to participate in this discussion and provide your views on the options outlined in this paper.

The Hon Bill Shorten MP

Minister for Financial Services and Superannuation and Minister for Employment and Workplace Relations

The Hon Julie Collins MP

Minister for Indigenous Employment and Economic Development
Minister for Community Services
Minister for the Status of Women

EXECUTIVE SUMMARY

The last 10 years have seen a substantial increase in consumer use of high-cost small amount short-term loans (defined as loans for amounts up to $2,000 with a maximum term of two years). The cost of these loans can be very high, with effective interest rates up to 1,000 per cent.[1] These costs are borne largely by consumers who can least afford them.

Australian research has shown there is a significant level of use of these loans by consumers who are unable to access mainstream credit products and who may experience financial exclusion. In summary, the data suggests:

- approximately 40 to 49 per cent of small amount loan customers have annual incomes of less than $24,000;
- between 50 and 74 per cent of small amount loan customers have annual incomes of less than $36,000;
- 50 per cent of small amount loan customers are partially employed or unemployed; and
- between 46 and 50 per cent of small amount loan customers are in receipt of government benefits.

The *National Consumer Credit Protection Act 2009* regulates the provision of consumer credit, including most short-term, small amount loans. The Consumer Credit and Corporations Legislation Amendment (Enhancements) Bill 2011 (the Enhancements Bill), introduced into Parliament in September 2011, proposes reforms to regulate small amount lending, including a cap on costs. Passage of the Bill is expected in the winter 2012 sittings of Parliament. The cap on costs will reduce the amount borrowers can be charged to a more acceptable and controlled level.

Financial exclusion represents a significant policy issue in Australia. Financial exclusion means that individuals are less able to participate fully in social and economic activities and financial hardship is increased.[2] For this reason, increasing financial inclusion is a key policy goal of the Government.

The Government therefore considers it important to canvass strategies to reduce the extent to which financially excluded consumers are dependent on these high cost small amount loans. There are a number of areas for potential intervention:

- reduce the need for high-cost, short-term, small amount credit;
- reduce the risks to individuals from high-cost, short-term, small amount lending (the objective of the reforms in the Enhancements Bill);
- provide alternatives to high-cost, short-term, small amount lending; and
- provide a greater level of assistance to individuals who are in a debt cycle.

---

1 RMIT University & the University of QLD (2011) *Caught Short: Exploring the role of small, short-term loans in the lives of Australians, Interim Report*, July 2011

2 Connolly, C., M. Georgouras, et al. (2011). *Measuring financial exclusion in Australia*. Sydney, Centre for Social Impact for NAB.

Other than the reforms included in the Enhancements Bill, the Government has not committed to implementing or advancing any particular strategy and further detail on how or whether this might occur would need to be subject to further specific consultation and analysis.

This paper has been prepared in consultation with the Department of Families, Housing, Community Services and Indigenous Affairs (FaHCSIA). Feedback received will inform any Government decision to proceed with any of these strategies, and will be used for regulatory assessment processes, including a Regulatory Impact Statement.

In this Discussion Paper, unless otherwise noted, a 'small amount loan or lender' refers to a high-cost, small amount, short-term loan or lender, sometimes also referred to as a fringe or payday lender. It excludes small amount loans provided by not-for-profit organisations and Governments, such as the No Interest Loan Scheme (NILS).

CHAPTER 1
FINANCIAL EXCLUSION OF SOME CONSUMERS

This Chapter provides background material on the following topics:

- the extent and nature of financial exclusion;
- research on the financial position of borrowers who use high-cost, short-term, small amount credit, and the use they make of these loans;
- the current extent of this type of lending in Australia; and
- the impact of financial exclusion for this class of borrowers.

FINANCIAL EXCLUSION

Australian research (for example, Connolly 2011[3]; Burkett & Drew[4], 2008; Chant Link 2004[5]) has identified the existence of a substantial minority of Australians who are unable to access mainstream financial products and services, particularly credit. This is commonly referred to as financial exclusion. Corr (2006)[6] identified a range of dimensions of financial exclusion, including:

- geographical exclusion: due to the absence, or closures, of mainstream services in particular geographical areas. This is often due to the high cost of servicing these areas;
- access exclusion: when there is a perception by mainstream financial services that some individuals are too risky to price, particularly those on income support or with credit defaults; and
- self-exclusion: occurs when individuals exclude themselves from mainstream services based on previous experience of discrimination or beliefs of discrimination — 'they don't accept people like me.'

Evidence on the prevalence of financial exclusion in Australia suggests:

- 15.6 per cent of Australians, or 2,650,000 individuals, are fully or severely excluded from financial services including credit[7]; and
- six per cent of adults have minimal access to financial services and around 120,000 people have no ownership of financial products.[8]

---

3 Connolly, C., M. Georgouras, et al. (2011). *Measuring financial exclusion in Australia*. Sydney, Centre for Social Impact for NAB.

4 Burkett, I. and B. Drew (2008). *Financial inclusion, market failures and new markets: Possibilities for Community Development Finance Institutions in Australia*. Brisbane, Foresters Community Finance.

5 Chant Link (2004). *A Quantitative report on financial exclusion*. Melbourne, ANZ.

6 Corr, C. (2006). *Financial exclusion in Ireland: An exploratory study and policy review*. Dublin, Combat Poverty Agency.

7 Connolly et al (refer footnote 3 above).

8 Chant Link (2004) (refer footnote 5 above).

Financial exclusion makes day-to-day money management difficult. Individuals find it harder to plan for the future or manage 'lumpy spending' such as large bills or unexpected expenses. Individuals become more vulnerable to financial stress and can fall into a spiral of debt, hardship and poverty.

Whyley (2010)[9], for instance, described a range of costs to individuals associated with financial exclusion, particularly a lack of access to credit, including:

- limited ability to smooth lumpy or unexpected expenditures leading to serious hardship, including going without food, fuel, school uniforms, disconnection from utilities and increased social exclusion;
- increased use of sub-prime lenders with high costs, confusing and punitive terms and conditions, being drawn into a cycle of borrowing and debt, stigmatisation, and negative impacts on household budgets and quality of life; and
- long-term impacts such as no opportunity to build up a positive credit history to allow transition to mainstream services, and decrease in financial capability.

In a modern society such as Australia, the need for small amounts of short-term credit to help manage cash flow and lumpy expenditure should be accepted as a universal element of financial inclusion.

CONSUMERS OF SMALL AMOUNT LOANS

Research suggests that many Australians who are financially excluded often resort to the use of high cost small amount lenders. The need for these loans emerge when consumers, often already vulnerable, find themselves with insufficient funds to meet recurrent basic living expenses such as food, rent, utilities and other bills, or one-off unexpected expenses such as medical costs, car repairs or the purchase of whitegoods. As a result of exclusion from mainstream credit providers, these consumers may have few alternatives other than to source finance as quickly as possible from the first available lender at whatever cost and accept the terms offered.

Research from a range of sources, consistently shows that a substantial proportion of small amount loans are used to meet recurrent or basic living expenses:

- A report by the Consumer Action Law Centre (CALC) in 2010 reported that 71.3 per cent of surveyed consumers used small amount loans to pay for basic expenses, including: utility bills (21 per cent), food (17.6 per cent), rent (10.7 per cent) and car repairs or registration (22 per cent).[10]
- In a Victorian study, Wilson (2002) reported that respondents had taken out small amount loans to pay for bills (32 per cent), day-to-day living expenses (26 per cent), car repairs or registration (10 per cent), and rent or mortgage (10 per cent). In total 78 per cent of borrowers borrowed for non-discretionary spending.[11]

---

9 *HMT Financial Inclusion evidence Review: the costs of credit exclusion and the benefits of access to affordable credit*, Financial Inclusion Taskforce

10 Gillam and Consumer Action Law Centre, Payday Loans, Helping Hand or Quicksand 2010 p. 59

11 Wilson, Consumer Law Centre Victoria, Payday Lending in Victoria – A research report p. 36

- Research by the Policis research consultancy[12] (undated) found that credit, particularly small amount credit, is used by low income households primarily for essentials and to ensure the effective functioning of household finances. Policis stated that 28 per cent of borrowing was 'distress borrowing' to deal with cash shortfalls; 29 per cent was used to meet unexpected bills and expenses and 9 per cent was used to meet regular bills and expenses. Credit was used to finance spending on discretionary items in only 10 per cent of cases.[13]

- Data provided by Cash Converters in a 2008 submission to Treasury is consistent with these findings, showing that nearly six in 10 of their clients with incomes of than $35,000 per annum would be unable to manage a cash emergency without borrowing and 55 per cent would be unable to renew or repair essential equipment.[14] This suggests that its clients are borrowing to meet emergencies of this type.

- Data provided by Cash Stop quoting Smiles Turner research identified that the top uses for credit were for basic expenses and bills (29.8 per cent), personal (32.9 per cent), car expenses (8.1 per cent) and groceries (5.6 per cent).

In summary, it is estimated that the majority of borrowers primarily use small amount credit to meet basic living expenses, presumably because of their low incomes.

The typical profile of consumers using these types of loans is broadly one of vulnerability and disadvantage. A review of Australian research[15] found:

- approximately 40 to 49 per cent of small amount loan customers have annual incomes of less than $24,000;

- between 50 to 74 per cent of small amount loan customers have annual incomes of less than $36,000;

- 50 per cent of small amount loan customers are partially employed or unemployed; and

- between 46 and 50 per cent of small amount loan customers are in receipt of government benefits.

The research therefore establishes there is significant use of high-cost, small amount loans by people who are on low incomes and vulnerable to financial exclusion. This can create a range of additional problems for these people, their families and the broader community.

IMPACT OF FINANCIAL EXCLUSION

Financial exclusion can result in or contribute to a range of broader problems, such as relationship breakdown and a decreased standard of living. A key driver of financial exclusion is low income and there is strong evidence that identifies the links between poverty, indebtedness and financial exclusion (Connolly, 2011; Chant Link, 2004). While little research has been undertaken on the long-term impacts of financial exclusion, studies

12 Ellison, Forster, The Dynamics of Low Income Credit Use, undated, p8.

13 Ellison, Forster, Policis, The Dynamics Of Low Income Credit use, undated p. 8

14 Cash Converters, 'Position Paper, Response to the Federal Government's Green Paper on Financial Services and Credit Reform, 2008', p. 10

15 The Regulation of Short Term, Small Amount Finance, Regulation Impact Statement, June 2011 – page 15.

on the range of social problems associated with its correlates, particularly low income, are numerous and include:

- Health problems — 35 per cent of people in the lowest income quintile report fair or poor health compared to only seven per cent in the highest income quintile.[16] People experiencing financial hardship have higher rates of suicide and self-harm than the rest of the population.[17]

- Intergenerational joblessness — jobless families with dependants may not be able to access or provide resources that would assist children in their development (such as healthy foods or educational materials); and this increases the likelihood that these dependants will be unable to break free from the cycle of disadvantage.[18]

- Increased incidence of crime — 49 per cent of prisoners in a recent Australian study of women prisoners and debt said they had committed a crime to repay a debt.[19]

- Inadequate housing — people experiencing financial hardship are more likely to live in housing that does not meet their needs, with consequent risks to their health or relationships.[20]

- Adverse responses to financial stress — relationship breakdown, mental health issues, drug use, homelessness and domestic violence.[21]

There can be a reciprocal relationship between low or declining incomes and other problems, so that financial exclusion can cause, reinforce or stem from other elements of disadvantage. The potential problems that can contribute to ongoing social exclusion and a cycle of disadvantage can therefore be self-reinforcing.

The Government's view is that a commitment to financial inclusion involves providing opportunities for those who are financially disadvantaged to improve their own situation, including improved access to mainstream financial services and more opportunities to take up mainstream credit that is fair and equitable. This could result in:

- lower financial and emotional stress;

- reduced risk of social impacts, such as levels of crime; and

- increased levels of self-empowerment, financial resilience and capability, motivation and confidence.

The Government therefore considers that alleviating financial exclusion can reduce both economic and social costs on individuals, families, the community and the wider economy.

---

16 Australian Social Inclusion Board, Social Inclusion in Australia How Australia is faring, January 2010, p. 1.

17 Ibid.

18 Reference Group on Welfare Reform, *Participation Support for a More Equitable Society*, Final Report, FaCS, Canberra, 2000

19 Stringer, A., CRC Justice Support, Women Inside in Debt, the Prison and Debt Project, Broadway, Sydney, 2000, 10. The project used a combination of research techniques, including a survey by questionnaire of 121 prisoners and 4 follow up interviews, plus focus groups and unstructured interviews with key stakeholders.

20 Western Australian Council of Social Service Inc, ER Factsheet #5

21 Department of Families, Housing, Community Services and Indigenous Affairs, *Community Development Finance Institutions (CDIs) Scoping Study*, Chapter 1: The Nature of Financial Exclusion, 2009.

EXTENT AND COST OF SMALL AMOUNT LENDING

Small amount loans fill a gap in the market for credit that is otherwise not readily available to some consumers. There are, however, alternative sources of credit and assistance that consumers can tap into but of which they may not be aware. Small amount loans, particularly for amounts of less than $500, have experienced significant growth over the last few years. Some estimates suggest that the market now provides approximately 674,000 loans annually.[22] However, researchers have noted the difficulty in obtaining reliable figures.[23] Cash Converters also recently reported that the exact size of the short-term lending market has not been quantified.[24]

According to the National Financial Services Federation (NFSF), in 2008 small amount lending constituted approximately $500 million worth of loans per year in Australia.[25]

The main features of small amount lenders and loans are that they:

- are frequently based on fixed price fees which, when converted to effective interest rates, may amount to rates of 1,000 per cent or higher;
- provide a quick turnaround on lending decisions;
- accept welfare benefits as a legitimate source of income when assessing borrower's capacity to make repayments;
- allow borrowers to provide direct debit authorisations to lenders, substantially reducing the risk of default to the lender;
- can require, for some lenders, security for loans (for example, bills of sale over motor vehicles); and
- 'roll over' loans, where loans can be extended for a further period for an additional fee (which may result in escalating debt).

Reviews of small amount lending have identified a significant divergence in the level of costs charged by different lenders, with some lenders charging significantly higher costs. A comprehensive analysis of the costs of loans charged by 40 Queensland lenders (undertaken by Howell in 2008) found considerable differences in cost[26]:

- for a loan of $300 over one week, consumers could be charged a minimum of $41 and up to $195 (a difference of $154);
- for a loan of $300 over 26 weeks, consumers could be charged between $157 and a maximum of $376 (a difference of $219); and

---

22 Payday loans: Helping hand or quicksand? Report by ZacGuillam and the Consumer Action Law Centre, September 2010.

23 Market Intelligence Strategy Centre (MISC) Australia for Consumer Affairs Victoria, 'Consumer Credit Report', 2006, p. 51

24 Cash Converters, 'Response to the Commonwealth Government Green Paper on Consumer Credit Reform - Phase 2' , 2010, p. 5

25 National Financial Services Federation, 'Submission to Financial Services and Credit Reform Green Paper', 2008, p. 2

26 December 2008 - Interest Rate Caps: protection or paternalism? - Through the Griffith University survey 40 members of the National Financial Services Federation representing micro and payday lenders in Australia.

- for a loan of $1,000 over a year, consumers could be charged between $622 and $2,074 (a difference of $1,452).

The differences in cost reflect the lack of competition in this area, where consumer choices are driven by the need to access credit rather than price.

CHAPTER 2
REDUCING THE NEED FOR SMALL AMOUNT LOANS

This section of the Paper discusses options to reduce the need for consumers to rely on small amount loans.

As noted in the previous chapter, the need for high cost, short-term, small amount loans emerges when individuals find themselves with insufficient funds to meet recurrent basic living expenses such as food, rent, utilities or other bills, or other one-off expenses such as medical costs, car repairs or the purchase of whitegoods.

The Government funds a number of activities to support vulnerable individuals to better manage their finances. These activities take the form of the funding of services and programs such as financial counselling and microfinance programs, and the provision of tools and materials such as advance payments and Centrepay, along with information available through the MoneySmart website.

THE FINANCIAL MANAGEMENT PROGRAM

The Government's Financial Management Program (FMP) aims to build financial resilience and wellbeing for vulnerable people and those most at risk of financial and social exclusion and disadvantage. The FMP helps individuals across a range of income and financial literacy levels to manage their money, overcome financial adversity, participate in their communities and plan for the medium to long term. The services are voluntary, free and available to those experiencing financial difficulties.

Strategies under the FMP include:

- *Emergency Relief* services provide support to address immediate needs in time of crisis. Assistance often includes food, clothing, transport vouchers, chemist vouchers, help with accommodation or payment of bills, budgeting advice or sometimes provision of cash. Importantly, Emergency Relief agencies make referrals to other services that help to address the underlying causes of financial crisis and social and financial exclusion.

- *Commonwealth Financial Counselling* services help people to address their financial problems and make informed choices. Services may include direct casework (including the provision of advice and information), advocacy and/or negotiation, referrals, or community education.

- *Microfinance schemes* to help people access small amounts for specific purposes. These include:

  - no interest loans and low interest loans. Further detail can be found in Chapter 4; and

  - Saver Plus, a matched savings and financial education program targeted at people on low incomes, which is run by the Brotherhood of St Laurence in partnership with the ANZ Bank and the Government. It offers people who meet their savings goal matched savings of up to $500 per participant. Participants must attend MoneyMinded financial education and learn about planning and saving, understanding paperwork, credit and debit, and rights and responsibilities.

- The Government's *Community Development Financial Institutions (CDFI) pilot project*, managed by FaHSCIA, has funded five organisations to provide low cost lending and other facilities for low income earners. Further detail can be found at Chapter 4.

- The *Home Energy Saver Scheme* (HESS) will provide support to low-income households across Australia experiencing difficulty meeting and paying for their energy needs. Further detail can be found later in this Chapter.

- *Money Management Services* provides practical and essential support to help people build their capability to manage their money better in the longer term and increase their financial resilience. The services are primarily delivered in remote locations with high Indigenous populations and are open to the broader community. Services may include: education and coaching in financial literacy and budgeting; provision of tools to support individual and family budgeting and savings and debt management plans; and delivery of approved money management courses.

- Other initiatives under the FMP include funding for the National Information Centre on Retirement Investments and research into problem gambling.

MoneySmart website

The MoneySmart website (www.moneysmart.gov.au), run by the Australian Securities and Investments Commission, is also available to assist individuals to make smart choices about their personal finances. This website provides free, independent guidance to individuals about how to improve their personal finances, including information on dealing with life transitions such as losing your job, having a baby, divorce or separation and buying a home. Tools available through the website include budget planners, a savings goal calculator, a financial counsellor online search tool, personal loan and credit card calculators and fact sheets on various topics such as payday lending and the No Interest Loans Scheme.

Centrepay, advances and weekly payments

In addition to programs and services funded under the FMP, the Australian Government has a number of tools and services available through the Department of Human Services (DHS) to assist with smoothing lumpy expenditure and quick access to money in times of crisis, such as Centrepay or Advance Payments respectively. Increased promotion and use of these options may assist individuals to better manage their money and reduce demand for high-cost, small amount loans.

Centrepay

Current arrangements

Centrepay provides DHS customers with a free bill paying service that allows for voluntary deductions direct from DHS payments. These deductions are forwarded directly to the participating entities as full or part payment for essential services prior to the customer's money being deposited into their bank account.

Centrepay was originally introduced in Indigenous communities to help with housing payments. It was expanded as a debt prevention measure to ensure bank accounts did not become overdrawn through bank direct debit arrangements and to minimise direct debit costs for low income earners. It has not to date been used to support customers' savings strategies. DHS has in the past explored providing a savings deduction option but this has not proceeded for a number of reasons, including:

- DHS is not a financial institution so banking laws do not permit it to hold customers' money in savings; and

- banks already provide savings schemes and therefore have been reluctant to pay the Centrepay fee.

Organisations pay DHS a fee for receiving payments through Centrepay and must demonstrate that they meet all legislative and regulatory requirements relevant to that business in order to become an approved Centrepay participant. Participants must demonstrate an external dispute resolution mechanism to be eligible for inclusion in the scheme. Should a Centrepay participant breach these requirements it may no longer be eligible to participate in the scheme.

In recent research, Good Shepherd Youth and Family Service highlighted the importance of Centrepay in helping people to manage their money and providing payment options for people on low incomes.[27] The report noted that the use of Centrepay was preferred to direct debits because household expenses are removed from welfare payments before they arrive at the financial institution. This allows DHS customers to better manage their money

In order to protect customers, DHS has restricted access to Centrepay to organisations that align with specific service reasons defined in Centrepay policy. These service reasons support the use of Centrepay as a tool that helps customers to improve their financial self-management, and cover payments for essential services and regular ongoing expenses such as accommodation, education and employment.

Currently, Centrepay is used successfully by Good Shepherd Microfinance for No Interest Loan Scheme (NILS) repayments by customers.

Options

One way to assist vulnerable individuals to pay for essential items without the need to resort to high cost, small amount loans could be to extend Centrepay eligibility for a broader range of purposes. This may include, for example, providing access to alternative financial products provided by CDFIs or other organisations with a charitable or social purpose.

Under any expanded criteria, services would have to meet the objectives of the Centrepay scheme to enhance the well-being of its customers by improving their social capacity and encouraging their movement towards financial self-management. Organisations funded under FaHCSIA's microfinance service strategy could achieve this by:

- providing access to credit for those underserved by mainstream financial services;

- providing an alternative to costly small amount, short-term lenders;

- building financial capability through financial education and money mentoring; and

---

27 Corrie, T.(2011). *Microfinance and the household economy: Financial inclusion, social and economic participation and material wellbeing*, Good Shepherd Youth & Family Service

- providing a pathway for individuals to transition to mainstream financial services by improving an individual's credit rating.

ADVANCE PAYMENTS

Current arrangements

Advance payments are delivered by DHS through Centrelink. Advance payment arrangements allow pension, allowance and family assistance recipients to receive a portion of their future entitlement as a lump sum. The advance is repaid through fortnightly deductions.

From 1 July 2010, the Government made pension advance payments more accessible and flexible. The changes apply to Age Pension; Disability Support Pension; Carer Payment; Widow B Pension; and Wife Pension. Pension advance payments are subject to maximum and minimum amounts, which are increased with pension indexation each March and September. Depending on the amount requested, pensioners may take one, two or three advances of their pension entitlement, up to a maximum amount (currently $1,074.90 for a single full rate pensioner), in a 13 fortnight period.

Eligible Parenting Payment Single and allowance recipients may access an advance of up to $500. The minimum advance payment available is $250. The maximum and minimum advance payment amounts are not indexed. These advances are limited to one per 12 month period.

From 1 July 2011, the Government also changed the Family Tax Benefit (FTB) advance payment arrangements to improve accessibility and flexibility to meet lumpy expenditure and provide families with alternatives to payday lending facilities. Since the introduction of these reforms, eligible FTB customers can now receive an unlimited number of advances of at least the minimum amount (around $160), with the total outstanding not exceeding 7.5 per cent of their annual FTB instalment rate (up to $1,000), with amounts becoming available again as each advance payment is fully repaid.

FTB advances include the qualification that customers with repeated requests for advances, rejections due to affordability or reduced or suspended advance payment recovery should be offered a referral to an appropriate financial counselling or support service. While this is not mandatory for other forms of advances, a referral is available to all customer groups.

Subject to eligibility, both pension and allowance advances may be held concurrently with an FTB advance.

Advance payments are a useful tool for customers who may have made a considered decision to use the advance payment for a specific lump sum expense, for example car registration. Other examples of their use include enabling individuals to avoid building up higher credit card bills or seeking small loans from high interest providers in times of crisis.

WEEKLY PAYMENTS

Current arrangements

The Australian Government currently makes weekly payments available to some vulnerable DHS customers to support them to better manage their finances and stabilise their circumstances. This means that a customer on weekly payments normally has less time to wait until they receive payment, which could assist them in avoiding financial crises and the need to access high-cost small amount loans.

DHS staff offer weekly payments in conjunction with referrals to other services as appropriate (for example, services such as housing, financial counselling, drug rehabilitation or domestic violence counselling). DHS staff may also promote the use of Centrepay and where appropriate, Voluntary Income Management.

Receiving income support payments on a weekly basis is voluntary and is specifically targeted at those who are financially vulnerable — such as recipients who have difficulty managing their finances, including those with mental health issues, gambling and/or substance addictions, victims of domestic violence, or others who have demonstrated they have difficulty managing their money to last to the end of a fortnight.

As at January 2012, there were more than 14,500 customers receiving their income support payments on a weekly basis.

Questions

1. Currently the Government offers Centrepay, advance payments and weekly payments as mechanisms for customers to manage their money. Are there any other mechanisms that could be used for this purpose?

2. Should referrals be made to FMP services at a certain stage as a matter of course?

ENCOURAGE GREATER USE OF UTILITY HARDSHIP PROGRAMS

Evidence from community organisations as well as the high numbers of customers using small amount lending services to pay utility bills suggests that their inability to pay utility bills is a major reason that people access, short-term loans. Demand could be reduced through improved access to utility retailer's hardship programs and other schemes aimed at improving energy efficiency and financial management.

EXTENT OF USE OF SMALL AMOUNT LOANS TO MEET UTILITY DEBTS

Between 50 and 70 per cent of borrowers primarily use small amount credit to meet basic living expenses, with data from a series of surveys of consumer use of this credit finding that up to 32 per cent of small amount loans were used for bills. In 2010, the Consumer Action Law Centre reported that around 21 per cent of these loans were used for the payment of utility bills.

Utility bills featured highly against other major uses of small amount loans, such as daily living expenses, food and rent, and car and registration costs.

Utility bills, specifically electricity and gas, are not discretionary expenses but are essential services which some consumers struggle to pay. The high rate of use of small amount loans to pay utility bills suggests that some borrowers could be better off entering into hardship arrangements with their provider or accessing other assistance rather than using the credit provided under a high-cost, small amount loan contract.

The introduction of obligations under soon to be implemented national legislation creates an opportunity to develop more rigorous standards in relation to the operation of utility hardship schemes and to provide consumers with more consistent messages about how to access these schemes.

CURRENT ARRANGEMENTS

There are around 20 retail providers of electricity and gas around Australia. Providers are currently required under State and Territory law to offer hardship plans and payment options for consumers in financial difficulty, with nationally consistent obligations coming into force on 1 July 2012 (except in WA and the NT).

Under existing State and Territory rules governing electricity and gas supply, each regime is different but the common options offered are payment plans, rebate programs and referrals to financial counselling services. More information on the types of financial assistance currently provided in each State and Territory is set out in Attachment A.

Any hardship plan needs to be agreed between the customer and the provider, be consistent and transparent and meet the needs of the customer. Importantly, while complying with a hardship or payment plan, consumers cannot be disconnected.

If agreement on a plan cannot be reached, consumers can seek to have the complaint dealt with internally initially. If they are still dissatisfied complaints can be heard through the Victoria, WA, Queensland, NSW, Tasmania and SA ombudsman offices. The ACT provides an alternative service for dealing with customer complaints.

REGULATION OF ENERGY DISTRIBUTORS

The *National Energy Retail Law (South Australia) Act 2011* (together with the *Statute Amendment (National Energy Retail Law) Act 2011*) establishes a national framework for the regulation of energy distributors, with jurisdictions working towards a common commencement date of 1 July 2012. The legislation applies to all energy retail providers except those in WA and the NT who are not part of the national energy framework.

- WA will remain covered by its own state regulatory scheme, which provides hardship programs, including rebates, concessions and payment plans for consumers in financial difficulty.
- The NT has no legislative requirement to provide hardship programs, and only two retail providers. The major NT retail energy supplier, PowerWater, has voluntarily implemented its own hardship program for its customers. The second provider is new to the market, but mainly services wholesale clients.

The national regime includes minimum requirements for the provision and management of hardship programs. In summary, providers are required to have:

- processes to actively identify customers in financial difficulties;
- processes for early response where required;
- flexible payment options, including a payment plan and use of Centrepay;
- processes to provide appropriate information to those in hardship, for example, government concession programs, counselling services;
- an outline of a range of programs to assist hardship customers;
- processes to review the appropriateness of any contract to assist hardship customers; and
- processes and programs to assist customers with strategies to improve their energy efficiency.

Providers will also be required to publish details of their approved hardship policies on their website for easier access for their customers. Some providers already include brief details of their hardship programs on bills, although this is not compulsory.

For pensioners and healthcare cardholders, State, Territory and Commonwealth government assistance will still be available in the form of rebates and concessions, subject to eligibility requirements.

The Australian Energy Regulator (AER), the independent national regulator of energy supply in Australia, and part of the Australian Competition and Consumer Commission, will approve, monitor and enforce the implementation of these hardship policies, and has issued guidance on its website for this purpose. Energy providers were required to submit their customer hardship policy to the AER for approval by 1 December 2011. Once the new national energy laws have been operational for a reasonable period of time, AER will be able to provide energy consumption data across different areas and demographics which will enable consumers to determine whether their own energy usage is high, low or average.

The introduction of nationally consistent legislation for hardship programs should contribute to reducing the need for consumers to resort to borrowing to pay their utility bills. These programs are free to access, and can deliver positive results for both parties, including affordable payment plans to reduce debt. Importantly, it also means that fewer customers will risk having their utility supply disconnected.

Limitations in consumer use of hardship programs

Evidence from community organisations as well as the numbers utilising small amount lending services to pay utility bills suggests that these hardship programs are not well utilised or recognised. This could be due to a number of reasons, such as not reading the relevant information, or people being embarrassed to advise the provider that they are struggling with their bills.

The new national energy legislation will help to address this by:

- requiring providers to publish their hardship program details on their website; providing greater visibility of the existence of these hardship policies; and

- encouraging providers to adopt best practice, particularly by developing programs to proactively identify consumers who may be in financial hardship but not necessarily taking the initiative in addressing their problems (for example, those who are consistently late in paying). This should also help to address those areas where consumers are reluctant to seek help.

Social media, such as Facebook and Twitter may also be an avenue to promote the various concessions and hardship programs available to individuals in need.

Another option would be the development and distribution of generic pamphlets and information on concessions, consumer rights and hardship programs which could, with the agreement of the Department of Human Services, be placed in Centrelink offices.

IMPROVED ACCESS TO OTHER ASSISTANCE WITH ENERGY HARDSHIP

Another avenue to explore in terms of reducing the demand for small amount loans linked to utility hardship is to improve access to energy efficiency and financial management programs to minimise the cost of energy bills and improve financial strategies in managing these bills.

ENERGY EFFICIENCY PROGRAMS

There are over 300 existing programs across Australia that assist households with improving their energy efficiency and management of their energy bills. These programs vary across states and territories but often include a home energy audit supported by varying levels of access to energy efficient devices and energy and financial management education. Enhanced promotion of these programs could increase access and reduce energy costs, potentially leading to reduced demand for high-cost, small amount loans to meet energy costs.

The Government has recently announced a range of complementary measures to assist low-income households with energy efficiency and energy bills as a part of its Securing a Clean Energy Future climate change plan, the Home Energy Saver Scheme and the Low-income Energy Efficiency Program.

THE HOME ENERGY SAVER SCHEME (HESS)

The Home Energy Saver Scheme (HESS) will provide $29.9 million over four years (until 2014-15) to support low-income households across Australia experiencing difficulty meeting and paying for their energy needs. The Scheme, which is due to be operational from July 2012, will provide access to energy efficiency and financial management information, advice, advocacy, support, referral to the No Interest Loans Scheme (if appropriate) and integrated service co-ordination around energy efficiency and financial management. These services will be delivered to 100,000 low-income households, including tailored in-depth assistance through a home visit by a trained worker to 50,000 households.

The Scheme will be delivered through existing not-for-profit organisations that provide financial counselling services and will focus on working with households to improve their financial and energy management practices and engagement with the energy market.

An important part of the Scheme will be to link participants with the No Interest Loans Scheme (NILS) as appropriate to enable them to access capital to make longer term energy efficiency improvements.

Financial Management Program service providers already encounter many individuals with energy hardship issues. HESS seeks to build on that service framework by improving its resourcing and capacity to provide advice and assistance to low income households on energy hardship issues. HESS will complement other energy programs.

The Low Income Energy Efficiency Program (LIEEP)

The Low Income Energy Efficiency Program (LIEEP) will provide grants to consortia of government, business and community organisations to assist low income and vulnerable households overcome barriers to energy efficiency and to better manage their energy use.

Trials under the program will be aimed at overcoming barriers to energy efficiency (such as information failure, capital constraints and split incentives) which prevent low income households from adopting more energy efficient practices. As LIEEP is focused on energy efficiency, grant funding will not be able to be used to fund installation of renewable energy generation systems.

The trials will consider innovative ways to deliver approaches that will implement energy efficient technologies, assessing costs and benefits, collecting and benchmarking data and establishing effective administration and communication tools.

Questions

3. Should providers of high-cost small amount loans be required to advise individuals about the existence of hardship programs where the individual is seeking loans to pay a utilities bill?

4. How can individuals be encouraged to use these alternatives for paying utility bills rather than using high-cost small amount loans?

5. What are the advantages and disadvantages of requiring energy providers to provide information on their payment plans and hardship programs initially when contracts are entered into or renewed, and on each bill?

6. Are there other support services that would help reduce energy hardship and the demand for small amount, short-term loans to pay energy bills?

7. Should energy hardship programs be promoted more widely? If so, what mechanisms could be used?

CHAPTER 3
IMPROVE THE SMALL AMOUNT, SHORT-TERM LOAN PRODUCT

The regulation of credit providers, including small amount lending, is now the responsibility of the Commonwealth after the 2009 referral of power and the commencement of the *National Consumer Credit Protection Act 2009,* incorporating the National Credit Code.

The Enhancements Bill complements the Credit Act's licensing and responsible lending obligations by introducing:

- a cap on the fees that can be charged on small amount contracts (defined as a contract for $2,000 or less, with a maximum term of two years);
- a national interest rate cap of 48 per cent in respect of all other credit contracts;
- limits on repeat borrowing; and
- the requirement for small amount lenders to disclose information on alternative options on their website, about the availability of alternative sources of assistance and alternative no cost or low-cost credit.

The provisions in the Enhancements Bill were the subject of a review by the Parliamentary Joint Committee on Corporations and Financial Services. At paragraph 5.223 of its report the Committee stated:

> *'The very nature of a small amount short-term loan indicates that the loans are being sought to address financial difficulty. In entering into a pay-day loan contract, consumers exchange what appear to be substantial fees for a rapid injection of cash. For consumers in financial hardship, or those not understanding the financial implications, this may be a perilous path. The committee considers that the short-term loan market is a complex market in which a proportion of consumers are not fully informed'.*

The Enhancements Bill is scheduled to be passed into law in the winter 2012 sittings of Parliament (following further consultations and amendments in light of the recommendations in the Parliamentary Joint Committee report). These reforms are intended to help mitigate the extent small amount lending causes financial harm to individuals excluded from mainstream financial services.

The Government has conducted extensive consultations with stakeholders in relation to the legislative reforms proposed in the Enhancements Bill. Accordingly, this Discussion Paper does not seek any views on those reforms. Further information on the Enhancements Bill can be found at:

http://www.treasury.gov.au/consumercredit/content/default.asp

CHAPTER 4
ENCOURAGE ALTERNATIVES TO HIGH COST, SMALL AMOUNT, SHORT-TERM LENDING

Another strategy to increase the financial inclusion of individuals is to ensure that fair and appropriate alternatives to high cost, small amount, short-term lending are available to vulnerable Australians. Such alternatives will need to cover the spectrum from products provided by not-for-profits through to mainstream alternatives to cover the different circumstances of individuals. These alternatives could include support with managing debt, as well as improving access to alternative sources of cheaper small amount lending and/or other financial management support services.

CURRENT ALTERNATIVES

Financial Management Program

As discussed in Chapter 2, the Government's Financial Management Program (FMP) provides funding to a number of services to assist in building an individual's financial resilience and well-being across a range of income and financial literacy levels. These services include microfinance initiatives, such as the no and low interest loans schemes (NILS and LILS) and the Community Development Financial Institutions (CDFIs) pilot.

No and Low Interest Loans Schemes (NILS and LILS)

The No Interest Loans Scheme (NILS) provides eligible low income people with loans ranging from $800 to $1,200 at zero per cent interest to buy essential household items. The scheme is run by Good Shepherd Microfinance in partnership with the National Australia Bank and the Government. A list of providers is available on the Good Shepherd website at: http://www.goodshepvic.org.au/microfinance.

StepUP, a low interest loan product, acts as a stepping stone to help people on low incomes transition into mainstream credit products. Loans range from $800 to $3,000, offer a low fixed interest rate (currently at 3.99 per cent), have no fees and a have repayment period of up to three years. The scheme is run by Good Shepherd Microfinance in partnership with the National Australia Bank and the Government.

Good Shepherd has been delivering the No Interest Loans Scheme for over 30 years and NILS sites are now operating in over 400 locations across Australia. In 2011, Good Shepherd announced the establishment of a new entity, Good Shepherd Microfinance, with the aim of further building their microfinance programs and developing new microfinance responses to community needs.

While these types of loans are able to assist many low income consumers to obtain small amounts of credit for specific purposes, there are characteristics of these products that make them an unsuitable alternative to high-cost, short-term loans for many consumers of these products. High-cost, short-term loans, for example, have a very fast application and approval process, with consumers often able to receive an immediate cash advance. There are few limitations on the amount that can be loaned or the potential uses of the loan.

This is in contrast to a NILS or StepUP product, which is ultimately designed to ensure that the loan is in the best interests of the consumer. Loans are provided for asset building purposes, specifically for the purchase of essential household items such as fridges, washing machines or other essential needs. Due to the diligence applied by community organisations, these loans can also take some weeks to be approved, there are restrictions on the amount that can be borrowed and they are only available to those individuals who hold a health care or pension concession card

The specific eligibility requirements applying to NILS and StepUP products, their limited coverage and lack of universal access for financially excluded groups has meant that there remains unmet demand for small amounts of credit. This is one factor that has led to significant growth in the high-cost, short-term loan sector.

Community Development Financial Institutions (CDFIs)

In 2011, the Government, through its Community Development Financial Institutions (CDFI) pilot, provided $6 million to five community finance organisations for a range of business development and infrastructure costs.

The FMP's CDFI pilot seeks to build the capacity and resilience of disadvantaged and financially excluded individuals by funding community finance organisations that offer them financial services and products they would otherwise not be able to access from mainstream sources. CDFIs provide financial products (such as loans) and financial services (such as financial literacy, counselling or business development advice).

In market terms, CDFIs helps to fill the gap between welfare and mainstream financial institutions. CDFIs target individuals on low incomes and those who experience discrimination in the lending market. These are individuals who could afford financial products and services but cannot gain access to them.

CDFI loans offer greater flexibility in loan purposes than NILS and LILS loans. However, due to the small number of CDFIs participating in the pilot, coverage and loan volume is limited.

Each CDFI in the pilot is working closely with a bank or credit union for capital funding purposes. At 20 March 2012, these organisations had provided 804 loans to individuals. The pilot is currently being evaluated and its future is subject to a report on the pilot, due in August 2012.

QUESTIONS

8. Is building upon existing programs and extending the criteria for accessing these programs, such as NILS and StepUP, an appropriate alternative to small amount, short-term loans?

9. If yes, should the eligibility and purpose criteria for no interest and low interest loans be expanded and what should these criteria be expanded to include?

10. How more partnerships could be developed between community service organisations and financial institutions to increase the number of these products and their coverage.

Encourage mainstream lenders to support small amount lending

There are a number of strategies which could be used to encourage mainstream lenders to support low-cost, small amount lending to a greater extent than is currently the case. For the purposes of this discussion, 'mainstream lenders' are lenders who are of a large enough size or have sufficient resources to offer a broad range of credit products other than small amount contracts.

This section will first examine how mainstream lenders are encouraged to support low cost small amount lending overseas and then present the Australian experience.

Overseas approaches

Overseas jurisdictions have considered the use of both statutory and non-statutory mechanisms to further the engagement of mainstream financial institutions in building their smaller lending sectors for the financially disadvantaged.

Approach in the United States

In the United States (US), the *Community Reinvestment Act* (CRA) was enacted in 1977 to require banks to serve the credit needs of the low and moderate income neighbourhoods to overcome reliance on fringe credit providers. It initially focused on residential mortgage lending but has now moved to offering banking services to individuals on low incomes. CRA encourages responsible lending as the law makes it clear that an institution's CRA activities should be undertaken in a safe and sound manner. It provides rewards in terms of ratings based on the extent of lending to marginalised borrowers and the range of services provided. The rating system assists financial institutions to obtain funding for this purpose and has resulted in the channelling of significantly more credit into low income and minority neighbourhoods than before its enactment. The CDFIs funded through this model can also benefit from tax credits which encourage further investment into this sector through entities who in turn offer those tax credits as an incentive for investment. To qualify for tax credit an organisation needs to demonstrate the primary mission of serving or providing investment capital for low income communities or persons.

In the US, the CRA has significantly contributed both to raising awareness of lending and investment in underserved markets and to opening up a flow of capital to community-focused entities such as CDFIs. However, there is also an argument that the CRA has not kept up with changes that have taken place in financial systems since it was enacted in 1977, and some argue that the issues it was intended to address have changed so much that the Act is now largely irrelevant. It remains, however, the key foundation legislation underpinning capital supply to CDFIs in the US.

Another form of incentive used in the US is the Program Related Investments (PRI). This may be considered a form of tax incentive in that PRI's enable a charitable foundation to count a qualifying investment as part of its required five per cent charitable distribution.

Approach in the United Kingdom

In the United Kingdom (UK), the Government's Financial Inclusion Growth Fund has provided lending capital and administration funding to increase the availability of affordable personal loans via third sector (not-for-profit) lenders such as credit unions and CDFIs. The Growth Fund is managed through contracts which incentivise and support third sector lenders to increase lending and improve professional standards. Institutions have sufficient flexibility to set borrowing costs so that they can recoup their delivery costs. While annualised percentage rates (APRs) can seem quite high, costs are still lower than for-profit lending to low income households and are significantly lower than those proposed in the Credit Enhancement Bill. The delivery model's success is also based on institutions' presence and profiles in local communities, which allows funded organisations to support their borrowers to repay loans.

Also in the UK, the Government contributes to the Community Development Finance Association (CDFA) for CDFIs, providing them with sector development support and with an advocate to liaise with government. The CDFA also established a Code of Practice for its member institutions. A voluntary disclosure regime has also been put in place encouraging CDFIs to report on their lending activities to marginalised communities but there are varied reports on its success with encouraging investment and lending in these communities. As such, there have been calls in the UK to make it mandatory. The UK Government also provides tax relief to CDFIs undertaking microenterprise lending but not personal lending. There have also been calls to extend this relief to attract further investment into this area.

Products delivered through the US and UK approaches

Due to the range of supports and incentives introduced by Government, an energetic CDFI sector has grown in other developed countries. Although at varying stages in their development, all have created significant social and financial outcomes for financially excluded individuals, organisations and communities.

As mentioned earlier, in the UK the Government's Financial Inclusion Growth Fund has provided lending capital and administration funding to increase the availability of affordable personal loans via third sector lenders such as credit unions and community development finance institutions.

In the US, the CDFI fund uses government resources to invest in CDFIs and to build their capacity to serve low-income and underserved individuals and communities. The program offers both financial and technical assistance awards through a competitive process to certified CDFIs. The awards can be used for financing capital, loan loss reserves, capital reserves or operations. They are made in the form of equity investments, loans, deposits or grants. Importantly, the CDFI is required to match the award dollar-for-dollar with private capital. Thus the fund not only provides government funds to the sector but it also leverages the flow of private capital into the CDFI sector. The certification program and technical assistance also play a role in helping CDFIs attract this private capital through instruments such as the *Community Reinvestment Act*.

In the US and UK markets, CDFIs have played a major role in increasing access to services for financially excluded individuals; however, in Australia the market is embryonic and consists of a handful of organisations providing a limited range of products to a small number of individuals.

Current Australian approaches

Current arrangements

The financial system both within Australia and overseas has changed markedly over the past few decades, and so what determines an 'underserved market' or a financially excluded group of people has also changed. In Australia friendly societies formed around making benefits and insurance accessible, building societies played a crucial role in making home loans accessible, and later (in the 1960s and 1970s) many local and industry credit unions began as savings and credit self-help initiatives for groups that found it hard to access mainstream credit. Though most of these organisations have now themselves become mainstream financial institutions, many could be seen to have been the original CDFIs, making key financial products and services accessible to underserved markets. There has been, however, a significant consolidation of the Australian financial services industry and this has led to changes in products and services, and in the nature of financial institutions themselves.

CDFIs have the potential to act as financial intermediaries, institutions that link financial services and products to the needs and capacities of underserved markets and thereby improve access, develop specialist products and services and enhance the flow of capital into underserved markets.

The products offered by the Australian Government's CDFI pilot are intended to provide alternatives to high-cost, small amount, short-term loans. Loan products have flexible purposes (asset building, debt consolidation, payment of bills) and are provided at lower interest rates and for similar amounts to those offered by small amount, short-term lenders. CDFIs also provide support through money management educators.

CDFI sector and access to funds

As already stated, in Australia the CDFI sector is comparatively underdeveloped. There were less than 10 CDFI-like organisations identified during the course of a scoping study commissioned by FaHCSIA in 2009[28], which operate a loan portfolio of less than $150 million. There is, therefore, scope for emergence of a CDFI sector in Australia.

The final results of the current FaHCSIA CDFI pilot evaluation will provide an evidence base for any further government action in this area. An issue that has already been raised through the pilot is the need to define CDFIs clearly and to have a system of certification. A clear definition and certification system would be crucial to ensuring integrity of any emergent CDFI sector in Australia including ways of targeting assistance to those most vulnerable in the community.

The growth of a CDFI sector in Australia will require access to capital and operational funding. More financial institutions would need to be encouraged to help meet the funding requirements of the local communities in which CDFIs are established. This could be assisted through a number of mechanisms, similar to those used overseas, including a UK style financial inclusion growth fund or CRA-like legislation. Additionally, a regulator such as ASIC would need to provide supervisory and regulatory oversight, consistent with safe and sound operation. In the US enforcement is undertaken through the examination of banking institutions for CRA compliance.

Introduction of similar legislation in Australia could also encourage mainstream financial institutions to develop a suite of alternative microcredit products such as debt consolidation loans, low income credit cards and insurance products or encourage the provision of low-cost capital to intermediary organisations such as credit unions and CDFIs to provide these services on their behalf.

28 Social Ventures Australia (2009), *Community Development Financial Institutions Scoping Study*.

POTENTIAL MECHANISMS TO ENCOURAGE MAINSTREAM LENDERS TO PROVIDE SMALL LOANS

Encouraging mainstream lenders to provide small loans

Most major banks or mainstream financial institutions are not actively providing affordable small amount, short-term mainstream loans. Increasing participation by these institutions would alleviate an important shortfall in the market place while also providing the financial institution with an opportunity to raise their profile, build trust within the community, produce future business opportunities, and increase their long-term customer base.

The size of some of these financial institutions suggests that offering these types of lending products would have little detriment on other services or to shareholders, would likely have a beneficial impact on their public image and community reputation and could lead to further investment in the organisation from those seeking more socially responsible investments.

The Government could encourage more mainstream financial institutions, particularly the major banks, to provide more affordable and accessible small amount, short-term lending opportunities as part of their social responsibility programs. This could be done either through mandating Corporate Social Responsibility (CSR) reporting requirements or through introducing or making more visible voluntary specific CSR reporting requirements.

If this strategy were to be progress, a policy or legislative framework would be required.

Mandated reporting requirements

Under this strategy, mainstream lenders would be encouraged to contribute more towards providing small amount short-term loans by mandating specific CSR reporting obligations on small amount short-term lending activities. Lenders could be required to disclose information such as:

- details of their overall strategy to provide services and resources to the financially disadvantaged in the community;
- specific details of any programs or funding they undertake that impact the community, particularly low income, welfare recipients or other financially disadvantaged groups;
- lists of target stakeholders and evaluations of its performance; and
- details of any future plans.

Mandating the reporting of a financial institution's activities in relation to small amount lending would provide shareholders, other potential investors and the community generally with information on whether that particular organisation is providing some form of assistance to financially vulnerable individuals and could encourage organisations to introduce products and programs for this purpose.

Voluntary reporting requirements

Under this strategy, mainstream lenders would be encouraged to contribute more towards providing small amount, short-term loans by introducing or making more visible voluntary specific CSR reporting obligations in relation to small amount short-term lending activities.

Although not mandatory, many corporate entities both nationally and internationally now commonly include non-financial reporting elements in their annual reports, including details of their CSR activities, through reporting frameworks such as the Global Reporting Initiative. Indeed, many corporations view this as an opportunity to publicise their activities and reap the benefits of being socially responsible. This in turn can lead to the building of better relationships with the community, employees, suppliers and environmental groups, and for attracting more investment.

The Global Reporting Initiative

The Global Reporting Initiative (GRI) produces a sustainability reporting framework that is used around the world. The GRI aims to encourage consistent mainstream disclosure on environmental, social and governance performance of corporate entities. Participants include global businesses, academic and professional institutions, with some Australian institutions, including some of the four major banks.

This reporting framework could support voluntary reporting and the Australian Government and other interested stakeholders, including shareholders, could actively encourage financial institutions to include small amount, short-term loans as an indicator of CSR.

The banking industry's Code of Conduct provides another means, also voluntarily, by which corporations can report on these issues. Government could engage with the sector to actively encourage the banking industry to include small amount, short-term loans through their Code of Conduct.

Encourage innovation, including CDFIs, by supporting the growth of services to assist low income individuals

Support could also be provided to increase the number, accessibility and coverage of CDFIs in Australia through a revised regulatory framework and access to capital for infrastructure and lending. This approach could provide a response to high-cost lending issues, although all the financial, legislative and regulatory requirements likely to be needed to support the growth of the sector would require careful consideration.

Under the model currently being piloted capital for CDFIs is provided from corporate responsibility funds of a limited number of banks through a bilateral relationship between the lender and CDFI. The provision of capital can take the form of a low cost line of credit, holding the loans on the bank's own loan book or, in a limited number of cases, operational and capital grants.

While these relationships provided capital for the CDFI pilot, mechanisms to improve the amount and flow of capital are required for growth in the provision of small amount loans to individuals who might otherwise access high-cost short-term loans. These mechanisms could include CRA-like legislation or requiring mainstream financial institutions to report on their service delivery to underserved groups (discussed above). Reporting could take the form of compliance reports under CRA-like legislation, or reporting requirements in annual reports which would be publicly available.

Extend deductible gift recipient status to cdfis

A deductible gift recipient (DGR) is an organisation that is entitled to receive income tax deductible gifts and deductible contributions.

CDFIs have a business model that maximises financial sustainability by leveraging philanthropic and private investment to cover costs and potentially generate a return on capital investment.

Evidence from the CDFI pilot to date suggests that reaching financial sustainability, particularly given the high cost of service delivery to the targeted client population, is a significant challenge for an emerging CDFI sector. Most prominent of these challenges has been the access to affordable capital to maintain a loan portfolio. Access to DGR status could provide one solution for CDFIs seeking to access affordable capital to maintain their loan program.

Senate Economics Committee — Inquiry into Financing the Not-For-Profit Sector

These options could be better examined through a mechanism recommended by the Senate Economics Committee in November 2011. In its inquiry into Financing the Not-For-Profit Sector, the Senate Economics Committee recommended that a Social Finance Task Force consider possible options to further develop CDFIs in Australia.

QUESTIONS

11. What mechanisms would be most successful in encouraging mainstream lenders to improve access for low-income individuals to small amount loans?

12. Would reporting be an effective mechanism for encouraging mainstream lenders to increase their small amount, short-term loan activity and, if so, what type of reporting would be most effective? Is it reasonable to expect financial institutions to support the CDFI sector through their corporate social responsibility activities?

13. Should the growth of a CDFI sector in Australia be supported? If yes, what are the base requirements for growth of the sector? Would a UK style financial inclusion growth fund be an appropriate mechanism for developing a pool of capital funds that CDFIs could access?

CHAPTER 5
ASSISTING LOW INCOME INDIVIDUALS WHO FALL INTO DEBT CYCLES

One strategy for increasing access to alternative products and assistance with debt could be to establish a retail presence in direct competition with high-cost, small amount lenders.

'ONE STOP SHOP' HUBS

This strategy considers the establishment of 'one-stop shop' financial services hubs as a means of providing financially excluded individuals on low incomes with improved access to local, affordable and appropriate financial products and services.

The aim of these hubs would be to address financial exclusion by providing a retail service delivery model which could compete with the service offered by high-cost small amount lenders. The hubs would be well placed to provide services through a coordinated crisis to capability and asset-building approach, including through offering financial counselling, access to microfinance products, Emergency Relief, money management education and referrals to the Home Energy Saver Scheme. Other local services could provide a virtual or physical presence in the hubs, including local employment services, Centrelink and other local support services. Additional products could also be developed to directly compete with small amount loans currently provided by payday and fringe lenders. These are discussed in more detail in Chapter 6.

Current arrangements

There are currently a number of financial management support services available to vulnerable Australians who may be experiencing financial exclusion or financial stress in sites where many high-cost small amount lenders operate.

The majority of organisations are Commonwealth-funded Financial Management Program services, with some organisations offering a combination of services. While most organisations are not specifically funded to offer fully integrated financial support or assistance to individuals, or have a highly visible retail presence, many services also actively refer clients to other relevant local service providers.

A small version of a financial management service hub is currently being trialled in three locations in Victoria by Good Shepherd Microfinance, in conjunction with the Victorian Government and the National Australia Bank. These *Good Money Hubs* are being trialled in Geelong, Collingwood and Dandenong. The pilot will run over three years (from 2011) with an evaluation expected to be completed at the end of this time.

The intended outcome of the proposed hub model is a positive change in financial capability and levels of financial stress experienced by low income individuals and households. Increased financial capability will result in fewer households and individuals seeking assistance through more expensive and less appropriate forms of credit.

The hubs will also provide individuals and households with a holistic assessment of their financial situation and referrals to other support services, where appropriate, to allow them to develop longer-term debt reduction strategies and build their capability to manage their income more effectively.

Integrating relevant services in a 'one stop shop' model would also be expected to offer quicker and more effective referrals to other appropriate services.[29]

Ultimately, providing these integrated financial services would offer individuals at risk of financial stress:

- a one stop shop to support their financial management program service needs;
- tailored financial products and services;
- the opportunity for immediate and appropriate referral to other local support services; and
- alternative microfinance products to assist the individual's need for short-term financial assistance.

The shop-front retail model of the hubs would also be expected to engage a wider range of individuals, including those vulnerable and financially stressed individuals who do not traditionally identify as clients of community or financial assistance services. These individuals may include: non-Centrelink clients, older persons (asset rich, money poor), younger people and students.

Debt consolidation products and debt management advice

The hub model also offers opportunities to develop specialist products which could be delivered in the retail setting, such as debt consolidation products.

Debt consolidation products could also provide some relief to consumers who have existing small amount loans or who are trapped a debt cycle. This can include debt consolidation loans, a debt advice system under a debt management plan and improved access to existing products. This is discussed further in the next Chapter.

QUESTIONS

14. Can a financial services hub provide a viable alternative to high cost small amount lenders?
15. Would a hub approach make services more accessible for individuals who may be reluctant to visit major church providers for assistance?
16. Are there other services that could be included in the hub model?

29 FaHCSIA, unpublished report (2011)

CHAPTER 6
DEBT CONSOLIDATION PRODUCTS AND DEBT MANAGEMENT ADVICE

Debt management assistance is likely to help reduce the overall demand for small amount loans particularly for those individuals with either multiple loans/debts or where continual rollover of these loans has escalated debt to unmanageable levels through the application of multiple fees and high levels of interest.

The provision of specific debt consolidation products and support services to address the immediate needs of longer-term vulnerable individuals would assist in breaking the 'cycle of debt', while also building financial capability and resilience.

DEBT CONSOLIDATION LOANS

There are a range of commercial debt consolidation products available from mainstream financial institutions, in the form of unsecured personal loans, with interest rates ranging from 12 to 15 per cent.[30] However, it is difficult for the financially excluded to access any mainstream products for this purpose. The needs of vulnerable consumers would be addressed if mainstream institutions developed specialist programs to provide them with access to loans for $2,000 or less.

A trial of such a loan scheme is currently being conducted in Victoria. Good Shepherd Microfinance, the National Australia Bank and the Victorian Government are conducting the 'Debt Deduct' trial in a number of sites in Victoria. These loans will take a similar form to the NILS product, in that the loans will be at zero per cent interest and provide an additional tool for financial counsellors working with individuals in financial stress and with multiple debts. Individuals are only able to receive a 'Debt Deduct' loan where they have been referred by a financial counsellor. The trial is expected to be completed in 2014.

If this pilot provides evidence of significant benefits to the target group, this could be used as a model to implement such a scheme nationally. To operate effectively, as with CDFIs, this program would require ongoing support, including significant funding from mainstream lenders and/or Government.

DEBT ADVICE SYSTEM

A debt advice system similar to that used in the United Kingdom (UK) may also be useful in assisting individuals to escape the 'debt cycle'. The Consumer Credit Counselling Service is a UK based free debt advice service run by a charity organisation. It offers telephone, email and website services, and is the only agency in the UK to offer an on-line debt advice tool — Debt Remedy. They also offer debt management plans (DMPs), individual voluntary agreements (IVAs), mortgage broking via a preferred broker, and equity release services for

30 See *http://www.infochoice.com.au/personal-loans/unsecured/interest-rate-comparison/*

over 55s. They are 100 per cent industry funded, via initial donations, plus creditor contributions (a fixed percentage of Debt Management Plan payments).[31]

Debt Management Plans allow the centralised management of an individual's debts following assessment of each individual's financial situation and negotiations with all creditors on an agreed, tailored approach to an individual's debt issues. The individual then makes one central payment and the organisation disburses those payments to all creditors and provides ongoing monitoring of the debt management plan. Advantages of such an approach include that all an individual's debts and ongoing financial needs are considered as a whole allowing a more realistic analysis of capacity to pay and reducing the likelihood of failure to meet the agreed approach. Creditors are not negotiating debt in isolation from other creditors and have some assurance that the plan has a likelihood of being achievable, reducing the risk of default and costly pursuant actions.

The establishment of a similar not-for-profit debt advice service in Australia could reduce the demand for small amount loans, and provide a holistic and sustainable approach to debt management. Industry may also see advantages to supporting a similar model. There would be a need to regulate relationships to ensure consumers were protected and the organisation acted in the best interests of the individual (that is, linking of industry funding and debt collection).

EXISTING DEBT PRODUCTS

A debt reduction product that could provide a useful approach is the expansion of the National Bulk Debt Project.[32] This initiative was developed by the West Heidelberg Community Legal Service and aimed to assist people in long-term hardship, who have no assets and are on Centrelink payments. The initiative involved financial counsellors, legal aid offices and legal centres referring clients to the West Heidelberg Community Legal Service to negotiate with creditors for bulk waivers on the debts of these clients.

The National Bulk Debt Project allowed more than 400 clients to have $3.75 million worth of debt waived where the debt has been assessed as either being acquired through a lack of due diligence on the part of the lender/creditor or where an individual's circumstances had changed since acquiring the debt such that the debt would never be able to be addressed without causing severe detriment to the individual. Criteria for accessing this project were strict, including types of debt addressed, and the project made use of existing mechanisms including Section 60 of the *Social Security (Administration) Act 1991* which provides some protections of Centrelink client income.

If such an approach were to be applied, consideration would need to be given to what this might look like on a larger scale including whether criteria should be limited to basic services such as energy, water, communication and medical products and services; and limited to recipients of long term Centrelink payment types.

---

31 Consumer Credit Counselling Service *Consumer Credit Counselling Service of the UK*, presentation at the 2009 AFFCRA Conference, July 2009

32 See www.bulkdebt.org

QUESTIONS

17. What are the advantages and disadvantages of debt consolidation loans in relation to the objective of decreasing the cycle of debt for vulnerable individuals?

18. Is a not-for-profit debt advice service which includes capacity to implement and administer debt management plans, similar to the one implemented in the United Kingdom, desirable in the Australian context?

19. Is a national debt reduction project another potential mechanism for reducing demand for small amount loans? If yes, what types of debts should be covered and what other eligibility criteria for client participation should be applied? Should this be restricted to long term Centrelink customers?

ATTACHMENT A

EXISTING UTILITY FINANCIAL ASSISTANCE PROGRAMS[33]

NB — except for WA and NT, all states will be moving to the national energy legislation from 1 July 2012 which sets out hardship program mechanisms which supplies must meet to gain approval from the Australian Energy Regulator (AER).

Jurisdiction	Options
Victoria[34]	• Payment plans if consumer is in financial hardship. • Utility relief grant from the Victorian government (normally concession card holders but some flexibility around this). • Centrelink recipients may be entitled to concession rates and grants.
WA[35]	• Payment plans if consumer is in financial hardship. • Energy Rebate: The Government provides a range of subsidies and rebates to assist with energy costs for a range of people including those at financial disadvantage. • Hardship Utilities Grant Scheme: This scheme can provide a one-off grant of up to 85 per cent of the amount that a household owes to an energy or water retailer. It also refers people to a financial counsellor for counselling.
ACT[36]	• Payment plans if consumer is in financial hardship. • ACT Civil and Administrative Tribunal is empowered to order continued supply despite failed payment, to set up payment schedules and to discharge part or all of overdue account.

33 Except for WA and NT, all states will be moving to the national energy legislation from 1 July 2012 which sets out hardship program mechanisms which suppliers must comply with to gain approval from the Australian Energy Regulator (AER).

34 http://www.moneyhelp.org.au/Housing-costs/Energy-and-water-bills.html accessed 10/02/2011

35 http://www.energy.wa.gov.au/2/3265/64/financial_hardship_assistance.pm accessed 10/02/2011

36 http://www.acat.act.gov.au/category.php?id=3

Jurisdiction	Options
NSW[37]	• Retailers are required to make two offers of a payment plan to a residential customer experiencing financial difficulties before the retailer can move to disconnect the customer. • A number of rebate programs and energy account vouchers are available. • Free financial counselling services offered.
Tasmania[38]	• Payment plans if consumer is in financial hardship. • Rebates available to consumers with concession cards. • Additional concession payment available in form of credit to account.
Northern Territory	• No current legislative requirements for dealing with financial hardship. • Major provider to retail consumers has voluntarily established a hardship program under its corporate responsibility obligations based on individual circumstances, which include payment plans and referrals to counselling services.
QLD	• Payment plans if consumer is in financial hardship. • Electricity and gas rebate available. • Free financial counselling services offered.
South Australia[39]	• Payment plans if consumer is in financial hardship. • Energy concession available.

37 http://www.industry.nsw.gov.au/energy/customers/questions-electricity-gas-prices accessed 10/02/2011

38 http://www.concessions.tas.gov.au/concessions/electricity_and_heating;
http://www.energyombudsman.tas.gov.au/making_a_complaint/frequently_asked_questions#five

39 http://www.eiosa.com.au/faq.html

ATTACHMENT B

GLOSSARY OF TERMS

Term	Definition
AER	Australian Energy Regulator
ASIC	Australian Securities and Investments Commission
CALC	Consumer Action Law Centre
CDFI	Community Development Financial Institution
CRA	(US) Community Reinvestment Act
Credit Act	*National Consumer Credit Protection Act 2009*
CSR	Corporate social responsibility
DHS	Department of Human Services
EDR scheme	External dispute resolution scheme
Enhancements Bill	Consumer Credit and Corporations Legislation Amendment (Enhancements) Bill 2011
FaHCSIA	Department of Families, Housing, Community Services and Indigenous Affairs
FTB	Family Tax Benefit
FMP	Financial Management Program
GRI	Global Reporting Initiative
HESS	Home Energy Saver Scheme
LIEEP	Low Income Energy Efficiency Program
LILS	Low Income Loans Scheme
NILS	No Interest Loan Scheme