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Brotherhood of St Laurence
Working for an Australia free of poverty

Submission to inquiry into competition in the banking and non-banking sectors

Brotherhood of St Laurence
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1 Introduction

Background to the Brotherhood of St Laurence's interest in competition in the retail banking and non-banking sectors

The Brotherhood of St Laurence is a non-government, community-based organisation concerned with social justice. Based in Melbourne, it is working nationally for a better deal for disadvantaged people, and provides important services for people who need them most. The Brotherhood also works in partnership with financial institutions to provide appropriate financial services to people on low incomes and address financial exclusion.

The Brotherhood welcomes the government's interest in competition in the Australian banking sector as this is an important issue for low income people. While this Inquiry is particularly concerned with home mortgage products, the financial needs of low-income people need to be considered.

Deregulation in the Australian banking sector has not created competition to provide services for people on low incomes, nor has competition addressed financial exclusion in Australia. The Brotherhood of St Laurence believes that the Inquiry into competition in the banking and non-banking sectors needs to consider the prevalence of financial exclusion in Australia today: the lack of access, by the neediest members of our community, to appropriate low-cost, fair and safe financial services from mainstream providers.

An inclusive financial sector contributes to the Brotherhood's vision of 'an Australia free of poverty' in many ways:

- **People on a low income need access to appropriate financial services to help smooth consumption.** Many people need to access a lump sum of money for a variety of reasons: repairing a car; purchasing household appliances; or paying for education. Yet research shows that 26 per cent of Australians in the bottom income quintile would not be able to raise $2,000 in a week (Headey et al 2006, p. 49). This places a large group of Australians in a vulnerable position when unexpected expenses occur. Ensuring that people on low incomes have access to appropriate to savings and credit facilities assists to reduce their vulnerability to unexpected expenses.
- **There is much asset-based poverty in Australia.** Research has shown that building a base of assets helps people to feel more secure, gives pride and hope and helps to develop a longer term mindset rather than just surviving from one payday to the next (see for instance, Page-Adams and Sherraden 1996). However, recent data produced by the Household, Income, Labour Dynamics in Australia survey showed that the top 10% of Australians own 45% of all household wealth. In contrast, the least wealthy 50% own only 8.8% of household wealth and the bottom decile actually has negative net worth (debts exceed assets) (Headey et al 2006, p. 56). To change this asset poverty, people first need access to financial services.
- **Access to Australia's mainstream banking sector and economy promotes social inclusion.** People on low incomes want to feel a part of mainstream Australian society. Using banks like everyone else helps to encourage that sense of belonging. Research and practice (both here and overseas) have demonstrated that possessing even a few thousand dollars in assets connects people to the economy, raises their economic expectations, and allows them to shape their futures. Given the opportunity and support, people on low incomes will save, build assets, pay back credit and connect to the mainstream economy. In the Brotherhood's view, unless the root economic causes of social exclusion in disadvantaged communities are tackled, any gains made by social inclusion policies will dissipate rapidly (See for instance Nicholson 2007).

The current state of the retail banking industry and low-income people

Deregulation of the banking industry has seen a dramatic expansion in the availability of financial products in Australia, but this has not been evenly distributed across society. There are many people, including those on low incomes, who have only limited access to appropriate banking services.

At an aggregate level, this is demonstrated by research which shows that low-income households are much less likely to hold any form of mainstream debt than higher income households (Kohler et al., 2004). In addition, data from an ANZ study showed that a significant majority of those surveyed on incomes less than $20,000 were financially excluded (Chant Link and Associates 2004). In contrast, research by the Consumer Law Centre Victoria in 2002 estimated that the fringe lending sector processed around $10 million in transactions in Victoria every year (Wilson 2002), which suggests there is a demand for credit services not met by the mainstream banking market.

On the demand side of the market, anecdotal evidence from low income clients of the Brotherhood demonstrates that they feel excluded from the market for financial services. The Brotherhood's experience is that most low income people are aware that it is difficult to access mainstream financial services and many have given up trying, anticipating rejection as indicated below.

> I suppose you have less options, it's less options obviously because your income is low.
>
> Many people like for example an unemployed person, pension people, if they approach the bank, the bank will say 'Sorry, you're not entitled because your income is less than $15,000', and Centrelink payment is between $12,000 and $13,000.
>
> Banks are very, very dominant over you. You feel very intimidated … You feel as though you shouldn't be in there. You're in this ivory tower, you shouldn't go near it.
>
> In the old days before they became globalised you could walk into a bank and you talk to the bank manager, and he would make a decision there. There was more leeway. But now they say 'the book says no'.

Meanwhile, on the supply side, there are many reasons for financial exclusion. These include risk assessment policies and conditions attached to financial products which make them inappropriate for some people; or pricing which makes products unaffordable for many people on low incomes. In addition, the marketing of financial products is often not designed to meet the concerns and needs of the low income group. For instance, market research shows that low-income people are more likely to assess affordability in terms of fortnightly loan repayments than interest rates and fees which are typically promoted. (Kempson and Whyley, 1999a, 1999b).

While some major banks in Australia have been actively involved in financial inclusion programs in recent years, Australia remains well behind other industrialised nations in the provision of financial inclusion programs to people on low incomes. The Brotherhood believes that there is much more governments and banks can do to promote financial inclusion.

In the US, there are over 50,000 Individual Development Accounts which have attracted about US$225 million in public funding and can be used for home ownership, business capitalisation and post-secondary education. In the UK, significant investments in financial inclusion have been made including the Child Trust Fund, Savings Gateway and Individual Learning Accounts. By 2001 more than one million Individual Learning Accounts were opened. The UK government has also established a Financial Inclusion Fund of £120m to tackle financial exclusion: access to banking, access to affordable credit, and access to free face to-face money advice.

The development of financial inclusion programs in Australia has been led by the community sector and in recent years through partnerships between community organisations and some of the major banks. State governments have also made contributions to the No Interest Loan Scheme and the Saver Plus program.

There are also a range of credit unions and friendly societies that have for several years operated financial inclusion programs including small loans, budget accounts and guidance on money management. More recently credit unions and friendly societies have developed programs to promote enterprise development to assist with self-employment.

2 Barriers that impact on competition in the retail banking and non-banking sectors

Universal access

Presumably, competition in the banking sector was expected to produce not only cheaper and more widely available financial services, but also greater social welfare through increased wealth. However, the existing competitive banking environment in Australia does not ensure that people on low incomes have access to mainstream finance and its wealth-building opportunities.

While banks have become involved in financial inclusion programs as part of their corporate social responsibility, the Brotherhood believes that access to appropriate financial services is a right of every Australian. To operate in society in a meaningful way, people need banking services.

Deregulation in the banking sector has not seen banks actively competing to provide financial services for people on low incomes.

> On the grounds that they are non-profitable and too risky to be regarded as serious customers, most mainstream credit providers make access to their services difficult, and often impossible, for people on low incomes. (Jones 2001, p.4)

This means that if low income consumers wish to access financial products (other than basic banking services), they may end up paying more for them. This is particularly the case for credit, with low income people frequently having to seek alternative forms of credit, rely on credit cards or simply go without. The types of credit currently used by people on low incomes are set out in the Appendix. Many of these alternative credit options are far more expensive than mainstream credit products.

Market failure in the banking sector

In Australia the social obligations attached to having a banking licence do not appear to include providing people on low incomes with appropriate services.

Following the deregulation of banking in the 1980s, the Australian banking sector remains dominated by the four major banks. Australian Prudential Regulation Authority data for the 12 months to December 2007 show that the four major banks account for 63 per cent of total operating income of all banks. While there is no doubt that banking services in Australia are profitable, and among the most profitable in the world (Standard and Poor's 2006), many low-income people remain unable to access mainstream financial services. This is particularly the case in the market for credit, where it is time-consuming for banks to distinguish between those low-income borrowers that are likely to repay and those that may default. This type of asymmetric information makes banks generally assume that low income borrowers are too risky to lend to.

Given these factors, this inquiry needs to consider the possibility that there is 'market failure' in the provision of banking services for people on a low income.

3 Policies to enhance further competition and product choice for consumers

As voluntary corporate responsibility and competition have not proved adequate to bring about appropriate access to financial services for all Australians, this Inquiry should give consideration to a range of initiatives that improve access and competition for low income consumers, including but not limited to the following policy suggestions.

A national financial inclusion strategy should be developed with leadership by the Australian government which includes a range of targets, indicators and benchmarks for developing industry standards that financial institutions would have to meet. For instance, in the first year of the strategy the minimum requirement might be a fee-free account for all low income earners; access to small loans for all consumers who can show a capacity and willingness to repay; responsible lending practices; ongoing financial literacy education.

A Commonwealth government review of financial inclusion and low income people. This review should consider the right for everyone to access appropriate financial services. People should not be excluded from the system because they are viewed as unprofitable.

The Brotherhood would welcome the opportunity to provide further details and looks forward to the outcome of the Inquiry.

Appendix: Credit options for low income groups

Some of the more common credit products and options for people on low incomes:

- **Pawn brokers**: Loans from pawn brokers are obtained when personal items are provided as security. Usually the main cost components for the consumer are fixed fees and charges which depend on how much is borrowed. For instance, Cash Converters and Cash Centre in Frankston charge **35 per cent and 25 per cent** per month respectively on loans secured by personal items.

Payday lenders: Payday lenders provide loans until the next 'pay day' in exchange for a fee. Loans are typically for two to four weeks for amounts around $250. Charges for payday lenders are equivalent to between **500 and 700 per cent** per annum in interest (Wilson 2002). For some payday lenders, the proportion of customers that are receiving income from Centrelink is relatively low. For instance, Money Plus estimates only 5 to 15 per cent of their customers receive government benefits and Cash Converters estimated 80 per cent of their customers have wage income (see Money Plus 2005 and Cash Converters 2005 respectively).

- **Centrelink Advance**: Recipients of a Centrelink payment are able to obtain one $500 advance each year. The advance is interest-free and usually has to be repaid over 6 months. Most Centrelink recipients are eligible for the advance payment and there seems to be a high level of awareness about this service (around half of the Brotherhood and the Bank's borrowers had the advance at the time of applying for a loan). Anecdotal evidence suggests that many long-term Centrelink clients re-apply for their advance as soon as they are eligible, so it is likely to be **unavailable when unexpected expenses arise**.

- **Other interest free loans**: Good Shepherd Youth and Family Service started the No Interest Loans Scheme (NILS®) in 1980. Loans are usually repaid over 1–2 years and the limit is generally between $800 and $1,000. As at 2005, there were 232 NILS programs operating across Australia. In the last 12 months, NILS loans totalled $3.5 million across 4,500 people. The repayment rate was 97 per cent (McInerney 2005).

- **Other such as savings, lending from friends or family**: Anecdotal evidence suggests that many people on low incomes do not use credit to fund large purchases. Instead, many save, go without, borrow from family or friends or obtain assistance from community organisations.

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