Submission

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

Discussion Paper

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Care Inc. Financial Counselling Service

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About Care Inc. Financial Counselling Service

Care Inc has been the main provider of financial counselling and related services in the ACT and region since 1983. Care is a not for profit community organisation that provides financial counselling, information, support and advocacy to people on low to moderate incomes who are experiencing financial stress. It is a free, independent and confidential service.

Care's financial counsellors work in a holistic way with their clients recognising that for many people there are a range of social and emotional issues that can have a direct impact on their financial situation. These issues include relationship breakdown, loss of employment, health issues and lack of affordable housing. Care is founded on the belief that the people who use our services have a right to self determination and the right to be able to make informed choices.

Care's integrated service model includes information services, casework, advocacy, community development and education and policy, social action and law reform comment. Care also operates the ACT No Interest Loan Scheme (NILS) and hosts the Consumer Law Centre of the ACT.

General Comments

Care's client group consists of some of the most disadvantaged consumers in the ACT and surrounds. A significant percentage exists on a government payment, combination of part government payment plus wages or very low wages. They struggle with the costs of everyday expenses and for a number of these clients the use of payday loans has become a way of trying to cope with unexpected expenses.

The appeal of payday loans is related to the accessible nature of the services provided. Clients at Care with payday loans remark on the ease of access, the quick turnaround time from inquiry to getting the loan; and the fact that the lender knows them and their story. They do not have to either prove their worthiness as 'poor' enough to be given one (as some perceive to be the case with other low or no interest loans programs) or 'rich' enough to be granted one either. Furthermore they do not have to approach companies (e.g. utilities) and declare they are a 'financial hardship' case to get assistance. For some low income people it seems easier to get the cash quickly, pay the bill and not have to deal with perceived stigma of approaching hardship sections in financial or other institutions.

Sadly, the outcome is that for many of these already vulnerable people the payday loan becomes a spiral of ongoing debt that sees them having spent their incomes in repayments before they have even received it; they therefore have to borrow again and again.

Care believes that if what people are seeking is a quick turnaround in ready cash for immediate expenses this indicates that they are living on incomes that are too stretched and in some circumstances too low for even a basic existence. Clients are driven to 'choose' payday lenders just as they 'choose' to pay their loan before buying food. In other words *there is actually no choice for them.*

As a general principle Care does not support the view that the solution to inadequate income is access to credit. In fact often credit leads to an ongoing spiral of debt rather than an easing of financial hardship. Whilst not directly relevant to this submission Care thinks that it is worth noting that an issue that should be addressed as part of the short term high cost credit debate is adequacy of current Centrelink entitlements. In particular we believe there needs to be an increase in the base level of allowances to assist people to meet their everyday, ongoing household expenses. Given the high proportion of Centrelink recipients who borrow from payday lenders, it seems likely that addressing income adequacy will go some way to reducing reliance on and therefore harm caused by payday loans.

The focus of the discussion paper is on alternatives to reduce reliance on high cost, short term, small amount lending. If there are to be alternatives for people to access, and we are broadly supportive of expanding NILS and LILS programs and providing financial hubs, there needs to be a strong presence of an alternative lender to combat the influence of payday lenders. People access payday lenders because they are readily available, they develop a relationship with them, they do not have to repeat their story over and over and they do not have to prove that they are poor to access the loan. Accessing other forms of 'credit' (including NILS and LILS) often requires people to identify themselves as poorer than the rest of the community.

While this allows a targeting of assistance to those who are eligible, it removes the person receiving the loan from the mainstream of credit provision. Care would argue that financial institutions of all sizes should have an obligation to provide financial services to all sectors of the community and not to discriminate against those who have less income. Offering low income products should be part of the corporate social responsibility of mainstream financial institutions. There is a need for government to work with industry to develop suitable products and support the establishment of schemes that would provide a genuine alternative to payday lenders. Our experience with NILS borrowers over many years suggests that they are among the most conscientious and reliable in repaying their loans. Many in fact come back to borrow for a different item, once a loan is paid out.

Financial counsellors provide support and assistance to people who are experiencing financial stress. Financial counsellors are able to provide clients with information on hardship programs as well as negotiate hardship arrangements with many creditors. Early identification of financial issues in conjunction with information on options to manage finances may reduce the need for some clients to seek credit from payday lenders and other fringe providers. It is therefore important to promote and support the financial counselling sector and in particular the 1800 007 007 telephone financial counselling services.

Below we have provided some brief responses to the specific questions in the discussion paper.

Q1. Currently the Government offers Centrepay, advance payments and weekly payment as mechanisms for customers to manage their money. Are there any other mechanisms that could be used for this purpose?

All of the above mechanisms are effective and well utilised by Centrelink customers to manage their limited budgets and to pay for large expenses. Possibly the Government could consider some incentive payment or matched payment arrangement to further support their customers who are managing on very low incomes. This might take the form of an additional one off payment if a person has repaid their advance within the agreed timeframe.

Q2. Should referrals be made to FMP services at a certain stage as a matter of course?

Referral could be offered as well as information about relevant services and how to access them, and also assistance with access if requested. This should in no way be seen as an obligation on people to follow through with the referral. It may in fact be better to provide the information to all people accessing assistance, thereby not 'singling' out people.

Q3. 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?

Ideally people should be made aware of any utility hardship provisions before they get into financial stress and approach fringe lenders to access the loans for utilities. The best and most obvious access point for this is the utilities themselves. They have the most up to date information about a customers' non-payment of their account, particularly where there is ongoing apparent difficulties with payments. From 1 July 2012, under the Retail Law, each energy retailer must implement a customer hardship policy to identify customers experiencing payment difficulties due to hardship and to assist those customers to better manage their energy bills on an ongoing basis. This may help prevent people from feeling they have to access payday loans for utilities; particularly if energy retailers are quick to identify customers in difficulty.

Having regard to the above, Care also broadly supports strong disclosure provisions within the payday lending industry including the provision of information on alternatives. Information on the risks and costs of payday loans as well as on alternatives such as hardship programs should be provided to all potential payday loan customers. We do not however think that disclosure on its own will effectively protect payday loan borrowers from harm. Borrowers are generally in a very difficult financial situation when they approach payday lenders and are focused on their immediate needs. They are more likely at this point to take whatever product is available quickly to meet their pressing financial needs.

Q4. How can individuals be encouraged to use these alternatives for paying utility bills rather than using high cost small amount loans?

An option for consideration is the development and use of a 'universal symbol' for financial difficulty that can represent this to people and can be used on all bills/accounts. There would need to clearly visible (bold and highlighted) information on utility bills as well as advertisements on TV and radio to promote this. The symbol should be supported by a phone number for the hardship section of the utility provider and possibly also the 1800 National Telephone Financial Counselling Service.

Information should be provided in a supportive and non-stigmatizing manner. Financial difficulties can occur for numerous reasons and impact on many people within the community. It is important that it is recognized and that support mechanisms are readily available and accessible. Information on concessions, hardship programs and other support mechanisms should be available in a range of universal access points.

Q5. 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?

Advantages are that people have been informed (provided they can read and understand it); it may mean that they act more quickly and less damage is done by the debt increasing further. It also brings financial difficulty into the open as an issue to be dealt with by both parties rather than a secret that people feel ashamed of.

There are no obvious disadvantages, though Care acknowledges that too much information on any written correspondence can be overwhelming and lose its impact. It also has restricted value for people who have low literacy skills. As noted above the addition of a 'universal symbol' for financial difficulty supported by a contact number for further information could overcome these limitations.

Q6. Are there other support services that would help reduce energy hardship and the demand for small amount short term loans to pay energy bills?

Emergency relief providers currently provide some assistance to clients who are experiencing difficulty in paying their utility and other essential household bills. This assistance differs depending on the provider and is not designed to assist people experiencing long term hardship.

The Western Australian Government operates the Hardship Utility Grants Scheme (HUGS). The Scheme provides financial assistance to people in financial hardship to pay their utility accounts so as to avoid being disconnected or restricted from supply. The grants are in addition to the utility supplement provided by the Commonwealth Government through Centrelink. A similar scheme could be considered by the Government to assist people experiencing utility stress on a national level.

Many states and territories have energy efficiency schemes which can assist in some circumstances to reduce the cost of electricity for a household. Some of these programs include the capacity to provide energy efficient appliance upgrades, such as the OUTREACH program in the ACT. Such programs also assist in reducing energy hardship and in the longer term may also reduce the demand for small amount short term loans.

Q7. Should energy hardship programs be promoted more widely? If so what mechanisms could be used?

It is absolutely essential that energy hardship programs be more broadly advertised and promoted. For some people there is a stigma associated with seeking assistance for financial hardship. It is therefore really important to promote concessions and hardship programs in universal points of contact such as information packages available at schools, medical centres and libraries. It is also important that this information is also more broadly publicised through community service organisations who work with clients on low and moderate incomes who may need to know about such programs. The national 1800 telephone financial counselling service can provide information on a range of available concessions, programs and support service services available.

Q8. Is building upon existing programs and extending criteria for accessing these programs, such as NILS and StepUP, an appropriate alternative to small amount short term loans?

As stated above, Care considers the NILS and StepUp programs to be very useful tools in assisting low income consumers to access limited credit. We support the expansion of these programs so that more people in the community are able to access them. They provide a lower cost alternative for some expenses; however they are not a replacement for payday loans. There are fundamental differences in the way they operate compared to payday loans. The purpose of microfinance programs is to alleviate poverty by helping people on modest incomes to accumulate assets. The loans are primarily provided for the purchase of essential household goods. The flow on effect of many microfinance loans is to improve the quality of life for the borrower and their family. We would not be in favour of changing the fundamental philosophy or purpose of NILS and LILS.

People accessing payday loans do so because of an urgent need to access credit to meet day to day living expenses. Payday loans are quicker and usually more accessible. If people want a payday loan for a dental bill that is due immediately the ready cash option is not available to them via either the NILS or StepUP programs.

Q9. If yes should the eligibility and purpose criteria for no and low interest loans be expanded and what should these criteria be expanded to?

As stated above microfinance programs are not necessarily a replacement for payday loans. The need for immediate cash is what drives people to payday lenders. NILS in particular requires a more prolonged process, including the person considering quotes and prices for products. Although people often access NILS loans in response to a breakdown of a fridge or washing machine for example, a significant percentage of clients at Care access these loans in a proactive fashion i.e. they anticipate a need to replace goods or upgrade them. This is not the case with payday loans as they are fundamentally a reactive strategy to deal with crises and are predominantly for events i.e. medical/dental or broken goods that have already occurred. Whilst expanding the availability of NILS across Australia will assist more people it is not in itself the solution to reducing reliance on payday lenders.

StepUP loans are available for a broader range of goods and services than NILS; however they are not available for fines, bills or cash. There is capacity for Low Interest Loans programs such as StepUP to be expanded. The focus should be not so much on the eligibility criteria as the availability of such loans across all regions of Australia. At present StepUP loans are available in in about 30 locations across Australia. When compared to the availability of payday lenders, it is clear that the latter are far easier to access. NAB is the only financial institution to provide microfinance loans. Care would support the introduction of similar products from all major financial institutions. This will not stop people from accessing payday loans but is certainly likely to reduce the current reliance on them. Any expansion of microfinance programs will involve a significant investment from the Commonwealth Government to assure the programs can be administered effectively and efficiently.

Q10. How could more partnerships be developed between community service organisations and financial institutions to increase the number of these products and their coverage?

As noted above, it may be that an expansion of the NILS and LILS programs in conjunction with them being better promoted as alternatives to payday lending could help prevent some people from accessing payday loans. Perhaps consideration could be given to services such as such as medical or dental needs when looking at expansion of any eligibility requirements.

Successful partnerships should also include government as any administrative or ongoing support role provided by community organisations would need to be appropriately funded. There needs to be stronger encouragement for all mainstream lending institutions to become involved in microfinance programs as part of their Corporate Social Responsibility. This issue is addressed in more detail in Question 11 below.

Care would caution however, against any use of short term loans for services where adequate funding for these services should be provided by governments and not leave low income consumers in financial difficulty in the first place. As an example loans should not be an alternative to adequately funded medical and dental programs.

Q11. What mechanisms would be most successful in encouraging mainstream lenders to improve access for low income individuals to small amount loans?

The main reason stated that mainstream lenders do not develop low interest, small amount credit products is that they are not profitable. Encouraging a culture of Corporate Social Responsibility amongst a sector that is profit driven will always be challenging, so mandating this will be necessary. Realistically programs such as these will be a small percentage of any financial institution's business and should not make a huge impact on overall profitability. The government should work closely with the Australian Banker's Association (ABA), the major financial institution and community organisations to develop more affordable credit products. Financial services hubs are one option that could be considered and are discussed at Question 14 below.

Q12. Would reporting be an effective mechanism for encouraging mainstream lenders to increase their small amount, short term loan activity? Is it reasonable to expect financial institutions to support the CDFI sector through their corporate social responsibility activities?

Care regards it as reasonable that financial institutions should provide services to low income consumers through corporate social responsibility activities. At its most basic, not providing appropriate financial services to all sectors of the community is discriminatory. Low income consumers should have the same rights of access to products and services tailored to meet their needs as any other sector.

Q13. Should the growth of a CDFI sector in Australia be supported?

Whether Community Development Financial Institutions (CDFIs) are a good fit within the Australian context will be better known after the evaluation of the pilot is known in August 2012. Given Care's experiences with the NILS program where low income consumers are very reliable in repaying loans and there are many repeat borrowers and extended family borrowers, it seem feasible that CDFIs could work. We note however, that the current interest rate on CDFI loans is around 35% which is higher than on most credit cards. Financial counsellors see many clients who are experiencing difficulty in repaying more than the minimum repayment on their credit card bill. It is therefore likely to be difficult for people on very low incomes to manage repayments on loan products that attract a higher interest than the current credit card rates. CDFI's may provide some benefit for people on moderate rather than very low incomes. . CDFI's should complement NILS and LILS and never be seen as a replacement for these schemes.

Q14. Can a financial services hub provide a viable alternative to high cost small amount lenders?

What is particularly important is the availability of a range of alternate products that can better meet the needs of consumers in financial difficulty. Care believes that there is value in exploring a system whereby all financial institutions with a turnover above a particular threshold, make a contribution into a fund. This pool of funds could be used for the provision of affordable loan products possibly through a financial services hub.

In order for a financial services hub to provide a viable alternative to high cost small amount lenders it needs to firstly be visible and readily accessible to the client group to which it is targeted. It then needs to provide services that this client group says it wants: fast, friendly and 'relationship' based. The people accessing it need to feel that the lender is approachable and that it is relatively easy to get loans; the lender knows them and their story. They do not have to continuously prove how 'poor' they are.

Financial services hubs are more likely to be effective if there is information available in the hub about other services such as financial counselling, emergency relief and energy efficiency programs that can assist people experiencing financial hardship.

Q15. Would a hub approach make services more accessible for individuals who may be reluctant to visit major church providers for assistance?

There can be reluctance on the part of some people to access church providers due to a sense (which may or may not be accurate) that they will be judged. Others may be unwilling to attend a church based service if they do not share the same beliefs as those espoused by the organisation. Placing hubs in the community (such as in major shopping centres) is likely to make them more accessible to a wider group of people. There will still need to be some discretion about the presentation and location of the hubs as people don't necessarily want to be seen to be borrowing money particularly on a regular basis.

Q16. Are there other services that could be included in the hub model?

Care acknowledges that it is sometimes preferable to place services together in a hub setting however people who access payday loans don't necessarily want more services. They want a payday loan! Perhaps asking users of hubs what other services they would like to be able to access while in the hub would provide some information about this question. Certainly access to information about other support services would be useful in a hub.

Q17. What are the advantages and disadvantages of debt consolidation loans in relation to the objective of decreasing the cycle of debt for vulnerable individuals?

The issue of debt consolidation is a complex one and there is not a simple response for this question. Consolidation loans have advantages and disadvantages. A factor to consider is whether or not a bill that does not attract interest (utility bill) is included in a debt consolidation loan where interest is being charged. This will impact on whether the person will end up paying more or less in the long term.

This option needs to be viewed with caution. Often, if a client is struggling to manage their existing debts, they will find it just as difficult to meet the repayments on a new loan. They may also find that they are ineligible to borrow sufficient money to refinance, due to insufficient income or a poor credit record.

Debt consolidation works for people who do not then go on to access other credit if they cannot afford to meet the loan repayments. It can allow a person to make a single payment at a lower rate than all the payments they were making previously. Ideally the overall cost of this credit would be lower in total than the original amounts to be paid out on individual loans; but in reality people often end up paying more overall. As the payments are more manageable however, people may prefer this.

Q18. 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?

Unlike in other countries, people with multiple debt problems in Australia do not have access to a free repayment service. The equivalent service in the United Kingdom is the Consumer Credit Counselling Service (CCCS). This service negotiates an affordable repayment arrangement, at no interest and usually for less than the full amount of all the debts. The consumer then makes one payment to the service each month and this is distributed on a pro rata basis to creditors. The CCCS service handles over 300,000 phone and online queries each year.

The introduction of a free, well-marketed repayment service into the Australian marketplace would provide people in financial difficulty with an option that does not exist at present. Because there is no such service in Australia at present, many people remain trapped in a cycle of debt. Others end up accessing payday lenders or other fringe credit providers.

The financial counselling sector is very concerned about the potential for “for profit” providers to set up such a service in Australia and to become a dominant force in the marketplace. A “for profit” service, or even one that was set up by a charity, would not necessarily make sure that consumers are given information about all of their options, including whether any debts were legally owed. The best model for Australia is one involving a cooperative approach between financial counsellors and industry. As a result Financial Counselling Australia (FCA) is working with the financial services industry to explore the possibility of establishing a not-for-profit service like CCCS in Australia that is free and ethical. In the proposed model access to the repayment service would only be after an independent assessment by a financial counsellor to ensure that consumers were given information about all options relevant to their financial situation.

A free and well run repayment service would hopefully reach many people before they got into serious financial difficulty and could free up people's income so they have enough money to live on and are less likely to become reliant on payday lenders.

Q19. Is a national debt reduction project another potential mechanism for reducing demand for small amount loans?

The National Bulk Debt Project assists people on very low incomes who are in financial difficulty by negotiating bulk waivers. This ensures that they can use their very limited income for food, shelter and household bills. The National Bulk Debt Project has assisted Centrelink recipients to have debts waived and has proven a valuable mechanism for relieving some of the very poorest and most vulnerable members of the community of debts they would for the most part have been struggling with forever.

This model could be expanded to include those people who have a very low income: either very low wages or part-Centrelink and part wages. Care would welcome ongoing support for the National Bulk Debt Project so that it can continue to assist low income consumers who are in financial difficulty.