Fair Finance

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The General Manager
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The Treasury
Langton Crescent
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Monday 4th June 2012

Dear Sir / Madam

Discussion Paper:

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

I write to you to in response to the discussion paper issued April 2012. Fair Finance Australia (FFA) notes the Government desire to see improved outcomes for this sector and welcomes the opportunity to provide feedback on the extensive options and strategies canvased in the paper.

FFA strongly believes that action to restrict any predatory lending by providers of small value loans is welcome, as is any moves to address poverty in Australia by enhancements to the social security systems by way of improved delivery or value of benefits. We would like to emphasise that any strategies should include the needs of the emerging movement of community development finance institutions (CDFI) in Australia.

As our major focus is addressing financial inclusion in an appropriate and affordable alternative we have addressed that strategy first followed by comments around the other strategy areas that we also have an interest in.

Strategy: Encourage alternatives

Question 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?

Yes and No.

Yes: Alternative access to appropriate and fair loan products will always be an alternative to small sort-term loans. Many people take multiple loans from different sources to meet an expensive purpose such as car repairs or medical expenses. These "low doc" loans are often not made to acceptable responsible lending criteria and people find themselves in a debt spiral. A more appropriate loan in these cases could be an affordable loan over a longer period matched to meet the budgetary needs of the client.

No: Many small short term loans are just a minor cash problem that can be solved by a sort-term loan that is repaid over one or two repayment periods. If significant income is being received then these do not develop into an issue. The NILS and LILS products are not designed for this type of purpose and as they usually take some time to approve and advance they will never replace short term cash advances.

Centrelink advances are designed for such purposes and if that facility is already used then the person has very little alternatives. Advances could be made more flexible such as allowing multiple ones or top ups, but if requests are being made repeatedly then this is a major indicator that income management is a issue and financial counselling should be encouraged.

Question 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?

Purpose:

As NILS & LILS are designed for asset / services then any worthwhile purpose should be included. FFA agrees that living expenses, rental arrears and utility bills should not be included as these debts indicate that income is insufficient to meet day to day costs and any loans will only decrease income further. In these cases emergency relief and other income substitution such as food vouchers and food banks are more appropriate to try and save on expenses that can be reallocated into payment of rent and utility debts via payment arrangements.

Likewise payment of cash, payments to a third party or the loan recipient should not be considered as these are high risk strategies that take extra investigation and evidence gathering that are typically beyond the limited time constraint of normal NILS workers.

If day to day bills have become an issue because of temporary illness and unemployment then a NILS or LILS loan could be used to overcome this temporary set back. Currently NILS/LILS generally do not cover this purpose and many people try first to get funds via pay day lenders and as these have a short repayment requirement find themselves in a debt spiral. FFA has assisted with our loan products in those cases where a significant impact can be achieved via increasing income via a debt consolidation over a longer term or decreasing expenses via lower rental (moving assistance loans) or assistance back into employment. These type of cases do require a significant time commitment to assess affordability and put the most appropriate loan in place.

Eligibility:

The current general requirement to have a health or pension card is a good indicator of low income category and makes it easy for the NILS workers. The idea of having a set criteria is good for easy of operations but there should always be flexibility for the special cases. The basic requirement of 3 months permanent residential status is one that needs some flexibility for people moving to get cheaper rent or moving due to domestic relationship issues. Some NILS & LILS do not cover these type of scenarios, and maybe this area needs consideration.

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

The partnership between Good Shepherd and NAB to facilitate the NILS scheme and the access for StepUp loans is an excellent example of such a partnership. The community service organisations understand the need and see the demand for small amount financial products. The financial institutions have moved out of directly servicing this market as it is costly to provide small amount credit products. The solution for the institutions has been the promotion of credit card type products. As we know these type of continuing credit products are not suitable for people on low incomes or poor money management skills, and the financial institutions have developed entry requirements for these products that mean that low income people are not eligible.

The major requirement for increased partnerships is better understanding on both sides on the importance of access to financial products to everyone and for both sides to engage in debate around innovative products. The community organisations understand the demand and the financial institutions have the ability to design and deliver products, but the ongoing networking between the two side is not well developed with only informal and other gatherings such as the AFIN meetings. We suggest more formal networking and conversions should be encouraged.

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

Whilst statutory requirements such as the Community Reinvestment Act in the US provides a good mechanism it is unrealistic to think that could be achieved in Australia today.

The most effective mechanism is for the community sector and CDFIs to provide the financial institutions with clear messages about the type of products in demand, the true costs of delivering these kind of products and encouraging them to take active part in a three way conversation between Government, the community sector / CDFIs and the mainstream financial institutions to develop a joint solution to financial exclusion.

Question 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?

It is reasonable to expect financial institutions to support the CDFI sector through their corporate social responsibility activities. In fact through the Federal Governments CDFI Pilot (funded through FaHCSIA) the program mandated capital support from a mainstream financial institution as one of the criteria for receiving funding. Although small in scale these existing relationships prove that financial institutions can and will support CDFI activity and that there is a bedrock of activity that could be built upon to increase scale of activity.

The relationship between financial institutions and CDFI's is present in many of the international examples of CDFI activity. In the United Sates and the United Kingdom CDFI'S have grown to great maturity and strength through partnerships with financial institutions. This recognises the important role that CDFI's have to play in delivering finance and investment with a social focus into places that mainstream financial institutions find it too difficult to go. These partnerships deliver outcomes for both the CDFI's and the financial institutions as they share value across diverse missions of community and commercial outcomes.

There is no evidence to suggest that the same trends should not occur in the Australian context although they will be driven by different funding, financial, policy and social motivations. It is our view that the success of CDFI's in Australia is premised on a mixture of partnerships with financial institutions, clear policy settings (i.e. reducing financial exclusion for low income people) and government funding with an expectation of enterprise outcomes and leverage.

On the subject of reporting by financial institutions that is best left for them to decide through the partnerships. This is particularly helpful where disclosure and reporting around say loan declines supports a CDFI to target excluded markets. This results in a win/win for all involved and avoids the distortion possible in the market where mandated reporting drives the purpose of partnerships and product development to meet reporting goals and not the most appropriate and best solution outcomes for the target groups.

Question 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?

Yes the CDFI sector growth should be supported and indeed will grow organically anyway but could gain ground with funding support for government.. The base requirements at this stage of the growth in CDFI's should focus on:

1. Providing targeted program funding to maturing or mature CDFI's, this may include ongoing programs of funding such as those already provided through FaHCSIA.
2. Providing seed or growth capital to expand the number of CDFI's in Australia. There are more than 1000 in the United States and about 60 in UK. Our market is much smaller than either the USA or UK but you would expect more that a handful of CDFI's could find success and sustainability in Australia.
3. A standards framework that embeds the social and community mission of CDFI's into their further growth and development. Avoiding the possibility of opportunistic activity that leads to more exploitation and financial hardship. This could be achieved through a rating system, a voluntary set of standards monitored by an industry body or through legislation. However, the measure of standardisation needs to keep pace with the development of CDFI's to ensure that the standards are meaningful.
4. The development of a clearer understanding of the skill sets required to deliver CDFI product and services. This is a blended skill set reliant on both financial skills and community skills. This understanding should allow the development and promotion of targeted training that reinforces the standards referenced above.
5. Education about this new form of financial intermediary will be critical in the ongoing task of developing the CDFI market in Australia and this should be taken on as an industry wide responsibility, regardless of the size of the industry.
6. Well governed organisations that are structured to deliver the outcomes they seek will be critical and should include using all of the existing regulatory mechanisms required for both the delivery of consumer finance and for raising capital. We believe that the current regulatory framework is adequate and should be used to provide structural strength to the sector as it grows.
7. An evidence base for this work needs to be a core focus of both CDFI's themselves and also the external researchers. The social mission, standards, structures and skills should be reported in a simple, consistent and transparent fashion.

The CDFI pilot and the continuation of CDFI individual lending support the development of the data required to fully understand the demand and cost in meeting the demand for lending. The cost of delivery will vary depending on the market focus, and mission of a CDFI. It is clear from our work that the demand for lending products is there and that these can be delivered but that the business model for delivery is a blend of self generated income and funding support.

Strategy: Reducing the need

Question 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?

FFA supports the concept of extending Centrepay eligibility for a broader range of purposes:

1. Extending to cover alternative financial products provided by CDFIs or other organisations with a charitable or social purpose.
2. Extending the current VIM concept into a full budgeting and bill payment service so amounts can be set aside into budgeting accounts for specific purposes. Currently commercial services are being offered on a fee for service basis (ie MyBudget). FFA would encourage the Government to develop this kind of service either within Centrepay or in partnership with a social purpose business or bank.
3. Extending the Centrepay eligibility to cover debt arrangement purposes. This would allow clients to make easy debt repayments to get back on track and clear credit defaults. Any service like this would need to be managed via the Commonwealth Financial Counselling service to ensure that any payment plans do not lead to unfair hardship and are managed on a whole of picture basis and not just ad hoc independent arrangements with may cause hardship.

Question2: Should referrals be made to FMP services at a certain stage as a matter of course?

FFA is often contacted by clients who are having difficulties with paying everyday bills such as utility bills and also by clients that have unmanageable debt that they are trying to refinance.

In these situations the client does not have sufficient income to meet daily needs, and any form of new debt that does not significantly lead to increase in discretionary income would not meet responsible lending requirements. The best outcome for most clients in these cases are hardship payment approaches that allocate affordable amounts to debt reduction.

For the best outcome in these cases early intervention is required. FFA suggests that at the time of any Centrelink advances referrals to FMP services are made to assist with increasing capacity and money management skills.

Question 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?

Yes very much so. As for Question 2 loans for utilities should normally never be considered (except for short term hardship due to sickness or employment). This is often the start of a debt spiral and other strategies are required and any more lending at this point is predatory.

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

Utility contracts and bills should clearly display information about payment plans and hardship programs. The use of fortnightly Centrepay payment plans should be a required discloser for any contract that involves a concession application.

Question 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?

As for Question 4 – the advantages are many with consumers have the option of a easy to manage payment plan that has minimum impact and a income smoothing effect. There seems to be no disadvantage to the consumers of such disclosers except the increased cost to the utility companies of the increased transaction charges of frequent smaller payments which is offset by less default and disconnection issues.

Question 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?

Centrepay advance applications should identify if the use is to pay energy bills and if so they should only be approved after evidence is provided that the consumer has applied for a payment arrangement or hardship application and for some reason be declined and the advance is the last option not the first.

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

Yes - some typical options are:

1. Prominently displayed on utility contracts
2. Prominently displayed on all utility bills
3. Promote on all utility web sites (front page link, not buried somewhere in the site)
4. Requirement for all ACL licence holders to inform clients if loan purpose (or part) is to pay an utility bill.
5. Requirement for all ACL licence holders to only offer loans for utility bill payments if evidence is provided that utility payment plans and hardship applications processes have broken down ie failed internal / external dispute decisions.
6. ER and other FMG programs to promote via information and other service delivery.

Strategy: Assisting in the debt cycles

Question 14: Can a financial services hub provide a viable alternative to high cost small amount lenders?

A “One Stop Shop” approach to offering financial services is a good idea as the client can access of the services and financial advise in the one location. FFA believes that this model would work best if the one organisation was offering all the services rather than the separate services co-located as the client does not have a consistent flow from service to service and needs to complete more forms and retell their story as they advance to the most appropriate solution.

One of the major issues around high cost small amount lenders is that their risk profile enables them to offer quick access and “low doc” type application processes. Clients often find this friendly, easy and a quick process. Any alternatives need to offer a quality and appropriate product in a timely process that is flexible to go someway to meet this issue without sacrificing the notion of responsible lending. Having a single case worker to assist and provide the appropriate product or service is an important aspect of any alternative solutions.

Question 15: Would a hub approach make services more accessible for individuals who may be reluctant to visit major church providers for assistance?

Very much so. Any hub approach should look and feel like a professional financial service organisation, as this is an important aspect in building capability and normalcy to assist clients to feel comfortable in a normal banking service centre. An interesting point is that the small amount short-term lenders often have outlets in shopping centres and are open 7 days a week. An hub approach needs to consider how and when their services are available.

Question 16: Are there other services that could be included in the hub model?

Ideally any hub model should offer a “one stop shop” for all financial and asset protection requirements of low income families. For financial inclusion to be achieved, all aspects of an individual requirements need to be offered. The understanding that asset protection goes hand in hand with credit products and that easy access to and awareness of affordable and appropriate financial products forms a major part of financial inclusion.

The hub model should provide financial counselling, appropriate credit products and insurance products via a single session in a active learning interaction. This is very similar to how a modern banking interaction occurs with financially included or high net worth individuals. Being financially excluded should not exclude you from having a holistic interaction and just receive piece meal band aid solutions by a collection of different agencies.

Strategy: Debt management

Question 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?

Debt consolidation is a very complex issue and can both form part of the solution or be part of the problem. Generally those seeking debt consolidation are experiencing difficultly with all the debt repayments which indicates insufficient income for all expenses. Any debt consolidation would require a significant outcome such as increased unallocated income to justify the restructure. Other strategies such as a “debt snowball” strategy may be more appropriate if workable or in extreme cases a fully managed debt renegotiation and repayment arrangement.

FFA does do debt consolidation but treats each client on a case by case basis and only offers a loan where a major benefit can be achieved. Any restructure that just shuffles debt around with no benefit should not be done.

Many short term loans that have involved up front brokerage fees or financial literacy product purchase are better snowballed or re-arranged rather than paid out as restructure can lead to increased interest or fees.

Many clients are best served by professional financial counselling that develops a detailed plan and involves a series of payment arrangements. This is almost always the case where income is insufficient to make any debt consolidation or debt snowball strategy workable.

Question 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?

Very much so. Please see comments to Question 17 where individuals or families with insufficient income that is not committed to day to day basic living expenses have very limited options. Any debt advice service that can offer negotiated payment arrangements and an ongoing payment system to administer them would be a much needed service and often a better option than the high impact and long lasting options currently available such as Part IX or bankruptcy.

Question 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?

An project that addresses the issue of debt solutions that has any approach other that just rearranging the debt with other debt are potential worthwhile. Other than low income assessment, schemes such as a national debt reduction project should not be restricted.

About Fair Finance Australia

FFA is addressing exploitative lenders at the point of access by providing a fair, alternative option. FFA offers fair, appropriate loans from $1000 to $4000 for terms up to 2 years. Our approach is very client / case focused and this leads to a lending experience that helps our clients either achieve their loan goal in a responsible way or gives them an understanding why a loan would be unsuitable for them at the present time and what sort of options they need to pursue to start their pathway to financial inclusion.

FFA was awarded a contract in February 2011 by FaHCSIA as part of the pilot of Community Development Finance Institutions (CDFI). FFA is a program within Foresters Community finance and is conducting a micro-loan pilot program to address financial exclusion for individuals. Foresters is a non-profit that offers financial solutions as a CDFI that operates across all financial exclusion segments of individuals, social enterprises and non-profit organisations. FFA believes that access to fair affordable credit is a right for all and encourages The Treasury to continue measures that increase access to credit and well as restricting predatory lending via reinforcing the responsible lending framework that covers all lending, including short term lending.

I would encourage Treasury to support the emerging alternatives such as the CDFIs and also other debt management strategies that could also be developed. The solutions to predatory lending and financial exclusion are multifaceted and require both credit reform and alternatives development via the partnership of the Government together with the community and finance institutions such as the main stream banks and CDFIs in Australia.

Yours faithfully,

Peter Pamment
Manager
Fair Finance Australia
Foresters Community Finance Ltd.