Productivity Commission Review of Consumer Policy
Submission by Foresters ANA Mutual Society Ltd
Submitted by email on 11 May 2007 to consumer@pc.gov.au.

1. About the submitting organisation.

Foresters ANA Mutual Society Ltd (Foresters) is an independent, community-based financial institution. Foresters helps build strong, just, equitable Australian communities which are financially and environmentally sustainable.

Its objective is to apply innovative community finance and investment strategies to support and strengthen community organisations and other entities that work to address the needs of underserved individuals and communities in Australia.

To meet that objective Foresters':

- pools funds through innovative ethical investment products;
- applies those funds to offer community finance products; and
- invests in companies and technologies directed at financial and environmental sustainability, social justice and associated initiatives.

Foresters is built on the 'friendly society' tradition of encouraging people and communities to help themselves towards a sustainable and just future through mutual aid and co-operation.

With a history dating back to the 1890's, Foresters stands alongside a small number of credit unions, banks and philanthropic societies exploring the application of innovative community investment strategies in the modern Australian economy.

Foresters is a company limited by guarantee, formed in 1999 as a result of the merging of the Ancient Order of Foresters in Queensland and the Australian Natives Association of Queensland Friendly Society Ltd.

2. Key problems in the current consumer policy framework.

Whilst the consumer credit market is competitive with respect to most consumers, it lacks competitiveness with respect to vulnerable and low income consumers who may not be regarded as attractive or profitable customers.

Chris Field has noted that low income consumers tend to be the 'losers' of competition, given the distributional effects of markets.[1] Whilst economic growth is said to be a benefit of competition policy, that growth is of no benefit to many low income consumers. This highlights the essential nature of

[1] Chris Field, 'Competition, Consumer Protection and Social Justice- Providing a Consumer's Voice' (2005) 33(1) *Australian Business Law Review* 51, p. 54.

effective consumer law in protecting the interests of those consumers, notwithstanding the appearance of a competitive market. As Field puts it:

> The poor can never be an inconvenience to the greater good. Consumer organisations must be a voice, when others are too often silent, for a fair distribution of the great dividends that our open and free market creates.[2]

An inability to access small, short-term loans on reasonable terms by people on low incomes is one aspect of the phenomenon described as 'financial exclusion', defined more broadly in the Australian context as:

> The lack of access by certain consumers to appropriate low cost, fair and safe financial products and services from mainstream providers.[3]

Where people are excluded from accessing credit from 'mainstream' credit providers such as banks and credit unions in order to acquire essential household items or to meet emergency bills, they may have the options of seeking credit from the not-for-profit sector through No Interest Loans Schemes (NILS) or Low Interest Loans Schemes (LILS); or from the high cost, fringe credit sector.[4] Whilst NILS and LILS programs are currently offered on a relatively small scale in Australia, there is evidence that high cost fringe lending is growing rapidly[5] and that this is likely to be the primary source of small loans for people on low incomes.

The financial exclusion of low income consumers as it relates to an inability to access small, short-term credit at reasonable rates and on reasonable repayment terms, is a failure of competition, and thus ultimately, it represents a market failure.

The growth in the fringe credit market has been linked to a failure on the part of mainstream credit providers such as banks to serve the needs of low income consumers.[6] Earlier in this decade in Australia we have seen closures of banks in low income areas, and banks trying to attract and retain a "more profitable" group of customers.[7] Iain Ramsay's observations in relation to banks in Canada seem equally apt in the Australian context:

> There is evidence that banks, notwithstanding their public relations efforts, are not strongly committed to cultivating lower income clients or branches

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[2] Chris Field, 'Competition, Consumer Protection and Social Justice- Providing a Consumer's Voice' (2005) 33(1) *Australian Business Law Review* 51, p. 54.
[3] Chant Link & Associates, 'A Report on Financial Exclusion in Australia' (ANZ, 2004), p. 58.
[4] See discussion in Consumer Affairs Victoria, 'The Report of the Consumer Credit Review' (2006), p. 37.
[5] Again, see discussion in Consumer Affairs Victoria, 'The Report of the Consumer Credit Review' (2006), p. 37.
[6] Ministerial Council on Consumer Affairs, 'Long Term Regulation of Fringe Credit Providers Discussion Paper' (2003) p. 5.
[7] Chris Connolly and Khaldoun Hajaj, 'Financial Services and Social Exclusion' (Financial Services Consumer Policy Centre, University of NSW, Chifley Research Centre, 2001) pp. 13&16.

> which serve lower income areas which do not generate sufficient profits in this age of shareholder-driven capitalism.[8]

Some Australian banks have certainly embraced the concept of corporate social responsibility, extending to meeting the credit needs of low income consumers, more readily since a report by the Parliamentary Joint Committee on Corporations and Financial Services in 2004, which stated amongst other things that:

> the Government has an obligation to intervene should the market fail to look after the needs of consumers especially in the area of access to banking and financial services.[9]

That same report also recommended that the Australian Department of Treasury consider the enactment of legislation such as the *Community Reinvestment Act 1975* (USA), which effectively links banking licences to investment in and service provision to low and moderate income communities, in the event that Australian banks did not meet their social obligations on a voluntary basis.[10]

Following this there has been support for NILS programs by both Westpac[11] and National Australia Bank[12], and LILS programs introduced by both ANZ[13] and National Australia Bank[14] in partnership with community organisations. Unfortunately these schemes currently operate on a small scale, and primarily in the state of Victoria.[15] This leaves low income consumers, seeking small loans to acquire essential household items or to meet emergency bills, in a situation where they are left with no choice but to pay exorbitant fees[16] for credit, with the perverse result that those consumers are paying more for credit services than more affluent consumers. Ramsay notes that:

> individuals are paying too much for services in these markets compared to consumers in middle income markets and that this is unfair.[17]

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[8] Iain Ramsay, 'Access to Credit in the Alternative Consumer Credit Market' (Office of Consumer Affairs, Industry Canada and Ministry of the Attorney General, British Columbia, 2000) p. 5.

[9] Parliamentary Joint Committee on Corporations and Financial Services, 'Money Matters in the Bush: Inquiry into the Level of Banking and Financial Services in Rural, Regional and Remote Areas of Australia' (Commonwealth of Australia, 2004) p. 307.

[10] Parliamentary Joint Committee on Corporations and Financial Services, 'Money Matters in the Bush: Inquiry into the Level of Banking and Financial Services in Rural, Regional and Remote Areas of Australia' (Commonwealth of Australia, 2004) p. 304. To date, there has been no Australian government response to this report nor its recommendations.

[11] Westpac Banking Corporation, 'Westpac 2004 Stakeholder Impact Report' (2004)

[12] National Australia Bank, 'Corporate Social Responsibility Report' (2006) In April 2006 NAB announced a $30 million commitment over 3 years to both NILS and LILS programs.

[13] ANZ, 'Corporate Responsibility Report' (2006)

[14] National Australia Bank, 'Corporate Social Responsibility Report' (2006)

[15] Consumer Affairs Victoria, 'The Report of the Consumer Credit Review' (2006)

[16] When converted to annual percentage rates the fees charged on payday loans, a form of fringe credit, can range from between 235% to 1300% per annum. See Queensland Office of Fair Trading, 'Payday Lending- a report to the Minister of Fair Trading' (2000).

[17] Iain Ramsay, 'Access to Credit in the Alternative Consumer Credit Market' (Office of Consumer Affairs, Industry Canada and Ministry of the Attorney General, British Columbia, 2000) p. 20.

Within the fringe credit market itself there seems to be no incentive to compete for business by offering reasonable rates. Low income consumers are in poor bargaining positions, and in any event the fringe credit industry has submitted that it is unable to operate at what more affluent consumers might regard as reasonable rates, due to its members' own operating costs and the nature of small amount lending which lacks economies of scale.[18] It may be that the fringe credit industry is simply not one that can be conducted both profitably and justly. There is a clear case for regulatory intervention in this market to protect low income consumers, by encouraging and facilitating non-exploitative lending to meet the demand for small loans.

> Despite an obvious market, competition has failed to provide low-income consumers with short-term credit at rates comparable to those for more affluent consumers. Low-income consumers have identified the sort of financial product they require. It is a matter of social equity that it be provided to them at a fair and just price.[19]

The current regulatory emphasis seems to be on ways of regulating if not effectively banning fringe credit provision through interest rates caps, rather than fostering and encouraging alternative forms of finance for low income consumers and thus creating a truly competitive market for short term consumer credit.

Low income consumers are not only disadvantaged in relation to credit products in the financial services arena, they are also disadvantaged in relation to fair and appropriate savings and insurance products (see examples below). In addition to market reluctance to engage effectively with low income consumers, current regulatory frameworks have effectively limited the creation of a range of alternative financial services products aimed at low income consumers.

Foresters ANA Mutual Society Limited (Foresters) has fostered the development of savings and loans circles in Queensland, whereby small groups of people meet regularly and contribute savings to a pool (initiated with seed funding from Foresters itself). The pool is cooperatively managed by the group members. After each member has demonstrated to group peers the capacity to save regularly over an agreed period of time, the pool is available to members of the group in the form of no interest loans.[20] This model is not without its regulatory difficulties. If an organisation such as Foresters sought to expand on the savings and loans model and administer the collection of savings and making of loans itself, it might be regarded as acting in breach of regulation by conducting an unauthorised deposit-taking business. Foresters have another model referred to as a 'distress fund' which involves members to the fund making 'contributions' (not defined as savings and therefore not characterised as deposits), and then being entitled to apply for loans from the

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[18] Consumer Affairs Victoria, 'The Report of the Consumer Credit Review' (2006)
[19] Dean Wilson, 'Payday Lending in Victoria- A Research Report' (2002) p. 82.
[20] See Foresters ANA web site http://www.forestersana.com.au, and the explanation of savings and loans circles in Ingrid Burkett, 'Microfinance in Australia: Current Realities and Future Possibilities' (Westpac Foundation, 2003), p38.

fund for certain purposes. This has been described as a ‘donor contribution based rotating loan system’[21], and as a model that

> enables people to have access to credit services which are non-exploitative and directed at alleviating their poverty rather than profit generation.[22]

This is a model that does not breach Australian Prudential Regulatory Authority regulations in that it does not amount to deposit-taking[23], and can be easily established without prohibitive structural and compliance costs.

It is not beyond the will and capacity of financially excluded people to act together to improve their positions by adopting the principles of mutualism. Organisations such as Foresters has a key role to play in that, but requires possible regulatory exemptions with respect to their role in savings pools, as well as government and industry support given that Foresters is a not-for-profit organisation, and many of its activities do not generate profits.

3. Examples or case studies that illustrate those problems.

Access to ‘fringe’ or exploitative credit:
A member of Foresters Financial Distress Fund (FDF) approached Foresters with a dilemma. He needed money rather urgently to pay for medical equipment. He discussed his financial situation, which included a no-interest benefit (loan) from the FDF (which he was regularly paying back) and a loan from a finance company (which he was paying back at an effective interest rate of 35% p.a.). He was in receipt of a Centrelink payment, understood the extent of his current financial difficulties, but could not see a way out of those difficulties. Foresters’ staff discussed with him the options in relation to the FDF. Although there was a willingness by the FDF to roll over his debts into one no interest benefit (loan), the member was reluctant to do this given that it is a mutual fund (that is, he felt he would be disadvantaging other members by taking a larger loan from a limited pool of funds). He did not live in a locality where there was access to NILS or LILS. He saw his only option as a further loan from the finance company. Despite the fact that he was financially literate and understood the consequences of his decision in terms of his financial future, there were very few options in terms of products for him to access.

Savings Products
Innovative savings products for low income consumers are rather limited in the Australian context. Overseas research has demonstrated that:

a. low income people can and do want to save;

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[21] Ingrid Burkett, 'Microfinance in Australia: Current Realities and Future Possibilities' (Westpac Foundation, 2003), p33.
[22] Ingrid Burkett, 'Microfinance in Australia: Current Realities and Future Possibilities' (Westpac Foundation, 2003) p33.
[23] Under section 8 *Banking Act* 1959 (Cth) as amended, only an authorised deposit taking institution (“ADI”) may carry on any banking business, which includes deposit taking activity. Foresters ANA Mutual Society Ltd has received written confirmation from APRA that its distress fund model does not amount to deposit-taking activity.

b. a crucial mechanism for addressing poverty is the creation of savings and assets;
c. savings products for low income people need to be appropriate and accessible – and the most effective are often linked to activities of people's every-day lives;

Some community organisations have developed 'savings products' that have been very successful in assisting low income consumers who have never before saved to 'save' what, for them, are considerable amounts. However, under current regulatory frameworks, these 'products' are effectively 'illegal'.

An example of such a mechanism is an emergency housing organisation in a rural area in Australia, which has developed a system whereby people pay 'rent in advance' – people contribute an extra $10 per fortnight into their rent accounts (which are automatically paid through Centrepay). When they leave the emergency housing and move to mainstream accommodation, this 'advance rent' is returned to them in the form of 'savings'. For many it is the first time that they have 'saved' any amount of money.

This is a very innovative financial 'product', which benefits low income consumers. However, because it is offered by a community organisation which does not have ADI status, the organisation knows it is potentially contravening regulatory practices.

Insurance Products
Low income consumers represent the majority of non-insured people in Australia. Foresters gave up its' insurance license when it ceased to be a 'Friendly Society'. However, we still hear of people's insurance needs through our FDF membership.

Foresters were recently contacted by a woman who had major dental needs but could not afford health insurance. She had been told that in the public dental health system there was a minimum waiting time of two years for the type of dental work she required. She discussed the need for basic health insurance products that were affordable and directed at the needs of low income consumers (which often do not include the add-on extras that middle income consumers access).

There have been recent discussions about exploitative insurance products and some actions to protect consumers from such products, but there needs to be further public debate and regulatory reform to ensure that low income consumers have access to affordable and appropriate insurance products.

4. Changes that are needed to overcome these problems.

Consideration needs to be given to a regulatory framework that rewards and encourages non-exploitative small amount lending to low income consumers.

Some of the current regulatory barriers to this work include:-

- The possibility that persons who provide advice on, or deal in savings account products on behalf of, members of a microfinance group may be carrying on a financial services business as defined by the *Corporations Act 2001,* and therefore must hold an Australian Financial Services Licence or obtain an exemption issued by ASIC from the requirement to hold the licence. Some clarification or exemption from ASIC in this regard is required.
- The possibility that some microfinance groups might be regarded as carrying on a banking business without having the necessary Authorised Deposit-Taking Institution status required under sections 7 and 8 *Banking Act 1959.* Some clarification or exemption from APRA in this regard is required.

Additionally, there should be state and federal government commitments to seed financing organisations such as Foresters that provide or facilitate non-exploitative small amount lending, and appropriate savings and insurance products, to people on low incomes, in order to provide genuine competition and real choice in this market.

Our estimate of the cost of administering microfinance funds is around $1 per week per member. We estimate that around 100 people per $100,000 can be assisted on an ongoing basis through mutual aid funds.

Ability to charge a small amount of interest on small unsecured loans (say up to 5% per annum) and not be caught up in financial regulation would increase financial viability of microfinance vehicles. However, for regulatory reasons this is currently not an option as licensing and compliance requirements add too much of a financial burden.

5. Organisation contact details.

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