Submission to:

The Senate Economics Reference Committee's

Inquiry into possible links between household debt, demand for imported goods and Australia's current account deficit.

Care Inc Financial Counselling Service
and the Consumer Law Centre of the ACT

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February 2005

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About Care:

Care Inc has been the main provider of financial counselling and related services to low income and vulnerable consumers in the ACT, since 1983. Care's core service activities include the provision of information, counselling and advocacy to low income and vulnerable consumers experiencing problems with credit and debt. Care also has a Community Development, Education and Research program, makes policy and law reform comment on issues of importance to its client group and has operated the ACT's only No Interest Loans Scheme since 1997.

In late 2002, Care was selected as the host agency for the Consumer Law Centre of the ACT. The CLC was officially opened in January 2003 and offers a range of legal services including representation and litigation in relation to consumer law issues. The service employs a full-time practicing solicitor.

Care receives funding from a variety of contributors, and specifically acknowledges the funding that it receives from:

- ACT Government, from the Department of Disability, Housing and Community Services and the Department of Justice and Community Safety,
- The NSW Financial Counselling Trust Fund administered by the Office of Fair Trading
- The Commonwealth Financial Counselling Program, administered by the Department of Family and Community Services.

In the 2004 calendar year, Care responded to over 2200 new requests for assistance. During the same period, Care presented educational information to over 900 participants in person and many more through the circulation of literature, media comment and so on.

Observations against the Terms of Reference:

As noted in the cover letter, we are not able to offer detailed comments, given the length of time available for making submissions. We would be happy to expand on the following observations at hearing if requested and if hearings are scheduled:

a) *current levels of household debt and whether these are historically high (as a proportion of household income or otherwise);*

Data in relation to rising household debt levels is compelling. Nowhere is the change more dramatic than in the credit card market. The most recent Reserve Bank data notes that Australians collectively owed $28.6 Billion on credit and charge cards at the end of November 2004. Just 5 years earlier in November 1999, that figure was $12 Billion.

Collectively, we spend more than we earn and an elongated period of low interest rates appears to have entrenched this approach.

The finance industry correctly points out that most consumers do not seem to have any problem managing their increased levels of debt. But the disparity between those coping well and those on the brink or already in crisis, is becoming more marked. For example, Care noted a dramatic increase in demand for its services in the first 6 months of 2004. We were not able to keep pace with that demand. What distinguished the 6 month period January to June 2004, from the one that went before and the one that followed, was two small interest rate rises to a total of .5% in November 2004. Copies of Care's general data (not including the Consumer Law Centre of the ACT and our Queanbeyan outreach service) for the periods 1 January to 30 June 2004 and 1 July to 31 December 2004, are annexed.

We have also noted some shifts in the demographic profile of our clients. Most noticeably, in a period of around 3 to 4 years, the proportion of clients over 50 years of age seeking assistance has risen from around 12% of intake to around 25%. That change is not entirely explained by the aging of our population and certainly not at the rate of change observed. It appears to be a significant shift in how and when credit and debt are accumulated and how and when both are repaid.

b) the factors, including the lending policies of banks and other financial institutions, that contribute to household debt levels;

Recent comments by the Governor of the Reserve Bank have drawn attention to the standards applied by banks and other financial institutions in assessing applications for and providing credit. Those comments have followed increasing public attention on personal debt levels in Australia.

What credit offers are provided to whom and on what terms are reliant on income levels. Lower income consumers generally have fewer credit options open to them and those that are available are more expensive. We are told by industry that the differentiation is driven by risk. Having been a provider of a No Interest Loans Scheme since 1997, Care is of the view that risk is not the only, or even the major contributing factor.

NILS essentially lend to those consumers that the credit industry claims are so risky as to not be credit worthy at all. Care's NILS has made over 200 loans, to a total of over $120,000 to assist low income consumers purchase essential household items. The Scheme initially had only $20,000 in lending capital. A further $15,000 was added in 2001. Over $27,000 remains in the Scheme, as recycling capital.

The issue therefore is less about whether low value loans to low income consumers will be repaid, but the terms on which that credit is offered. In short, the commercial market structures products for low income consumers that generally cost more and deepen disadvantage in the process. Further, the market has responded to disadvantage by creating providers that target that type of consumer and play to their vulnerability. Governments have so far failed to address the burgeoning fringe credit market in any practical way. Further competition is not the answer, if that competition is about products and services that are unsafe and unfair.

A consequential impact of the increasing numbers of alternative credit providers, advertising less rigorous tests for credit assessment, is that banks and other more main stream credit providers have lost market share. Again, this is an issue that the Reserve Bank has acknowledged and expressed concern about. The Australian Prudential Regulatory Authority has also made public comments in recent years about the need for caution and maintaining appropriate lending standards.

One product range in which Care has taken a close interest is the credit card market. The practice of sending unsolicited offers to consumers, described as pre-approved, is in our view inherently unsafe. The ACT is so far the only jurisdiction in the country to have taken some steps to address the issue. In the ACT Credit providers are now required to assess a consumer's capacity to repay the credit being offered before it is advanced on new credit cards, or through offers of increased credit on pre-existing cards. We believe this approach should be adopted nationally. That is not the same as saying there should be no marketing of credit offers, which raises another set of issues. It is also not the same as saying that industry efforts to better target offers have no value. In our view, there is however no safe and fair way to advance credit without conducting basic tests of affordability, specific to the consumer to whom the credit is being offered.

c) *the extent to which demand for imported goods contributes to household debt levels;*
We are not able to make comment, beyond noting that the credit and debt issues with which clients present at Care, are rarely if ever linked to purchases of expensive or significant imported consumer goods.

d) *the extent to which demand for imported goods by Australian households contributes to the current account deficit;*
We refer to our preceding comment.

e) *risks for households and the economy of high household debt levels;*
Other economic commentators are far better placed to assess the causes and effects of high household debt at an aggregated level. Our understanding of that commentary however, is that the shift from large public debt to significant personal debt, has been a considered and deliberate policy objective.

As a direct service provider Care has experience of the impacts of debt on its client group and some of those are referred to in preceding comments. In particular the immediate nature of our clients' vulnerability to small moves in interest rates is revealed in the service delivery data from 2004 annexed. That has broader implications for the entire community.

f) *whether there is a case for addressing the lending policies of banks and other credit providers and if so, what practical options are available;*

We believe there to be a strong case for intervention on two levels:

- financial institutions have been slow to test or introduce credit products that are designed with the needs and vulnerabilities of low income consumers in mind. There have been some positive developments in trials of alternative credit provision through community and industry partnerships. We are aware of projects of that type involving the ANZ Banking Group and the National Australia Bank. The developments are welcome, but insufficient to deal with the exploitation delivered by the fringe credit market. More reliable and substantial levels of response would be delivered by clearly articulated policy on expectations of corporate responsibility. The articulation of those expectations should include a timeframe, with a clear message that greater proscription will follow if the expectations are not met.
- As noted in our comments under b) above, Governments have so far failed to take effective action to curb the excesses and unfairness of the fringe credit market. The hesitancy seems to be a mixture of not wanting to diminish the already limited options available to low income consumers and not wanting to interfere unduly with market activity. Both are poor excuses for inaction in Care's view. There is no doubt that limiting credit options at the low income end of the market increases the pressure to produce alternative safer, fairer products. Allowing a booming industry in unsafe and unfair lending is however not an alternative and that industry will never, left to its own devices, address and fix its problems.

g) *whether there are other measures that might be taken in place of possible restrictions on lending practices which would be as effective;*

Restrictions, or at least better articulation of expectations of lending practices, are in our submission required. They are not necessarily the only options available. Governments themselves have a role in developing alternative service models and products that are sensitive to vulnerability or disadvantage. For example the Commonwealth has provided a fee waiver on charges to access the Centrelink direct payment facility for community No Interest Loan Schemes. For a relatively modest outlay, that assistance helps borrowers repay their loans and the providers to circulate the funds faster, without eroding lending capital.

h) *whether any Commonwealth social and economic policy settings should be changed as a result of matters identified above;*

In a number of submissions in recent years to a variety of Inquiries and consultation processes, Care has drawn attention to the Commonwealth's failure to prioritise social policy and consumer protection. Almost all responses to consumer issues are considered through the framework of competition law and policy. That approach is flawed. We have welcomed the Productivity Commission's recommendations that consumer protection laws and policies be reviewed. It is an undertaking that is long overdue. Fairness, equity and sustainability will not be delivered if such a review is conducted using only competition principals.

One obvious example of the Commonwealth's failure to understand the impacts of financial disadvantage on low income and vulnerable consumers can be seen in a current review of fees and charges being conducted by the Insolvency and Trustee Service of Australia (ITSA). ITSA's review is in response to Government's cost recovery principals and has canvassed as a recommendation in the truncated consultation process, the imposition of a filing fee for Debtors' Petitions. In its original form the proposed fee was a flat $250 applying universally and without discretion to waive, as an entry prerequisite to bankruptcy. In a varied proposal ITSA suggested an exemption to pension or health care card holders.

In Care's view the imposition of any entry level fee for bankruptcy will fundamentally undermine the intention and operation of the bankruptcy system. In the context of a discussion of the credit market and its impacts on low income consumers, imposing an unaffordable entry fee to bankruptcy will deliver a double blow. Consumers caught in that process will not only not be able to pay their debts, they will be unable to access a process designed to respond to crippling and unaffordable debt and allow people to move on with their financial lives. The fact that a proposal of this type even sees the light of day is a clear indicator that social policy considerations are either not working or do not exist.

We note also a growing recognition in some quarters of the need to priortise issues of vulnerability and disadvantage in order to understand the causes of those problems and design appropriate responses. Comments of that type were made by the Senate Community Affairs Committee in reporting on the Inquiry into Poverty and Financial Exclusion – a view rejected by the minority Government Senators. We also note and applaud the moves by ACT Government, through its Social Policy and the establishment of a Community Inclusion Board, to test lateral responses to the problems of unaffordable household debt levels, for low income households.

i) *whether there is any need for any other form of regulatory intervention in relation to this issue; and*

Our answer is yes, but it is beyond the scope of this submission to list exhaustively the possible interventions. Several priority matters we would draw attention to are:

- the need for national uniform legislation to deal with unfair contract terms,
- similarly a national and uniform system for responding to problems with finance brokers,
- consideration of including credit in the Financial Services Reform Act framework and, as noted in b) above,
- responses to the unsafe, unsolicited marketing of pre-approved credit card offers.

j) *any related matters.*

We conclude by drawing attention to the lack of investment in Australia in developing consumer research and policy capacity. Many of the problems and issues raised in this submission would benefit from further research or consideration, and in turn benefit low income and vulnerable consumers and the community as a whole. Unfortunately there is no facility or voice at a national level to take those issues up, investigate them further and develop considered policy responses.

Like many consumer groups around Australia, Care continues to draw attention to this lack of capacity and to request that it be addressed as a matter of priority. Specifically we have referred to the National Consumer Council model adopted in the United Kingdom, as one that would add great value to the types of issues being considered by the Committee.

February 2005.