



Financial System Inquiry

Submission by:

Good Shepherd Microfinance and
Good Shepherd Youth & Family Service
to the Financial System Inquiry

March 2014



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Monday March 31st 2014

Good Shepherd Microfinance and Good Shepherd Youth and Family Service welcome the opportunity to make this submission to the Financial System Inquiry which will establish a direction for the future of Australia's financial system.

In this submission Good Shepherd Microfinance and Good Shepherd Youth and Family Service argue strongly for financial inclusion and resilience building as a means by which to encourage economic mobility and to eliminate the consequences of financial hardship in Australia. We believe that financial inclusion and building resilience should be a stated aim of the Australian financial system. Increasing financial inclusion and resilience in the Australian community will drive economic growth and have positive impacts on competition, innovation, efficiency, stability and consumer protection.

In line with our values of human dignity, respect, social justice, compassion, audacity and reconciliation, Good Shepherd will continue to advocate for and provide access to increase financial inclusion.

We look forward to the Inquiry's Interim Report later in the year, enabling informed second submissions.



Adam Mooney
CEO
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March 31st 2014



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March 31st 2014

EXECUTIVE SUMMARY

In 2010 in Australia 2,265,000 adults (and as many as 2,831,000 people, including children) were severely or completely excluded from the Australian financial system. Constituting 12.8 per cent of the population, the great majority were living in poverty. By 2012 this number had risen to 3,123,519 adults with 17.7 per cent of the Australian population being either severely or fully excluded from mainstream financial services (ACOSS, 2012; Connolly, 2013).

Given that the level of poverty has increased over recent time, the likelihood of economic mobility for these Australians is restricted, if not non-existent, without dedicated action and policy focus. Without access to fair, safe and appropriate financial services, the capacity of individuals and families to live full lives, participate economically and realise their own wellbeing is directly impacted.

Financial hardship and financial exclusion result in greater demand for emergency relief, families go without meals or other basic necessities, and individuals are forced to sell or pawn their possessions (ABS, 2011). This constrains economic mobility of large numbers of people and puts an added short term impost on governments and civil society to offer crisis and hardship services such as housing, counselling, mental health support and prevention of family violence, which could have been avoided if appropriate investment had been made in preventative measures to build resilience and financial inclusion.

In response to growth in financial exclusion, Australia, and other nations, have advocated for financial inclusion mechanisms and services to alleviate the consequences of financial hardship (Australian Government Treasury, 2012). Although a noble idea in theory, banks around the world have more recently generally plateaued or retreated from voluntary financial inclusion commitments, driven by a sense of inevitable banking and consumer protection regulation as they emerge from the financial shocks of the last five years. Most banks in high-income countries have refocused away from increasing and improving access to financial services towards building capacity and community education through financial literacy to change customer behaviour. The business case to promote financial inclusion appeared in their view to have a too-distant investment break-even horizon, moving institutional and retail investors to seek shorter-term returns to recover losses experienced during the Global Financial Crisis. Equally, several bank executives state that addressing financial exclusion is the responsibility of Government primarily rather than the banks.

As a consequence fringe lenders, whose only business model is to perpetually entangle vulnerable clients, have flourished and capitalised on the increase in financial exclusion. In particular, the broader financial inclusion agenda in Australia has seen an increasing use of short-term, small loans provided by fringe providers who often adopt predatory lending practices, offering loans at high interest rates and subject to hidden charges (Banks, Marston, Karger, & Russell, 2012; Marston & Shevellar, 2010; Rivlin, 2011). Though fringe loans are considered the least affordable and appropriate for low-income, financially excluded individuals, such people are more likely to use them as a buffer against financial shocks or unexpected expenses (Burkett & Sheehan, 2009; Connolly, Georgouras, Hems, & Wolfson, 2011).

Good Shepherd Microfinance argues strongly for financial inclusion and resilience building as a means by which to encourage economic mobility and to eliminate the consequences of financial hardship in Australia. We believe that financial inclusion and building resilience should be a stated aim of the Australian financial system. Increasing financial inclusion and resilience in the Australian community will have positive impacts on competition, innovation, efficiency, stability and consumer protection. Consumer protection is a core consideration of a well-functioning financial system – and should be valued over costs, flexibility and profits.

Good Shepherd Microfinance is committed to working with others to find breakout creative solutions. In short, we aim to work with the three million adults who seek to move from financial crisis and hardship towards economic resilience, through clearly defined phases.

This economic mobility will have substantial benefits not only for people on low incomes who are shut out of our financial system (our clients), but also for the Government and financial market participants. A client in financial crisis or experiencing hardship can be supported with people-centred products and services, to move along a financial inclusion continuum towards resilience through key phases – from crisis, through hardship, stability, asset building, income generation, growth and consolidation, wealth creation, to independence and resilience.

Good Shepherd Microfinance has undertaken a preliminary population mapping exercise, using criteria to place people on this continuum and the services and interventions needed. Our modelling indicates that if one in four financially excluded people are able to progress up one phase in this continuum every two years, \$73.4 billion of additional net income would be created within the Australian economy, delivering a substantial boost to employment, GDP and broad economic wellbeing.

RECOMMENDATIONS

With 33 years of experience, Good Shepherd Microfinance is the largest and most experienced organisation in Australia focused on economic inclusion. Good Shepherd Microfinance, along with Good Shepherd Youth and Family Service, submits the following recommendations to the Financial System Inquiry, to build strategic policy aimed at realising full employment, enabling productive economic mobility and optimising social inclusion through reform of the financial system.

We base these policy recommendations on our knowledge and experience, in addition to our latest research findings and modelled financial inclusion and resilience continuum. Good Shepherd Microfinance, along with its network of 257 organisations across 650 locations nationally, is committed to creative policy initiatives that will get real traction in terms of economic mobility and full employment. Most, but not all, of our recommendations focus on Term of Reference No 2. We present these recommendations under four main themes: Strengthening microfinance and alternative services options – encouraging economic mobility; Strengthening focus on financial inclusion and resilience; Strengthening protective regulation; and Strengthening community banks and credit unions as middle ground.

1. Strengthening Microfinance and Alternative Financial Services Options to Encourage Economic Mobility

The rapidly growing alternate financial sector points to failure of the mainstream to meet the demand of the market. Through a rich and capable national network of community organisations offering finance, Good Shepherd Microfinance has earned the trust of people on low incomes. We see considerable opportunity for large-scale investment in this network and in other innovative initiatives to enable economic mobility and overall economic growth.

The systematic guaranteeing of retail deposits by central banks has been a signal to all banks that governments are the best provider of confidence and strategies to promote economic participation and full employment. This is an opportunity for the Australian Government, the Reserve Bank of Australia (RBA) and other stakeholders to expand the physical and virtual footprint of alternative financial services, but with adequate regulation to ensure protection of those most excluded.

We believe it is in the interests of the RBA to invest directly in financial inclusion and resilience initiatives to achieve its charter of improving the efficiency of the Australian financial system and as a lever to realise full employment.

Recommendation 1

That the Government, the Reserve Bank of Australia and other stakeholders invest in microfinance banking and financial services as a long-term proposition, in collaboration with the not for profit and community sector. This could be achieved by:

- R 1.1** Sector building investment in Community Development Finance Institutions (CDFIs).
- R 1.2** Mandatory minimum proportions of bank risk weighted assets (RWA) or bank profits being invested in economic inclusion programs for people on low incomes
- R 1.3** Scalable and sustainable income generating microenterprise development schemes
- R 1.4** Performance oriented financial capability programs (financial capability bonds)
- R 1.5** Insurance cover for people on low incomes
- R 1.6** Investment in alternative people centred financial services similar to Kiwibank in New Zealand
- R 1.7** Impact investment social performance bonds focused on impact at the client level.

To develop these to stable policy positions the Government would need to:

Recommendation 2

Undertake a thorough examination of the role that financial services play in directly enabling economic mobility for people on low incomes and the role this plays in driving economic growth and fair and inclusive communities, especially, but not limited to:

- R 2.1** An examination of the particular banking and finance needs of remote communities, especially those that are predominantly Indigenous.

2. Strengthening Focus on Financial Inclusion and Resilience

Essential to the underpinning of a fair and just Australian financial system is knowledge growth and understanding related to financial inclusion and financial resilience, both at a micro and macro level. Good Shepherd Microfinance, RMIT University and Smart Services CRC researchers (supported by the Victorian Government) have formed a Financial Resilience Co-operative Research Centre (CRC) bid team. Through a collaboration between researchers and end-users (i.e. a public or private entity capable of deploying the research outputs), this team is seeking CRC funding to deliver significant economic, environmental and/or social benefits to Australia through a focus on financial resilience.

The proposed Financial Resilience CRC will foster cross-sectoral, long-term applied research on both the demand- and supply-side issues of exclusion, providing a rigorous evidence base to inform integrated policy/regulation frameworks. The CRC will guide industry and community action, and leverage existing knowledge both in Australia and overseas. Key to the CRC will be innovative 'Living Labs' which co-locate researchers with service providers, enabling users to co-create sustainable solutions, instead of 'research for the sake of research'. The expected research outcomes include new financial products and services that will better meet the needs of financially excluded Australians, and efficient, sustainable processes including technology-enabled business models offering low-cost, scalable and 'high-touch' financial service provision.

In the future, this dedicated focus will further strengthen academic prioritisation of financial inclusion research, which is still an emerging discipline in Australia. The Financial Resilience CRC will also have a vital role to play as the Financial Services Inquiry progresses. Through researchers collaborating with domestic and international experts, it will contribute to current thinking related to developing and testing effective solutions for the 'under-banked', and address access issues in remote/regional areas enabling Australia to strengthen its thought-leadership in regional (i.e. Asia-Pacific) and international arenas.

The need for a continuous collaborative learning process and framework for players actors in financial services is increasingly becoming apparent as more developed economies explore microfinance and related alternatives. Therefore we strongly recommend that:

Recommendation 3

A Cooperative Research Centre for Financial Resilience be established which comprises banks, research institutes and universities, community organisations, governments and consumer groups.

Just as Australia has focused on the importance of developing Reconciliation Action Plans, so this review presents an opportunity for Government to take a lead in focusing on a broad Financial Inclusion and Resilience program. Just as Australians have been challenged to close the gap of inequality for Indigenous people, so too we must now take up the challenge of closing the gap between Australians who are financially excluded from mainstream banking and those who are not. Therefore it is recommended that:

Recommendation 4

That Government support and advocate for a systematic nation-wide program to develop financial inclusion and resilience plans for and by all key actors. Similar to Reconciliation Action Plans, these financial inclusion and resilience action plans would enable all Australians, within their individual sphere of influence, to optimize financial inclusion to mutually benefit people, customers and financial service providers.

R 4.1 That Government takes a lead in developing its own departmental action plans, and that it offers support and incentives to enable organisations to develop their individual action plans.

3. Strengthening Protective Regulation

The issue of regulation and deregulation is an important one, as was recognised by the Wallis Report. However, it would seem that an unintended consequence of deregulating the financial system has been that the financially excluded, rather than being protected or supported by welfare payments, have become even further disadvantaged. Equally, government dollars are being expended alongside a growing fringe-lending sector, which takes advantage of the vulnerable and the financially excluded.

Recommendation 5

That strengthening regulation is a priority, especially of the fringe-lending sector, rather than further deregulation.

Maintaining competition is paramount, but not in a way that will make fewer options available for the financial excluded than previously. Although increased competition can spur a financial system to greater efficiency, leading to lower costs and prices for consumers, for those Australians who are excluded from mainstream banking the benefits have been few. Granted, higher regulation may well incur greater administrative costs. However, a recent analysis by Good Shepherd Microfinance of the potential government savings if the financially excluded were mobilised positively into inclusion, predicted a substantial saving to the Australian Government. Therefore we recommend that:

Recommendation 6

That Government review and strengthen the regulation of the practices of small and large credit providers, particularly where:

- a. exploitative practices exist, or
- b. there is inadequate support in the form of responsible referrals or diversion away from exploitative operators for the financially vulnerable, or
- c. self-regulation within the industry is not strong enough to maintain responsible practices.

Recommendation 7

Appropriate regulation of credit providers, while still retaining balanced competition, could be achieved by:

- R 7.1** The expansion and enhancement of current legislation to prevent credit providers from offering or imposing ‘extras’ on credit loans. We welcomed the introduction in July 2013¹ of the cap of 48% on annual credit rates. However, currently the legislation allows for some maverick credit providers to operate within the law while exploiting loopholes; consequently genuine and ethical providers are disadvantaged.
- R 7.2** Providing the necessary resources for monitoring and compliance of the consumer protection and credit lending legislation. Currently there do not appear to be adequate and dedicated resources to monitor compliance of the legislated regulations. Resource constrained regulators find it difficult to respond quickly on such matters and often the consumer complaint process is onerous and slow.
- R 7.3** Reviewing the position that the credit industry has the capacity to self-regulate and therefore will. It would seem that credit providers have become highly competitive and sophisticated in their marketing and practices. Financially vulnerable Australians without the resilience, eligibility criteria for loans or asset building capacity are easy prey for these operators. Expecting such a competitive industry to self-regulate is unrealistic.

Equally there should be a focus on mainstream financial service providers and institutions to responsibly refer vulnerable and excluded customers to safe and affordable alternatives. Good Shepherd Microfinance has substantial evidence of all major banks referring people seeking personal loans below \$5,000, in the first instance to the option of a credit card, and in the second instance to payday lenders. In an exercise in mystery shopping the customer met the criteria for a NILS or StepUP loan, and in some cases had to walk past a NILS or StepUP provider in one of Good Shepherd Microfinance’s 650 locations around Australia to get to the referred payday lender. Clearly there is a need for banks to engage in a responsible referral process to ensure customers are not exposed to unsuitable products.

Recommendation 8

Develop a Responsible Referral Framework for banks to refer to alternative financial service providers.

A Responsible Referral Framework would create greater awareness among frontline bankers of small one-off credit options where bank products are not suitable.

¹ National Consumer Credit Protection Amendment (Enhancements) Bill 2011: caps on costs etc. for credit contracts. Exposure Draft, July 2013, Treasury, Australia.

4. Strengthening Community Banks and Credit Unions as Middle Ground

Recommendation 9

That the Australian Government responds to the need for tighter regulation of the practices of small and large banks, and superannuation and insurance agencies that threaten to monopolise the middle ground traditionally occupied by community-based banks and credit unions.

Partly due to the onerous cost of compliance of recent times, the 'Big 4' banks have absorbed smaller credit unions that were well placed within their communities and with their consumers, and often provided sensible and safe lending. Lack of competition in this market makes the middle ground vulnerable to the take over and competitive practices of much larger and well-resourced institutions who may not have the same commitment or capacity to provide access to smaller loans and community-led banking solutions. If we are to realise the economic mobility of the financially excluded, then these middle ground banking options offer a means by which vulnerable Australians can enter the banking market safely.

Denise

Denise (not her name) has three children, all with disabilities. She is not working, and is a victim of Domestic Violence. When Denise approached the local NILS provider she had been receiving intensive family support and had financial difficulties due to separation from her partner. As a consequence Denise was constantly renting household items from Radio Rentals and was paying high interest, keeping her constantly in financial hardship.

With assistance from the NILS provider and a NILS loan Denise was given the opportunity to purchase items that she would own. Without the burden of high repayments Denise was able to manage her finances more effectively and was able to pay off her NILS loan within three months. She is currently paying another!

Denise describes feeling supported, is less stressed, feels more confident, and is outwardly happier. She feels empowered and her self-esteem has improved. The extra money Denise now has enabled her to purchase items for the children such as school clothes and medical expenses. Previously, the high interest paid to Radio Rentals was preventing her from meeting her children's needs and providing what other mums were able to do. In fact Denise is now able to save and can look forward to planning a holiday with her children.

Provided by a NILS caseworker in Liverpool, NSW

ABOUT GOOD SHEPHERD MICROFINANCE

Good Shepherd Microfinance is Australia's largest microfinance organisation. We offer a suite of people-centred, affordable financial programs for individuals on low incomes at different financial stages of their lives.

Our aim, together with those of our community partners, is to enable people to realise their own economic wellbeing, as they define it themselves, through appropriate financial services. As a result, people feel valued, accepted and included and in control of their own finances and lives.

Drawing on knowledge gained over 33 years, and on its commitment to these aims, Good Shepherd Microfinance has already reached over 140,000 people across all states and territories, who were excluded from mainstream banking.

Good Shepherd Microfinance's provider network includes 246 community organisations across 650 locations in Australia who offer safe, fair, and affordable loans, savings, energy inclusion and other programs.

Underpinned by the basic principles of trust, respect and non-judgement of people and their financial circumstances, our low and no interest loans programs enable people to build assets, engage in community life and / or find, or keep, a job. Our suite of microfinance programs includes the following products.

No Interest Loan Scheme (NILS®)

NILS is a national community based program that enables people living on low incomes to access fair and safe credit (up to \$1,200) to buy essential goods and services. Known as circular community credit, NILS is a demonstration of communities taking action to address their own needs. NILS is delivered through accredited community partners across Australia.

StepUP

StepUP provides low interest loans to people on low incomes through community providers across Australia. StepUP is delivered in partnership with National Australia Bank (NAB) and provides loans of between \$800 and \$3,000 for personal household purposes to individuals or families on a benefit. Interest is charged at a fixed rate of 5.99% and loans can be repaid over three years.

AddsUP

AddsUP is delivered in partnership with NAB and focuses on helping people on low incomes develop financial independence through savings. The program does not impose restrictions on the object of savings, nor does it set a regular payment amount. Recipients gain basic financial literacy throughout the AddsUP program and individual savings are matched dollar for dollar as an incentive to develop savings behaviours that last well beyond the program period.

Energy Inclusion

The Home Energy Savings Scheme (HESS) provides assistance to low income households concerned about energy use and costs. HESS will provide no-interest loans on selected energy efficient goods as well as information about easy and affordable ways to use less energy, rebates and assistance. A program has also been designed by Good Shepherd Microfinance to enable people on low incomes to buy subsidised energy efficient appliances and finance these purchases through a NILS loan, with the assistance of an online buying service.

Good Money

Good Money is a pilot program of three community finance stores in Victoria that offer new ways of delivering financial services to people currently experiencing financial exclusion. In partnership with the Victorian Government, NAB and Good Shepherd Microfinance, Good Money is a one-stop shop providing a more distinct safe alternative to the growing fringe lending sector.

Debt Deduct

Debt Deduct is a pilot program that provides access to affordable and safe credit for people who need to break cycles of unaffordable credit. It is a 'circuit breaker' addressing the immediate need for debt relief while also building in ongoing financial capacity and resilience.

Aboriginal Financial Inclusion

Good Shepherd Microfinance is building its experience and knowledge of NILS into remote Indigenous communities, funded through Department of Social Services (DSS). In partnership with Indigenous communities, Good Shepherd Microfinance is supporting the delivering of Microfinance into Far North Queensland, Rockhampton, Darwin/Kimberly, and Alice Springs/APY Lands.



ABOUT GOOD SHEPHERD YOUTH & FAMILY SERVICE

Good Shepherd Youth & Family Service works to promote the human rights and dignity of people who are marginalised in the community. Our organisation assists, empowers, and advocates on behalf of those people who are at the very fringes of society. Each year we directly support over 12,000 young people, women and families in Victoria.

Central to our work is the strong belief that everyone deserves a stake in their community and the conditions of life that make participation in community possible. This includes access to an adequate income, affordable housing, high quality education and training programs, decent employment and a non-exploitative market.

The communities in and around Melbourne in which Good Shepherd Youth & Family Service operates experience financial disadvantage, and our programs directly address this and many of the accompanying challenges. These programs include financial counselling, microfinance, family support, youth emergency housing, family violence support services and refuge accommodation, and community education.

Our inheritance of the mission and vision of the Good Shepherd Sisters directly informs our advocacy and direct service work, especially where it impacts on the lives of disadvantaged young people, women and girls. Recent research projects conducted by the organisation (in partnership or independently) include investigations into fringe lending, emergency relief, microfinance, bankruptcy and mental illness, women's financial capability, and family violence.

Good Shepherd Youth & Family Service is linked in with a broader network of organisations, including Good Shepherd in the United States. Since 1996, Good Shepherd has had a consultative status at the United Nations Economic and Social Council. This affiliation has enabled Good Shepherd to further its mission to promote the human rights of vulnerable groups of people, and to challenge the conditions that condemn people to a marginalised life.

This practice experience and research give us an understanding of how the financial system impacts on people who are marginalised. It is this evidence base that we draw on in making this submission.

Financial hardship and financial exclusion result in greater demand for emergency relief, families go without meals or other basic necessities, and individuals are forced to sell or pawn their possessions (ABS, 2011).



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GOOD SHEPHERD MICROFINANCE'S SCOPE

Good Shepherd Microfinance believes that the Financial System Inquiry presents a fresh opportunity to find new ways to enable economic participation for the one in six Australians that are financially excluded. One in six, or 3.1 million adult Australians, are financially excluded and unable to access a bank account, small credit or insurance policy, which has social as well as financial implications on individuals, families, communities and our economy.

We see this as a significant opportunity for investments, up front, by the Government, the Reserve Bank of Australia or the banks themselves in investing directly in community finance. Recently, in an ABC interview Good Shepherd Microfinance CEO Adam Mooney pointed out: "There is tremendous opportunity in community finance/microfinance. At the moment, we're by far the biggest microfinance provider, and we're reaching less than two per cent of demand. Investment of around the \$100-200 million mark over the next three to five years through community finance would be a step in the right direction, not just from a social and moral perspective – there's a profound economic case for economic mobility as well."

Good Shepherd Microfinance's modelling shows that GDP would increase by 2% if a quarter of those 3.1 million adults that are financially excluded can make a small progression from financial hardship to financial stability. Good Shepherd Microfinance is calling for well developed and implemented financial system reform, employment and enterprise policy improvements to enable this progression.

TERMS OF REFERENCE

1. The Inquiry will report on the consequences of developments in the Australian financial system since the 1997 Financial System Inquiry and the global financial crisis, including implications for:
 1. how Australia funds its growth;
 2. domestic competition and international competitiveness; and
 3. the current cost, quality, safety and availability of financial services, products and capital for users.
2. The Inquiry will refresh the philosophy, principles and objectives underpinning the development of a well-functioning financial system, including:
 1. balancing competition, innovation, efficiency, stability and consumer protection;
 2. how financial risk is allocated and systemic risk is managed;
 3. assessing the effectiveness and need for financial regulation, including its impact on costs, flexibility, innovation, industry and among users;
 4. the role of Government; and
 5. the role, objectives, funding and performance of financial regulators including an international comparison.
3. The Inquiry will identify and consider the emerging opportunities and challenges that are likely to drive further change in the global and domestic financial system, including:

1. the role and impact of new technologies, market innovations and changing consumer preferences and demography;
 2. international integration, including international financial regulation;
 3. changes in the way Australia sources and distributes capital, including the intermediation of savings through banks, non-bank financial institutions, insurance companies, superannuation funds and capital markets;
 4. changing organisational structures in the financial sector;
 5. corporate governance structures across the financial system and how they affect stakeholder interests; and
 6. developments in the payment system.
4. The Inquiry will recommend policy options that:
 1. promote a competitive and stable financial system that contributes to Australia's productivity growth;
 2. promote the efficient allocation of capital and cost efficient access and services for users;
 3. meet the needs of users with appropriate financial products and services;
 4. create an environment conducive to dynamic and innovative financial service providers; and
 5. relate to other matters that fall within this term of reference.
 5. The Inquiry will take account of the regulation of the general operation of companies and trusts to the extent this impinges on the efficiency and effective allocation of capital within the financial system.
 6. The Inquiry will examine the taxation of financial arrangements, products or institutions to the extent these impinge on the efficient and effective allocation of capital by the financial system, and provide observations that could inform the Tax White Paper.
 7. In reaching its conclusions, the Inquiry will take account of, but not make recommendations on, the objectives and procedures of the Reserve Bank in its conduct of monetary policy.
 8. The Inquiry may invite submissions and seek information from any persons or bodies.
 9. The Inquiry will consult extensively both domestically and globally. It will publish an interim report in mid-2014 setting out initial findings and seek public feedback. A final report is to be provided to the Treasurer by November 2014.

INTRODUCTION

Good Shepherd welcomes the Federal Government's conduct of an Inquiry into the Financial System, especially the intention to make recommendations that will foster an efficient, competitive and flexible financial system, consistent with financial stability, prudence, integrity and fairness.

Our submission will focus on the way the financial system should address financial exclusion and the financial capability of those most vulnerable and excluded from the financial services system.

FINANCIAL CAPABILITY

Good Shepherd's approach to financial capability is informed by research done from the Financial Services Authority in the United Kingdom. It incorporates understanding of the skills, knowledge and behaviours of the individual, as well as the socio-economic context that enables them to exercise their agency.² The individual skills, knowledge and behaviours are:

1. **Money Management** – including managing budgets, keeping track of expenses, planning for uneven expenditure and resisting pressure to spend or borrow
2. **Planning Ahead** – including saving money for an emergency and/or for future goals
3. **Making Choices** – such as choosing appropriate financial services
4. **Getting Help** – including knowing where to go or who to ask if there are any questions about money
5. **Strategies** – for when there is money left over or when there is a money shortfall³

Financial skills, knowledge and behaviours need to be viewed within their socio-economic and structural context. The capacity to exercise agency is dependent on (Figure 1):

- **income adequacy** – that citizens have an adequate income to enable them to make safe financial choices and meet their material needs
- **an emergency buffer** – so people have access to funds when needed for emergencies
- **a non-exploitative market** – a market that does not exploit vulnerability or result in a disproportionate allocation of risk to people who can least afford to absorb it
- **financial information and support**– the availability of information and support to people that is appropriate, contextualised and relevant to their needs⁴
- **financial exclusion** – consumers are able to access:
 - a moderate amount of credit which is safe and affordable
 - basic insurance
 - a transaction account⁵

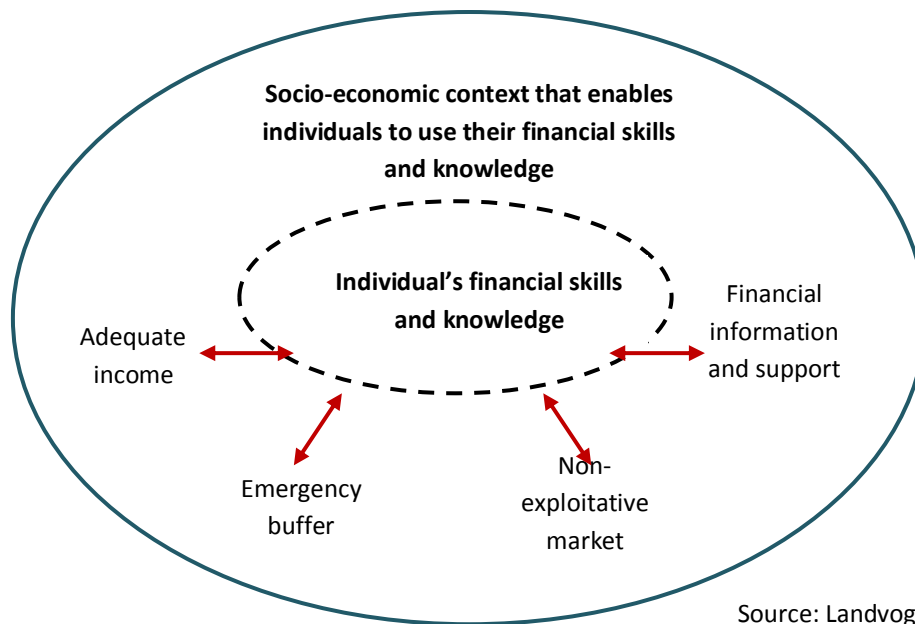
² Landvogt, K (2008) 'Money, Dignity and Inclusion: The role of critical financial capability' Good Shepherd Youth & Family Service, Collingwood

³ Kempson E, Whyley C, Caskey J, & Collard S (2000). *In or Out? Financial Exclusion: a Research and Literature Review*. Financial Services Authority (FSA), Bristol, UK.

⁴ Landvogt, K (2008) *Op. Cit.* pg. 84.

⁵ Connolly, C. (2013). *Measuring Financial Exclusion in Australia*. Sydney: Centre for Social Impact (CSI) University of New South Wales for National Australia Bank.

Figure 1: Financial capability



Financial exclusion

Financial exclusion is a combination of 'insufficient income to participate successfully in a market based economy' (Landvogt, 2006, p. 3) and 'processes that prevent poor and disadvantaged social groups from gaining access to the financial system' (Leyshon & Thrift, 1994). Five key elements of financial exclusion are identified as: Affordability, Appropriateness, Access, Awareness and Availability (Burkett & Sheehan, 2009, p. 4).

In Australia, financial exclusion is measured through financial product ownership and the price of these financial products and services.

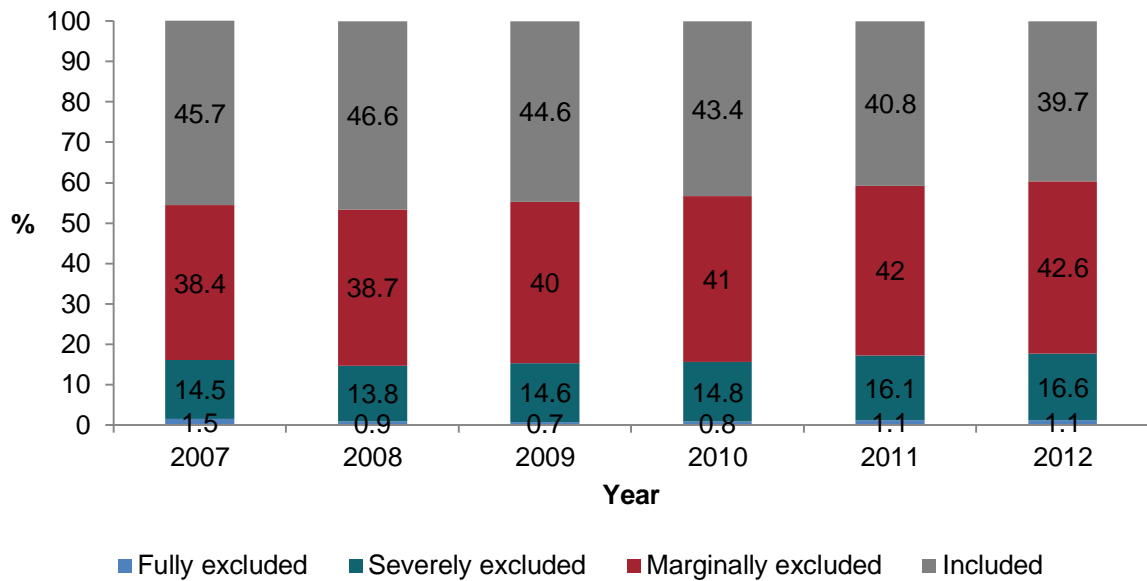
Product ownership

It is considered necessary in Australia to have access to basic financial services in order to participate economically and socially. These include:

- a moderate amount of credit which is safe and affordable
- basic insurance (Connolly, Georgouras, Hems, & Wolfson, 2011).
- a transaction account

Figure 2 outlines the results as they relate to ownership of these products.

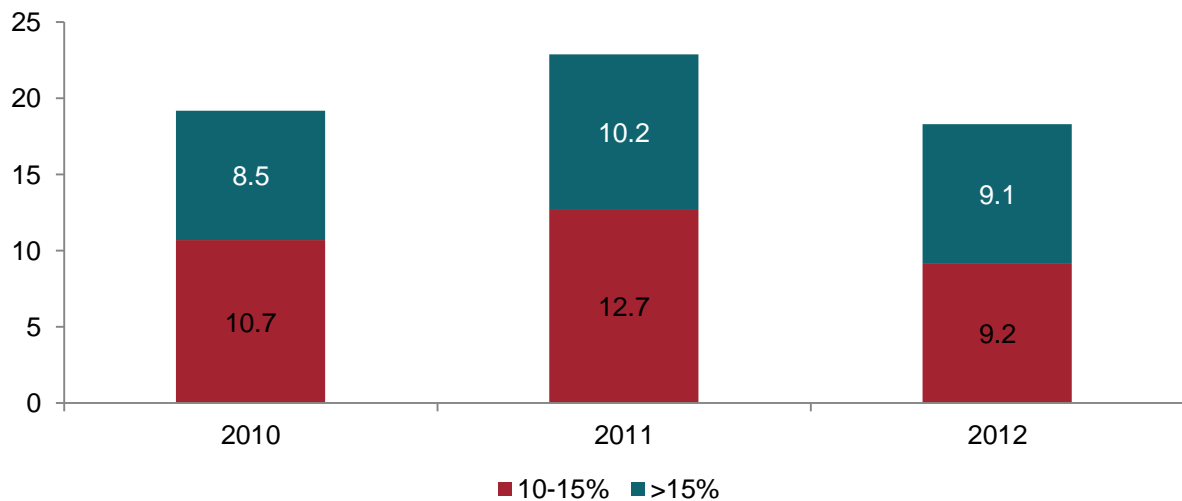
Figure 2: Financial exclusion in Australia 2007-2012, Product ownership



Price Exclusion

In 2012, around 18.3 per cent of individuals faced challenges in being able to afford basic financial services. That is, they would need to spend 10 per cent or more of their incomes to access financial products and services. This figure has improved slightly since 2010 and is illustrated in Figure 3.

Figure 3: Proportion of income required for basic financial services 2010-2012



A summary of the terms of reference and the financial capability principles to which they apply is outlined in Table 1.

Table 1: Financial System Inquiry and financial capability

Financial Terms of Reference	Financial capability principal	Summary
1. Examine the controls, risk management and administrative processes in place to ensure the Centrepay service is used in a way that protects people's entitlements.	Structural: Income adequacy, financial information and support	Centrepay being able to identify financial hardship and exploitation; referrals to FMP providers; limits on deductions; examination on costs of service; enabling information sharing and information symmetry
2. Examine the approaches taken to ensure Centrepay is used to distribute money to legitimate organisations providing services to people on a fair and reasonable basis, and the associated contract management approaches used	Structural: Non-exploitative market	Non-exploitative businesses only able to use the system; development of guidelines for use
3. Provide suggestions about which businesses and services should have access to the Centrepay service, and services that might be excluded	Structural: Non-exploitative market	Regular audits and public listing of organisations with access to Centrepay, swifter and more responsive complaints process
4. Look at ways in which Centrepay can be used to build the financial capability of its customers and to assist them to manage their money in the best way possible	Individual: Skills (budgeting, planning ahead), knowledge (information, making choices) and behaviours (saving and borrowing) Structural: emergency buffer	Reviewing costs of use; enabling use of bill smoothing ('lumpy expenditure'); access for savings (planning ahead); not legitimising exploitative business (making choices)
5. Examine the complaints and feedback mechanisms associated with Centrepay to ensure that issues are resolved in a fair way	Structural: Non-exploitative market; financial information and support	Guidelines clear and publicly available; swifter response; greater citizen involvement and action
6. Examine how Centrepay relates to other financial products and services available to the Department's customers	Individual and structural: Financial information and support; income adequacy	Flexibility of Centrelink Advance Payments; alternative to Income Management
7. Suggest future opportunities and directions for the Centrepay service	Accessibility for insurance; interaction with other systems	

This submission will address each of the terms of reference within the framework of financial capability and financial exclusion, and what this means for economic mobility. It will also indicate where the financial system in Australia can best support these ideals.

Term of Reference One

The Inquiry will report on the consequences of developments in the Australian financial system since the 1997 Financial System Inquiry and the global financial crisis, including implications for:

1. how Australia funds its growth;
 2. domestic competition and international competitiveness; and
 3. the current cost, quality, safety and availability of financial services, products and capital for users.
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1. The consequences of developments in the Australian financial system since the 1997 Financial System Inquiry and the global financial crisis

The 1997 Financial System Inquiry and Increased Deregulation

The 1997 Financial System Inquiry (the Wallis Inquiry) was undertaken at a time when there was increasing deregulation of financial systems, resulting in a rapid transformation and internationalisation of the Australian economy. One of the major consequences of the Wallis Inquiry was to speed up this deregulation. For example, the Wallis Report found that ‘the widespread existence of cross-subsidies between products, channels and customer groups reduces efficiency in the financial system by creating divergences between costs and prices.’ The recommended solution was for governments to step back and give financial institutions ‘full freedom to set fees and charges on their services and products according to cost-relevant criteria.’⁶

Good Shepherd’s submission to the Wallis Inquiry noted that financial deregulation had brought with it a number of unintended consequences: ‘Disadvantaged consumers have had their already limited access to the banking system diminished and have borne the brunt of increased fees and charges.’⁷

In the years following the 1997 Inquiry, Good Shepherd witness the continued diminishing access and discriminatory pricing of banking services faced by individuals, families and young people living on low incomes. To address the diminishing access to financial services for low income families, the Wallis Report did recommend that: ‘Other ways should be sought, such as through the tax/ transfer payments system, to provide low cost transaction services to groups such as social security recipients.’⁸

This is where services such as Centrepay, a free direct bill-paying service offered to customers receiving Centrelink payments, can be a very useful tool to assist our clients to manage their finances. However, outside of the development of Centrepay, individuals and families on low-incomes have been progressively excluded from mainstream financial services.

⁶ Hanratty, P (1997). *Research Paper 16: The Wallis Report on the Australian Financial System: Summary and Critique.*

⁷ Good Shepherd Youth & Family Service (1996). *Submission to the Financial System Inquiry (The Wallis Inquiry).*

⁸ Hanratty, P (1997). *Research Paper 16: The Wallis Report on the Australian Financial System: Summary and Critique.*

An increase in microfinance programs is also a response to this situation. Good Shepherd recognised some time ago that mainstream financial services were not meeting the needs of people on low incomes.

Financial stress and Microfinance

The Social Impact of the Global Financial Crisis (GFC)

Australia's experience of the GFC was not as damaging as the experience in many overseas advanced, developed economies.

Saunders and Wong (2011) have looked at broad ranging wellbeing surveys from before and after the GFC and concluded that:

*The resilience demonstrated by the Australian economy in response to the GFC, reinforced by the direct (income-enhancing) and indirect (macroeconomic) impacts of the fiscal policies introduced to counter its effects, have meant that the adverse social impacts that many had feared when the crisis first broke in late 2008 have been avoided. The fact that most people were better off in 2010 than in 2006 suggests that any negative social effects of the GFC were modest and temporary.*⁹

However, concerns have been raised over the social impact of the financial crisis, with the reports of increased demand for welfare assistance during the GFC. A number of studies from community services suggested that those with lowest incomes and/or reliant on welfare services for support were most adversely affected by the GFC.

In 2008, Access Economics was commissioned by a consortium of leading community sector NGOs to prepare a report on the impact of the GFC on social services in Australia. The report, released in November 2008 when concern about the impact of the crisis was at its peak, began with the bold claim that:

*The current global financial crisis and its likely impact on the Australian economy will have an acute impact on the most disadvantaged members of society, as well as pushing increased numbers of low and middle income earners to seek the services of welfare agencies ... Economic growth will inevitably slow, the extent to which is uncertain [but the] impact will vary across different segments of society, with the unemployed and other vulnerable groups particularly hard hit.*¹⁰

Research by the Wesley Mission in 2010, drew on an online and telephone survey of over 620 adults in New South Wales and found that more than one-third of those surveyed reported being financially stressed, as indicated by struggling to pay utility bills, going without meals or being forced to pawn items.¹¹

⁹ Saunders, P. & Wong, M. (2011). *The social impact of the global financial crisis in Australia* [online]. Australian Journal of Social Issues, The, Vol. 46, No. 3, 2011: 291-309. p 306

¹⁰ Access Economics (2008). *The impact of the Global Financial Crisis on social services in Australia*. Canberra. p2.

¹¹ Wesley Mission (2010), *Making ends meet: financial stress is not just about money*, Sydney, Wesley Mission

Saunders and Wong also assessed these claims by community service organisations and found that, although the social impact of the crisis on all Australians has been small, there is evidence that those already facing the most severe levels of social disadvantage were most adversely affected. 'In this sense, the GFC may have led to greater inequality in living standards, at least in some dimensions.'¹²

It is important that the risks associated with financial services are not borne by those who are least able to afford it. When analysing the ways in which growth is funded and risk is apportioned, attention must be paid to the people who are likely to be impacted.

Similarly, growth cannot be maintained if it is not shared equally in the community. Questions of fairness aside, demand is stifled and growth stunted if strategies are not put in place to share the benefits of economic growth.

Fringe Lending and Affordable Credit

The years immediately before the GFC were characterised by 'a combination of easy credit conditions, low risk premiums, aggressive lending practices and less disciplined risk management and underwriting standards.'¹³

Post-GFC conservatism and inefficient selective client targeting by the banks has led to many people who can actually afford bank credit missing out. Banks use automatic scoring models, based on income as the sole indicator to predict whether a family has sufficient capacity to service a loan. This short sightedness has seen a ten-fold increase in the predatory and exploitative payday loan and rent to buy market in ten years.

This again provides evidence that the management of risk negatively impacts on those people who are most vulnerable, and opens up the market to predatory and expensive lending operations. Effectively, the least able a person is to afford credit based on certain risk principles, the more they pay for that credit, thereby increasing the risk.

This is clearly an untenable situation.

Increase in Financial Stress

Access Economics noted that, even before the GFC – during a period of strong economic growth – social welfare agencies had noted an increase in demand for their services.

Most significantly, agencies began to see a new type of client: low and middle income earners facing severe financial stress. Among the contributing factors are high rent or mortgage increases; fuel and food costs; utilities bills; medical fees; and childcare costs. (Access Economics 2008 p3)

Good Shepherd Youth & Family Service Financial Counsellors have had similar experiences in this regard. There was also a new, emerging group of consumers who had never needed to access social support services before. These were people who may be working, but unable to meet their ongoing expenses. The safety net was failing.

¹² Saunders, P. & Wong, M. (2011). p 291

¹³ Access Economics (2008) p5

Housing Affordability and Homelessness

Good Shepherd draws attention to the significance of a financial system that is able to keep people housed adequately and capable of servicing their mortgage debt over extended periods. In the event of financial stress, it is important that the financial system remains focused on maintaining people's housing - rather than foreclosing. Therefore we urge that this Inquiry examines financial inclusion and resilience that prevents homelessness.

When commenting on the GFC, Access Economics also mentions housing:

Low income households, especially in the bottom income quintile, generally have very low levels of household wealth holding, relying heavily on wage income. If these households do have an asset it is often their family home. Increasing job losses will severely impact on income streams and spending power including the capacity of low-income households to service mortgages. The potential result could be the loss of even the modest non-income economic assets held by low-income households. (Access Economics 2008, p6)

Microfinance Loans vs Fringe Lending

We've already noted the growth of both fringe lending and microfinance loans in the period between the 1997 Wallis Inquiry and today. It is important to identify the differences between microfinance loans and payday lending and the implications of both for financial inclusion and for consumer protection and public policy direction.

NILS and StepUP loans adhere to responsible and ethical lending practices. These products assess each applicant's capacity to repay in a way that does not result in increased financial hardship for them. We believe that fringe lenders also need to adhere to responsible and ethical lending practices.

Independent evaluations of our microfinance products have shown that they reduce the reliance on fringe credit and short term loans:

- According to the 2014 NILS evaluation¹⁴, 42% or 105 of the 250 respondents who had obtained fringe credit in the past either stopped or reduced their use of fringe credit due to their NILS loan;
- According to the 2013 CSI StepUP evaluation, 65% or 73 out of 113 respondents stopped using fringe lenders after receiving the StepUP Loan;
- According to the 2013 RMIT Interim Good Money Report, after visiting a Good Money store, 53% or 78 out of 148 respondents said they do not intend to use a payday lender in the future.

¹⁴ Bennett, S. Georgouras, M. Hems, L. Marjolin, A. and Wong, J. (2013). An Outcomes Evaluation of the Good Shepherd Microfinance No Interest Loan Scheme (NILS), Centre for Social Impact (CSI), University of New South Wales, for Good Shepherd Microfinance

Although we understand the need for people to access small amounts of credit, we do not believe an under-regulated fringe lending market is best placed to fill that gap. More often these loans create more financial hardship than they remedy due to the exorbitant associated costs. Given access to alternative forms of support, the fringe market should be a last resort and should be regulated to that effect. The broader financial system has an obligation in this regard as the rise of fringe lending is related to the market's failure to provide affordable credit.

1.1. Implications for how Australia funds its growth

In funding growth, the current system unfairly apportions a lot of the risk to those who are unable to absorb it. The growing rates of inequality and financial stress, as well as the higher levels of financial exclusion of those on a low income, are evidence of this problem.

Unequal growth and the unfair allocation of risk have many implications for those involved. On a macro level, demand for products and services is far more sustainable when the growth in wealth is evenly shared.

In the absence of these principles, those who are disadvantaged – and the social issues that come with that – will continue to languish. This has ramifications for the community more broadly.

1.2. Implications for domestic competition and international competitiveness

Unfortunately, our experience has been that competition has not benefited most consumers, with many still excluded from mainstream financial services. The growth in the payday lending and rent to buy schemes are a by-product of this exclusion.

Many banks are taking steps to address these problems. For over ten years Good Shepherd Microfinance has worked with NAB to deliver financial services for those people traditionally excluded from the system. This is a positive effect of competition and the value add of corporate social responsibility.

1.3. Implications for the current cost, quality, safety and availability of financial services, products and capital for users

As mentioned previously, the current system excludes people on low incomes, and the pricing of risk means they often pay more for financial services.

Microfinance programs are a way of addressing this financial exclusion, but they are unable to meet all of the demand on their own. There needs to be a continuing focus on regulation of the fringe lending industry to ensure that limits are placed on how much money can be made from people's poverty. There also needs to be a continued push for mainstream financial services to offer alternatives for people who are excluded from financial services, such as programs like NILS, StepUP and AddsUP. These programs need the capacity to scale up to meet the needs of low-income consumers.

Financial counselling services also need to be accessible to support those who experience financial stress and have difficulty navigating the financial services system. Enabling financially stressed people the opportunity to engage in the economic system, ensures that risk is not unfairly absorbed by those least able to afford it.

Term of Reference Two

The Inquiry will refresh the philosophy, principles and objectives underpinning the development of a well-functioning financial system, including:

1. **balancing competition, innovation, efficiency, stability and consumer protection;**
 2. **how financial risk is allocated and systemic risk is managed;**
 3. **assessing the effectiveness and need for financial regulation, including its impact on costs, flexibility, innovation, industry and among users;**
 4. **the role of Government; and**
 5. **the role, objectives, funding and performance of financial regulators including an international comparison.**
-

2. The philosophy, principles and objectives underpinning the development of a well-functioning financial system

Good Shepherd believes that individuals and families living on low incomes can make sustainable and responsible financial decisions if they have access to the right resources and are protected from exploitative and expensive lending arrangements.

Good Shepherd Microfinance and Good Shepherd Youth & Family Service believe that all Australians should be financially included as a basic right, with access to affordable, appropriate basic products as a minimum while being protected from predatory, unfair and inappropriate products.

In line with our values of human dignity, respect, social justice, compassion, audacity and reconciliation, Good Shepherd will continue to advocate for and provide access to increase financial inclusion.

We would like to see a well-functioning financial system that will primarily protect vulnerable customers. The best way to do this is a comprehensive approach that includes:

- Providing access to safer alternatives;
- Improving access to financial education;
- Ensuring people have enough money to meet their living costs;
- A comprehensive package of consumer protection measures;
- A responsible referral framework where banks refer clients appropriately to fair, safe and affordable alternative financial service providers; and
- Regulating the payday lending sector to ensure safer lending practices.

2.1. Balancing competition, innovation, efficiency, stability and consumer protection

Consumer Protection is Key

Good Shepherd Microfinance is in agreement with the broader community sector that in a well-functioning financial sector, consumer protection is a vital component. As Financial Counselling Australia Executive Director Fiona Guthrie commented on this Inquiry, 'There's a danger that the focus will be on the big end of town. While that's important ... we also need to focus on whether the system works for the twenty million Australians who use it for everyday banking.'¹⁵

While we maintain that consumer protection has primacy, strong consumer protection is not mutually exclusive of competition, innovation, efficiency or stability. Rather, it is now generally agreed that competition and consumer protection are mutually reinforcing.¹⁶ The Productivity Commission has acknowledged 'the role of consumers in facilitating competition, and promoting well-functioning markets, is long recognised'. The Commission has also stated that:

As a general rule, competition works best when the bulk of consumers are reasonably well-informed and willing to act on information. To this end, a key goal of consumer protection is to overcome significant information failures that can hinder effective competition. ... It is also important to note that good consumer protection benefits good businesses (and their shareholders) as well as consumers.¹⁷

Good Shepherd supports the view as articulated by the Consumer Action Law Centre, that 'the inquiry needs to also consider how consumer protection and a strong regulatory framework can stimulate competition, productive innovation and a well-functioning economic system.'¹⁸ Furthermore, in consideration of consumer protection we would recommend that special notice be given to the protection of disadvantaged consumers – in particular Indigenous people, women, culturally and linguistically diverse (CALD) groups, and those of lower socio-economic status.

Lack of Competition and Market Failure in Alternative Financial Services

Good Shepherd recommends that the Inquiry give consideration to domestic competition both within mainstream and alternative financial services (such as payday lenders). The burgeoning alternative credit market populated by payday lenders and rent-to-buy agents points to an unmet demand and market failure.

Good Shepherd also recommends an exploration of the lack of competition in the small amount lending (up to \$5,000) market. Credit unions and building societies have not shown enough interest, and banks (leaving aside CSR contributions) tend to stop at credit cards. A well-functioning financial system would cater to all client types instead of the current context where high net worth individuals have a whole array of financial products and services and low income individuals struggle to access basic financial products.

¹⁵ *The Age*, 21 January 2014

¹⁶ *Consumer Action Law Centre (2013). Submission to the proposed Financial System Inquiry Terms of Reference.*

¹⁷ *Productivity Commission (2008). Review of Australia's Consumer Policy Framework, Inquiry Report No 45, April 2008, p 28.*

¹⁸ *Consumer Action Law Centre (2013). Submission to the proposed Financial System Inquiry Terms of Reference.*

2.2 How financial risk is allocated and systemic risk is managed

As we have mentioned in previous sections of the submission, we firmly believe that financial risk should not be apportioned to those who can least manage it, and that there needs to be a re-examining of risk in terms of low income consumers' access to credit. Current risk frameworks perversely make the costs of credit more expensive for people on low income.

We also argue that in managing systemic risk, attention needs to be paid to those who will be impacted when making decisions.

2.3. The effectiveness and need for financial regulation, including its impact on costs, flexibility, innovation, industry and among users

Consumer protection over competition and efficiency

While much of this has also been covered in previous sections, we would like to specifically address the issue of efficiency. When announcing this Inquiry, the Prime Minister mentioned that, 'As part of our broader deregulation agenda, the Government intends to reduce the regulatory burden on the financial services sector wherever the benefits to competition, efficiency, market stability or consumer protection are questionable.'¹⁹

We are in agreement with Consumer Action Law Centre when they say that:

...government intervention in markets is itself not cost-free and poorly designed intervention can be bad for consumers in the long term...However, in assessing the consequences of financial regulation, we submit that the focus of the Inquiry should not entirely be on the compliance costs or impact on innovation and financial services trade. Rather, the focus should be on whether regulation is achieving a desirable social or economic purpose in the most efficient way.²⁰

The Need for Regulation That Protects and Supports Users

Individuals living on low incomes are particularly vulnerable to lack of access to suitable financial products; inadequate information about credit options; and unscrupulous practices by financial institutions. Good Shepherd supports regulation which ensures both a non-exploitative market and adequate information and support for the individual.

Good Shepherd welcomed the contribution of industry codes such as the Australian Bankers Association (ABA) Code of Practice to the development and take up of hardship processes in financial institutions. We also welcomed the aims of the credit code, although we are aware of fringe lenders who try to circumvent the regulations.

We would therefore recommend an assessment of the effectiveness of the national consumer credit code in promoting fair and affordable financial services.

¹⁹ The Prime Minister's media release, 20 Nov 2014. <http://www.pm.gov.au/media/2013-11-20/financial-system-inquiry>

²⁰ Consumer Action Law Centre (2013). Submission to the proposed Financial System Inquiry Terms of Reference.

We would also recommend that the Australian Securities and Investments Commission (ASIC) be enabled to regulate the fringe financial sector with a broad anti-avoidance capability, and not have to wait for customers to be impacted negatively before taking action on unscrupulous providers.²¹

Credit Card Regulation

The use of credit cards to pay otherwise unaffordable expenses is widely practised in Australia and people living on low and fixed incomes are vulnerable to a debt spiral as a result. It is the key way 'access to a moderate amount of credit' is calculated when measuring financial exclusion in Australia. Credit card debt represents the largest contributing factor to the people seeking financial support from the financial counselling services provided by Good Shepherd Youth and Family Service.

Good Shepherd believes that further regulation of credit card lending is required. While the ABA Code of Banking Practice sets good standards many credit card offerings sit outside these guidelines.

2.4. The role of Government

Government has a key role in ensuring the financial services sector complies with its obligations and contributes positively to the economy and the people who live within it.

It does this through:

- **Regulation:** in particular to protect vulnerable customers and address market failures of which the growth in payday lending is one. Self-regulation is often insufficient, particularly in areas where the market does not work particularly well.
- **Policies:** which encourage fair market dealings, and support the community sector to develop solutions and work with financial services to address the needs of low income consumers.
- **Enforcement:** ensuring that financial services comply with government requirements, such as through the support of organisations like ASIC and APRA.

The key messages we believe here are that:

- Government cannot always rely on the market to sort itself out. Therefore the Australian community needs the Government to play a role to regulate and to protect vulnerable customers, especially from payday lending which, as the market has failed, have become increasingly predatory.
- Government needs to monitor excessive and unjustified profits from a sector that has significant barriers to entry and a close relationship with Government
- Self-regulation of the financial services sector seems to be erratic at best, with little commitment from associated bodies to oversight or to rein in maverick operators at the smaller end of the system, or equally the 'take-over' tactics of the higher end of the system.

²¹ *In line with Good Shepherd Microfinance's submission on the Small Amounts Credit Contract Exposure Draft (2014)*

In sum, we recommend a policy environment created where microfinance is supported.

Support for Sustainable Community Finance Organisations

The not for profit sector delivering community finance requires a policy and funding environment that supports the delivery of high quality services to those people who need it most. This requires investment in financial and human resources, which extends well beyond the four-year budget cycle or the three-year election cycle.

The sustainability and viability of alternative community finance organisations is critical in addressing the entrenched, and often intergenerational, disadvantage facing many people in our society. We would therefore see the Government's role as ensuring the viability and support of community finance organisations that exist for social good rather than capital gain.

Ensuring access to the financial system for all

Our current belief in the role of Government to ensure affordable and safe access to financial services for all Australians is consistent with Good Shepherd Youth and Family Service's 1997 submission to the Wallis inquiry. GSYFS's submission to the Inquiry argued that the rapid transformation and internationalisation of the Australian economy following financial deregulation had resulted in low income families and young people suffering increased costs for, and diminishing access to, the banking system:

While some groups have benefited from the process of deregulation, our experience indicates that a significant section of the community has been further disadvantaged. It is therefore essential that the Federal Governments' regulatory regime for the financial system ensures that appropriate mechanisms are in place to ensure that low income and disadvantaged consumers are able to have access to the full range of benefits available from the system on fair terms. (GSYFS 1997; p. 3)

2.5. The role, objectives, funding and performance of financial regulators including an international comparison

This has been covered in previous sections; however we would like to focus particularly on the role of ASIC, as a regulator, enforcer and provider of financial information.

The role and objectives of ASIC

Providers of fringe lending stand at the interface with the most immediate financial needs of quite desperate consumers. It is therefore inevitable that avoidance of regulatory requirements and unlawful lending will be a continuing challenge. As GSYFS mentioned in their submission to the National Credit Reform Green Paper, it has to be conceded that keeping up with this very creative industry has been no small task.

As the Assistant Treasurer's Explanatory Statement notes, some credit providers are using existing exemptions in the national credit legislation more broadly than their application was intended to be. It is also the experience of the community finance sector that payday lenders will seek to avoid any regulation that affects their business. Even if this current exposure draft closes all the loopholes, it is likely that lenders will continue to find more ways of avoiding the law.

When consumer protections are adopted, it is also important that attempts at avoidance can be countered by regulators. We therefore recommend that:

- Treasury includes a broad anti-avoidance provision, and considers the merits of placing these provisions in the National Credit Code rather than as regulations to the Credit Act; and
- ASIC be given the resources necessary to make enforcement of payday lending regulation a priority.

Our direct experience with the harmful outcomes for people in receipt of small amount loans shows us that by the time courts and regulators have identified and reacted to an avoidance scheme, significant damage has already been done to individuals and families. Currently a consumer must suffer significant harm before avoidance practices and exploitative business models can be addressed by the regulator.

A general anti-avoidance provision, and the strengthening of ASIC's ability to respond, would mean that action could be taken before individuals and families in already precarious situations have even more financial hardship and stress inflicted on them by a scheme or trader designed to avoid the operation of the Credit Code. This anti-avoidance provision would put the customer or client first and also make it less likely that we will need further regulatory amendments in the future.

Tony

Tony (not his real name) was in hospital when his house was broken into and his son's computer was stolen. His son is currently in his final year of school, so all his study notes and main tool for study had disappeared. Tony did not have the money to buy his son a new computer outright, but wanted to replace it quickly, especially seeing as his son was currently topping four out of five subjects and didn't want to fall behind.

Tony is on Centrelink payments and receives child support, so he rang a local community organisation to find out if he had any options. They referred him to the community finance store, Good Money, as they are known to be friendly and efficient. Tony applied for a NILS loan, expecting the whole loan to be devoted to the laptop. However Tony was also able to buy a new fridge, which was a major source of relief because for the last few months he has been living without one. Being fridge-less proved to be unsustainable and expensive with lots of take-away food, lunch money for his son and daily supermarket visits to buy fresh food. Now, Tony is paying off his loan at an affordable rate, his son is up to speed with his studies, and they are not only enjoying their new fridge, but also saving money through lowered energy costs and fresh food on-hand.

Provided by a NILS caseworker – Good Money store, Collingwood, Vic

Term of Reference Three

The Inquiry will identify and consider the emerging opportunities and challenges that are likely to drive further change in the global and domestic financial system, including:

1. the role and impact of new technologies, market innovations and changing consumer preferences and demography;
 2. international integration, including international financial regulation;
 3. changes in the way Australia sources and distributes capital, including the intermediation of savings through banks, non-bank financial institutions, insurance companies, superannuation funds and capital markets;
 4. changing organisational structures in the financial sector;
 5. corporate governance structures across the financial system and how they affect stakeholder interests; and
 6. developments in the payment system.
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3. The emerging opportunities and challenges that are likely to drive further change in the global and domestic financial system

The Economic Opportunities Created by Addressing Financial Inclusion

The gap between the financially excluded and financially included is increasing in Australia with 17.7% of the adult population unable to access mainstream financial products.²² Unless this is addressed, the opportunity to increase economic mobility towards inclusion will be missed. In global markets the Australian financial system is much admired, yet 3.1 million adults – or one in six – are financially excluded and unable to access a bank account, small credit or insurance. At a human level, we know that this exclusion directly creates feelings of isolation, reduced hope and confidence and of not being connected to, or included by, other people and society itself. In short, people are not able to realise the fullness of life.

At an economic level there are profound opportunities for economic mobility – people moving away from financial crisis and hardship towards resilience and self-sufficiency – to make our communities more prosperous and inclusive and to drive economic growth. Good Shepherd Microfinance modelling shows that GDP would increase by 2 per cent if even only a quarter of those financially excluded made one small progression from hardship to stability. Well-developed and implemented financial system reform, along with employment and enterprise policy improvements, will enable this.

Good Shepherd recommends an examination of access to and usage of financial services in Australia and of how an efficient, competitive and flexible inclusive financial system, consistent with financial inclusion and resilience, stability, prudence, integrity and fairness, can be enabled.

²²Connolly, C. (2013). *Measuring financial exclusion in Australia*.

3.1. The role and impact of new technologies, market innovations and changing consumer preferences and demography

Although covered to some extent in 3.6, Good Shepherd Microfinance sees the role of technology as important, mainly because it allows financially excluded clients greater access to information online and enables remote access, especially for on-line NILS and StepUP loan applications.

3.2. International integration, including international financial regulation

3.3. Changes in the way Australia sources and distributes capital, including the intermediation of savings through banks, non-bank financial institutions, insurance companies, superannuation funds and capital markets

Distribute capital through no and low interest loans

Good Shepherd Microfinance has a range of programs, each providing safe, fair and affordable credit to people who are excluded from the mainstream financial providers. These programs include the No Interest Loan Scheme (NILS®); StepUP; Good Money; AddsUP and Debt Deduct. Our low and no interest loans programs enable people to build assets, engage in community life and find and keep jobs. We have seen that much of the distribution to date has not been to low income consumers, and distribution of capital through not-for-profits and community owned financial institutions is a positive way to ensure a level of equity.

3.4. Changing organisational structures in the financial sector

As an organisation that values diversity and advocates for the rights of women and girls in particular, Good Shepherd Microfinance and Good Shepherd Youth and Family Service would like to commend the banking sector on their commitment to gender equity at a senior level. We are disappointed that progress has been slow despite the commitment, and would like to see that the focus remains on ensuring more women are in leadership roles when looking at organisational structures.

3.5. Corporate governance structures across the financial system and how they affect stakeholder interests

To ensure the voice of the excluded is maintained when making decisions in financial services, we believe there needs to be a mandated place on boards of financial institutions for consumer representatives who work with low income consumers. These can be individual consumers, representatives from community organisations, peak bodies or other groups that advocate for the rights of low-income consumers.

3.6. Developments in the payment system

Developments need to continue to ensure a fair payments system. GSYFS research supports that:

*Having access to appropriate bill paying options, such as Centrepay, direct debits and bill smoothing was a significant enabler for people to manage their money, ensure important items were paid for, and avoid bill shock. Importantly, these options need to be flexible.*²³

²³ Corrie, T (2011) Microfinance and the Household Economy: Financial exclusion, social and economic participation and material wellbeing. Good Shepherd Youth & Family Service, Collingwood,

Centrepay

Centrepay offers 'a free direct bill-paying service offered to customers receiving Centrelink payments'.²⁴ It is an important way for people reliant on income support, to manage their finances more effectively. Given the inadequacy of the Newstart allowance and the low rates of other income support payments, people who rely on Centrelink incomes cannot afford for any of their money to be misappropriated. Their low incomes alone make them more vulnerable to exploitative business practices.

This can be further compounded by mental and physical ill health, language barriers or other vulnerabilities. As a primary source of information and support for many marginalised people, Centrelink has a duty of care to ensure that it does not inadvertently support practices that further exacerbate financial hardship and encourage exploitative business practices.

In the GSYFS submission to the Centrepay system, it was posited that Centrepay, therefore, should be seen as a means to build financial capability.

Centrepay has been shown to be a positive tool for people receiving income support payments when used properly, and we would like to reiterate these points.²⁵ The national NILS response greatly values access to Centrepay fee free. Additionally, the benefits of Bpay, eftpos, mobile and online banking payment changes are evident. From a financial inclusion perspective people need easy access to those systems at an affordable (or no) cost.

Mobile Banking and Financial Inclusion

According to the 2013 Mobile Financial Services State of the Industry Report, there are 219 mobile money services available in 84 countries, with over 60 million active accounts globally. While challenges still persist, there is increasing evidence that mobile financial services play an important role in driving financial inclusion and resilience. This is particularly true for those in remote communities, who can end up with fees of \$40 or more before they can even access their funds.²⁶ Continuing the development of such technologies is important for these consumers, as long as they remain low or no cost and are accessible.

Good Shepherd Microfinance is currently exploring future options with regard to mobile lending and would welcome an opportunity to contribute to this important area of development.

²⁴ <http://www.humanservices.gov.au/customer/services/centrelink/centrepay> accessed 25/01/13

²⁵ *Good Shepherd Microfinance and Good Shepherd Youth & Family Service (2013), Financial Capability and the Role of Centrepay: Submission to the Independent Review of the Centrepay System*,

²⁶ *Australian Financial Counselling and Credit Reform Association (AFFCRA) (2010) ATM Fees in Indigenous Communities AFFCRA, Brisbane*

Term of Reference Four

The Inquiry will recommend policy options that:

1. promote a competitive and stable financial system that contributes to Australia's productivity growth;
 2. promote the efficient allocation of capital and cost efficient access and services for users;
 3. meet the needs of users with appropriate financial products and services;
 4. create an environment conducive to dynamic and innovative financial service providers; and
 5. relate to other matters that fall within this term of reference.
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4.1. Policy options that promote a competitive and stable financial system that contributes to Australia's productivity growth

We have covered earlier our firm belief that growth can only be sustained if it is shared equally, and if the risks are not disproportionately allocated to those on low incomes. We would also like to endorse Consumer Action Law Centre's statement in their submission:

Consumer Action welcomes a focus on competition, which is a means to improve consumer wellbeing. Despite the recent wave of consumer banking reforms aimed at increasing competition and consumer mobility, Australians are still not switching products in significant numbers, particularly beyond the big four banks. Measures should be considered to improve competition to improve consumer outcomes. However, it is important that competition is not considered from the perspective of the supply-side alone. As noted above, consumers play an important role in 'activating' competition. To play their role effectively, consumers need to be confident and supported by strong protections. When consumers are not confident:

- *they may avoid transacting so that they do not face the possibility of a bad deal and its consequences;*
- *it may result in consumer inertia—they may opt to stay with an existing supplier because of the perception they will face risk or costs by switching, or that 'they're all as bad as each other' even if there is a better deal on offer;*
- *they may spend considerable time and effort investigating or will accept higher costs attempting to avoid a bad deal.*

In other words, consumers may incur additional costs or competition may be adversely affected where they lack confidence and protection.

For these reasons, we submit that the Inquiry must also consider the adequacy of consumer protections to promote consumer confidence as well as the behaviour of consumers in facilitating competition²⁷.

²⁷ Consumer Action Law Centre (2013). Submission to the proposed Financial System Inquiry Terms of Reference.

4.2. Policy options that promote the efficient allocation of capital and cost efficient access and services for users

Access for Financially Excluded Individuals

When announcing this Inquiry, the Prime Minister mentioned that, ‘The inquiry will make recommendations to foster an efficient, competitive and flexible financial system, consistent with financial stability, prudence, integrity and fairness. This should result in less costs, lower fees and greater efficiency in the allocation of capital.’²⁸

The experience of the deregulation following the 1997 Inquiry was that of higher costs, increased fees and the further exclusion of individuals and families on low income. To this end we recommend that the Inquiry consider policy recommendations that encourage mainstream financial services to cater for all Australians – not just those who present high profit potential.

4.3. Policy options that meet the needs of users with appropriate financial products and services

Financial exclusion is currently measured in Australia. This is a way of understanding how many Australians have access to basic financial services, and what the costs of this access are.

However, Good Shepherd Microfinance understands there is a continuum of financial services and understanding and measurement of people’s movement along this continuum, and further, what this means for their economic mobility is only just emerging.

We believe there needs to be a better understanding of financial services in the non-bank sector – specifically rent-to-buy schemes, payday lending and other fringe products – that takes into consideration the following:

- Economic mobility moving up the continuum
- Policy options that include the promotion of a competitive, inclusive and stable financial system that will drive economic growth and fair and inclusive communities
- Policy options that assist the financial system to directly enable economic mobility for people on low incomes
- how the ‘unbanked’ population can be safely and efficiently reached.

4.4. Policy options that create an environment conducive to dynamic and innovative financial service providers

While much of this has been covered in previous sections, to reiterate what this means for a ‘dynamic and innovative’ financial services:

- Product development and product growth should include the needs of low income consumers, to ensure growth is fair and sustainable.

²⁸ *The Prime Minister’s media release, 20 Nov 2014. <http://www.pm.gov.au/media/2013-11-20/financial-system-inquiry>*

- In focusing on low-cost, efficient ways to deliver financial services for people on low income, there is an enormous scope to be innovative and embrace new technologies. This could be a way of including those people who are excluded because of geography, and young people in particular.
- Focusing on the needs of all consumers – not just those who currently use financial services – forces the financial service sector to adopt a different paradigm in service development.
- Ensuring consumer needs are being represented at a governance level will support innovation in financial services that is sustainable.

Government has a role in ensuring that financial services are clear about their eligibility criteria and their requirements.

Similarly Government can examine ways in which regulation can support the sector in being innovative and sustainable.

4.5. Policy options that relate to other matters that fall within this terms of reference

No comment.

Angela

Angela (not her real name) came in for a NILS loan for a lounge. She had a surplus of around \$111 a fortnight. She had been receiving high energy bills. She was up to date with her current bill, but concerned about the consumption for her household composition. She was working casually, and trying to increase her hours as it was important to her to increase her financial capacity. She had two young children aged 2 and 11 months.

Angela's energy usage was discussed and she was referred to HESS. The NILS provider spent a lot of time working with Angela on her budget and her work and family supports, as it was important to determine how secure her casual employment was. The HESS worker identified that the Angela wasn't receiving her entitled NSW Government rebates due to her name being incorrectly spelt on the bill. The HESS worker is seeking backpay of 18 months, and future rebate. The HESS worker also helped Angela apply for the Trade and Investment-Family Energy Rebate of around \$125 a year. In addition she signed up for Centrepay for future bills, and is seeking incentives, such as every payment being honoured for signing up.

Angela said she had a positive experience engaging with the No Interest Loans Scheme. She is a young mum, a strong proactive woman who needed a small amount of support. She came into the centre for a NILS loan, and because of the report that was built, she was able to solve some of the other issues that she was having. This allowed Angela to focus on the more important elements of her life, such as her children, and most importantly will help her feel safe to ask for help in the future. The other important issue was to see how effective the HESS referral was. 'In the past advocating for an energy provider would have been something us NILS workers may have had to try to squeeze into a busy workload, but it is great to see that the referral for Angela was so successful.' (NILS worker – Marrickville, NSW).

Terms of Reference Five, Six, Seven, Eight and Nine:

5. The Inquiry will take account of the regulation of the general operation of companies and trusts to the extent this impinges on the efficiency and effective allocation of capital within the financial system.
 6. The Inquiry will examine the taxation of financial arrangements, products or institutions to the extent these impinge on the efficient and effective allocation of capital by the financial system, and provide observations that could inform the Tax White Paper.
 7. In reaching its conclusions, the Inquiry will take account of, but not make recommendations on the objectives and procedures of the Reserve Bank in its conduct of monetary policy.
 8. The Inquiry may invite submissions and seek information from any persons or bodies.
 9. The Inquiry will consult extensively both domestically and globally. It will publish an interim report in mid-2014 setting out initial findings and seek public feedback. A final report is to be provided to the Treasurer by November 2014.
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5. The regulation of the general operation of companies and trusts to the extent this impinges on the efficiency and effective allocation of capital within the financial system.

No comment

6. The Inquiry will examine the taxation of financial arrangements, products or institutions to the extent these impinge on the efficient and effective allocation of capital by the financial system, and provide observations that could inform the Tax White Paper.

Although not within our scope, a quote from UnitingCare Australia – Position Statement 2013 *Towards a Decent Life* clearly reflects the importance of the role of taxation in mobilising financially excluded people towards economic independence and resilience:

*Tax is the price of a good society. Recognise that we can only get what we pay for. A range of valuable services can only be delivered effectively with government support, particularly where providing a decent life for all requires universal access to services such as education and essential health care. Australia currently underinvests in these, undermining our overall living standards and excluding people. Achieving a proper balance will require collecting more tax, and could be achieved by winding back inefficient and unfair tax concessions.*²⁹

²⁹http://www.unitingcare.org.au/images/stories/publications/2013/130828_pub_pos_UA_AnEconomyToServeSociety.pdf

7. The objectives and procedures of the Reserve Bank in its conduct of monetary policy

No comment

8. The Inquiry may invite submissions and seek information from any persons or bodies

Listening to Microfinance Clients and Providers

Good Shepherd would welcome the opportunity to make a verbal submission to the Inquiry. As a leader in a rich and capable national network of community finance organisations that have earned the trust of people on low incomes, Good Shepherd sees considerable opportunity for large scale investment in the network of alternative fair, safe and affordable finance and in other innovative initiatives to enable economic mobility and overall economic growth.

Good Shepherd Microfinance's provider network includes 257 community organisations across 650 locations in Australia offering safe, fair, and affordable loans, savings, energy inclusion and other programs. The experience and wisdom of the microfinance network should be listened to when considering the philosophy, principles and objectives that underpin a well-functioning financial system.

We also feel it is very important that the voices of those isolated and excluded from the current financial system in Australia be heard. We have already reached over 125,000 people and will be encouraging our network to have a strong voice to represent those marginalised and vulnerable people on low incomes during this Inquiry. We are willing to consult with our microfinance clients and encourage them to make a verbal or written submission to the Inquiry to share their lived experience of financial exclusion.

9. The Inquiry will consult extensively both domestically and globally. It will publish an interim report in mid-2014 setting out initial findings and seek public feedback. A final report is to be provided to the Treasurer by November 2014

Good Shepherd Microfinance and Good Shepherd Youth and Family Service look forward to the interim report of the Financial System Inquiry and will ensure that we respond to its findings and outcomes.

Equally we welcome the opportunity following the Interim report to include the voice of our customers whose experience of, and insights into, the financial system we highly value.

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