

Redfern Legal Centre



31 March 2014

Chairman, Mr David Murray AO
Financial System Inquiry
GPO Box 89
SYDNEY NSW 2001

Email: fsi@fsi.gov.au

Dear Mr Murray,

Thank you for the opportunity to provide our input into the direction of Australia's financial system over the next decade.

Redfern Legal Centre welcomes the Financial System Inquiry and the opportunity to address significant issues still faced by vulnerable consumers in spite of the relative strength of Australia's economy and financial system.

Our submissions aim to highlight these issues to ensure they are not overlooked in the FSI's wholesale review of the financial system.

We would welcome the opportunity to appear before the Financial System Inquiry panel or to meet with you to discuss our submission further.

Yours faithfully,

Redfern Legal Centre

Jacqui Swinburne
Acting Chief Executive Officer

Redfern Legal Centre



SUBMISSION:

Discussion Paper – Response to the Financial System Inquiry

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Table of Contents

Executive Summary	4
RLC's work in Credit & Debt	4
Financial System Inquiry Context and Objectives	4
Summary of RLC submissions	5
Specific Issues and Recommendations	6

Executive Summary

- The FSI presents an opportunity to consider and respond to financial hardship, financial exclusion and financial literacy, issues which continue to affect vulnerable and disadvantaged users of our financial system.
- We recommend that the Government take proactive measures to shift vulnerable consumers away from the market for small amount credit contracts or 'payday loans', towards sustainable microfinance and No Interest Loan Schemes.
- The FSI should consider how to improve the quality and source of financial products available for low-income end users.
- We recommend that the Government and industry members provide greater support for financial inclusion initiatives. We hope the FSI can help to improve financial literacy for vulnerable consumers. We hope the FSI can increase equitable access to, and engagement with, our comparably strong financial system.

1. Introduction: Redfern Legal Centre

Redfern Legal Centre ('RLC') is an independent, non-profit, community-based legal organisation with a prominent profile in the Redfern area.

RLC has a particular focus on human rights and social justice. Our specialist areas of work are domestic violence, tenancy, credit and debt, employment, discrimination and complaints about police and other governmental agencies. By working collaboratively with key partners, RLC specialist lawyers and advocates provide free advice, conduct case work, deliver community legal education and write publications and submissions. RLC works towards reforming our legal system for the benefit of the community.

2. RLC's work in Credit & Debt

RLC recognises that the protection of financial and consumer rights is an important mechanism to secure other rights and freedoms such as secure housing, effective education and social and economic participation. RLC runs a specialist practice, which focuses on credit & debt and consumer law issues. We also provide a direct line of inquiry for Financial Counsellors across NSW.

3. Financial System Inquiry Context and Objectives

We note that the purpose of the Financial System Inquiry ('FSI') is to understand the impact of changes to Australia's financial system since the 1997 Wallis Report and, in light of the global financial crisis, identify the key factors that will influence the development of our financial system over the next decade. The FSI will establish principles and policy recommendations that respond to these key factors.

This submission aims to advocate for the interests of the most vulnerable and disadvantaged users of our financial system. Many of RLC's clients fall within this category. Although our economy has enjoyed significant benefit from the changes and deregulation since the 1981 Campbell Report and 1997 Wallis Report, a significant number of RLC's clients continue to face financial hardship and exclusion. Many of these experiences of hardship can be attributed to systemic issues that have persisted, and indeed have become more acute, in the post-GFC environment.

We note from Mr. Murray's recent keynote address before the Committee for Economic Development of Australia, that some of the key themes for the FSI will include:

1. The sources of funding, and the allocative and dynamic efficiency of the

- Australian economy;
2. The growth of superannuation funds and the utilisation of this source of capital;
 3. The effective use of regulation in balancing stability, competition and efficiency objectives in examining the state of competition in banking, payments, insurance, funds management and financial markets; and
 4. The development of computing and communication technologies that have had a profound effect on the financial system.

It is RLC's submission that considerations of fairness and consumer protection should pervade all aspects of these key themes. We stress the particular importance of appropriate regulation to ensure fair outcomes are achieved for vulnerable and disadvantaged users.

In relation to the FSI terms of reference, RLC's submission focuses in particular on:

Point 1.3: the implications of the consequences of developments in the Australian financial system since the 1997 Financial System Inquiry and the global financial crisis on the current cost, safety and availability of financial services, products and capital for users;

Point 2.1.1: the philosophy, principles and objectives underpinning the development of a well-functioning financial system, including balancing competition, innovation, efficiency, stability and consumer protection;

Point 2.1.3: the philosophy, principles and objectives underpinning the development of a well-functioning financial system, including assessing the effectiveness and need for financial regulation, including its impact on costs, flexibility, innovation, industry and among users;

Point 2.1.3: the philosophy, principles and objectives underpinning the development of a well-functioning financial system, including the role of Government; and

Point 3.1: the emerging opportunities and challenges that are likely to drive further change in the global and domestic financial system, including the role and impact of new technologies, market innovations and changing consumer preferences and demography.

In attempting to develop a blueprint for our financial system over the next decade, the FSI presents an opportunity to address financial hardship, financial exclusion and financial literacy. We trust that the FSI will endeavour to ensure that our financial system does not sacrifice fairness and consumer protection in the name of apparent efficiency. We emphasise the importance of recognising that the needs of *all* end users, particularly those with limited resources and expertise, be considered in the future policies underpinning our financial system. A financial system that has significant failures in the market will not provide a sound platform for the economic development of a fair, just and stable society that in turn underpins an effective economy.

We provide below a summary of the key issues faced by RLC's clients, and our suggested recommendations for addressing those issues.

4. Summary of RLC submissions

RLC recognises that the broader, macro-level improvement of the financial system may improve outcomes for low-income participants in our financial system. In this regard, we support the FSI's focus on the effective allocation of capital in the economy, such as the consideration of investment of superannuation funds, the development of bond markets, and the effective regulation of the banking, insurance, funds management and financial markets. Care should be taken this root and branch review delivers fair outcomes and that

all end users can benefit from the net efficiencies, not just the top income brackets.

For the purposes of this submission RLC has concentrated on concerns with small amount credit contracts (or 'payday lending'), regulation of non-bank lenders, the quality and sources of credit available to low income earners, proposed fees to file for Bankruptcy, superannuation, regulation of new financial technologies, financial exclusion, access to non-biased information in the client's best interest and effective and affordable dispute schemes.

5. Specific Issues and Recommendations

5.1. Small Amount Credit Contracts ('SACC')

RLC submits that the issue of SACC is within the consumer protection scope of the FSI. We note the Treasury's review of SACC and reiterate our previous submissions¹ to Treasury dated 13 July 2012 in response to its 2012 discussion paper ('Discussion Paper'). RLC also endorses the joint submission prepared by the Consumer Action Law Centre, Consumer Credit Legal Centre (NSW) and Financial Counselling Australia dated 7 May 2012 ('Joint Submission')².

The issues raised by the Joint Submission continue to be relevant today

RLC's submissions in relation to SACC are as follows:

1. RLC considers that the new restrictions enacted on 1 March 2013 were a positive step in the legislative scheme of consumer protection measures. However, the FSI presents an opportunity to consider encouraging vulnerable consumers to shift away from the SACC industry by supporting the viability of fairer alternatives that deliver better consumer outcomes. These alternatives, such as No Interest Loan Schemes, presently require greater government and industry support.
2. It appears to us that the business models of payday lending and SACC providers rely in large part upon low-income consumers, with lower financial literacy, who are unable to obtain other forms of credit. These consumers are necessarily more vulnerable and in greater need of protection. It also appears to us that features of the market such as the widespread use of direct debit payments, the refinancing of SACCs, multiple loans, incorrect 'business purpose' declarations and the other features as set out in the Discussion Paper, have effectively propped up the industry and made lending to the poor on high interest rates more viable than it would otherwise be (and better business than it should be). It is not in the interests of consumers, or the economy more generally, to continue to prop up this industry. We **recommend** that the FSI explore longer-term structural reform to encourage vulnerable consumers to shift away from this industry.
3. In addition, it is important to address the fundamental question of why the very poor continue to use payday lenders. In our experience, our clients use payday lenders because their income is insufficient to meet their needs, especially expenses that arise unexpectedly. The recent report by the NSW Council of Social Services has found that 14.3% of NSW residents live below the poverty line, and those in the lowest bracket of median household income get by on just \$348 per week³. If policy makers are serious about wanting to provide low-income

¹ <http://rlc.org.au/publication/submission-response-april-2012-treasury-discussion-paper>

² <http://consumeraction.org.au/wp-content/uploads/2012/05/FINAL-joint-submission-Treasury-discussion-paper-Enhancements-bill-reforms-in-re-SACC-May-2012.pdf>

³ 'Cost of Living: Who's Really Hurting' Council of Social Service of New South Wales (NCOSS), March 2014 at

earners with alternatives to payday lenders, the inadequacy of, and discrepancy between, Centrelink payments must be considered. We also refer to the findings of the Independent Review of Centrepay,⁴ which found that the Centrepay as a financial capability tool is under-utilised by Centrelink recipients.

4. We support the proposal for the additional disclosure requirements to include information about alternative sources of finance and financial counselling. It is important for consumers in financial hardship to be informed about financial counselling advice and empowered to investigate alternatives to SACCs.
 - a. However, we note that demand for financial counselling and alternative sources of finance, such as No Interest / Low Interest Loans ('NILS/LILS'), is already high. This proposal would place greater pressure on already scarce resources. Financial counselling services and schemes providing alternative finance need better resourcing from our government. We **recommend** that the FSI consider the need for increased government spending and industry contributions to financial counselling services.
 - b. We submit that increased investment in financial counselling and alternative finance schemes can be offset by a levy on all financial service providers. Given the number of concessions already made to this industry, we **recommend** to the FSI that a levy be imposed on all industry members. Those industry members who continue to profit from the financial hardship of very low income earners and Centrelink recipients, should contribute to the cost of addressing the resulting financial and social problems, rather than relying on tax-payer dollars and charitable institutions to pick up the pieces. We **recommend** that a levy be imposed on industry members to provide for better resourcing of financial counselling services, and to expand existing NILS/LILS availability. The levy would be invested in NILS or LILS schemes to increase their availability and to broaden the criteria for eligibility.
 - c. We note that finance under the NILS and LILS is not available currently for many of the purposes for which consumers seek SACCs. Resourcing and eligibility criteria must be enhanced for NILS to present consumers with a viable alternative to SACCs.
 - d. Currently, many of the NILS/LILS alternatives are administered by charitable organisations. RLC would support the introduction of a NILS/LILS option administered by government and we strongly **recommend** that the FSI consider the viability of this option.

Case Study: Structural benefits of NILS

John is 62. His only source of income is the Disability Support Pension. He lives in social housing, has no substantial assets and expects to receive the aged pension in three years when he is 65. He was a mechanic for most of his working life.

<http://ncoss.org.au/costofliving/cost-of-living-0101.pdf>

⁴ Anna Buduls, June 2013, Report to the Secretary of the Department of Human Services, Australian Government, <http://www.humanservices.gov.au/spw/corporate/government-initiatives/centrepay-review/resources/report-of-the-independent-review-of-centrepay.pdf>

Around 13 years ago he obtained a loan of \$1000, to pay for expenses around Christmas time, from his industry credit union. Shortly afterwards his financial situation spiraled downhill. He lost his job and divorced from his wife. He incurred significant costs involved with this family breakdown including having to sell the family home and pay child support. John had made one repayment but was otherwise unable to service the loan after he lost his job.

In early 2014, John came to RLC with escalating letters of demand from a debt collection agency. They sought repayments on the debt, which had grown to over \$6,000. They sought to enforce a court judgment obtained by the creditor 11 years earlier. John had no capacity to repay this amount. He was desperate to clear the fog of debt, which had been following him for the last 13 years. We assisted John to articulate his personal and financial circumstances. The original creditors were then able to recognise that this debt was unrecoverable. John was overwhelmed by the escalation of the debt, but felt it important to make some repayment on the original loan. RLC help John to negotiate a settlement figure with his creditors, which he could manage on his limited income. John scraped together \$500, and the creditors accepted this as full and final settlement.

Had John been able to get a NILS loan 13 years ago, this protracted and inefficient recovery process could have been avoided. John's decade long experience of anxiety could have been avoided.

5. We support the Joint Submission's proposals on the issue of repeat lending and concurrent and successive loans. We strongly **recommend** that the FSI consider the proposal, which limits the number of loans that may be advanced to an individual in a given period. In this regard a centralised government administered SACC register would assist vulnerable consumers.
6. We support the Joint Submission's proposals in relation to prohibiting single-repayment loans and the suggestion that a minimum term of three months (and a minimum of six approximately equal repayments within that period) would be appropriate.
7. We support the Joint Submission's proposals on the issue of direct debit repayment options. From our experience we know that the fees and charges associated with failed direct debits impact disproportionately on the very poor. While these fees and charges can be relatively small, they add up and amount to a significant percentage of a low-income earner's budget.
8. We support the Joint Submission's proposals on the introduction of a protected earnings amount.

We further note that on 7 February 2014 the Federal Government released an Exposure Draft of proposed enhanced regulatory protections for consumers relying on SACCs. RLC broadly supports the Consumer Action Law Centre's response to this Exposure Draft, submitted on 5 March 2014⁵. We reiterate the need for an anti-avoidance provision in the national credit laws, which would enable the regulator to take action against unscrupulous lenders attempting to circumvent the consumer protections.

5.2. Quality and Sources of Financing Available to Low Income End Users

⁵ <http://consumeraction.org.au/wp-content/uploads/2014/03/Joint-CALC-CCLC-submission-payday-lending-regulations-Mar-2014.pdf>

RLC supports the submissions in relation to the FSI's Draft Terms of Reference by the Consumer Credit Legal Centre (NSW) and Financial Counselling Australia. We agree that many of our clients struggle to find appropriate financial products such as fee-free bank accounts and affordable credit for small amounts.

We recommend that the FSI consider the availability of appropriate financial products for lower income end users of the financial system. One of the proposals considered in a prior iteration of the FSI was a potentially more efficient use of existing government infrastructure, such as Australia Post and Medicare Offices, for the distribution of financial products to facilitate improved competition. RLC would support the development of such sources of financing if they improved competition and provided accessible and low risk credit for vulnerable consumers.

5.3. Australian Financial Security Authority (AFSA) proposal to introduce filing fees for Bankruptcy

RLC opposes AFSA's charging individuals filing a Debtor's Petition for Bankruptcy. Individuals who are considering bankruptcy are already in a desperate, intractable and impecunious situation. The very fact that they are considering bankruptcy means they will be unable to afford the fee. This will lead to the sad irony of having to borrow money from charitable organisations to fund a bankruptcy application. We support the submissions of Financial Counselling Australia, Consumer Action Law Centre, Consumer Credit Legal Centre and Footscray Legal Centre⁶ to the 'AFSA Cost Recovery Impact Statement on New and Revised Fees for Personal Insolvency and Trustee Services'.

5.4. Superannuation

We note that the rise of self-managed superannuation options has made it possible for financially literate consumers to manage their own retirement investment options and avoid extensive superannuation management fees. All end users should be empowered with financial literacy sufficient to access and assess these options. Superannuation is often our largest investment. Information about how to properly manage and capitalize on this investment should be simple and freely available. It is RLC's submission that these principles of fair and simple access should underpin the future development of our financial system.

5.5. Regulation of new financial technologies

We agree with the Chairman's recognition that new technological developments have transformed the nature of the financial system. New technologies provide the opportunity for reduced costs and greater consumer choice. However, new forms of online credit need effective and contemporary regulation to protect consumer rights.

We note that small amounts of credit and SACCs can now be obtained more easily online. The online sales approach, and the level of disclosure provided by these lenders, needs to be closely regulated.⁷ However we echo the Joint Submission's position that disclosure alone is not effective in reducing risk for consumers entering into unsustainable or inappropriate loan agreements.⁸

⁶ <http://consumeraction.org.au/media-release-advocates-object-to-new-fee-for-entering-bankruptcy/>

⁷ <http://www.consumer.vic.gov.au/library/publications/resources-and-education/research/payday-loans-helping-hand-or-quicksand-2002.pdf>

⁸ Joint Submission, Discussion paper - Proposed reforms relating to Small Amount Credit Contracts, 7 May 2012, page 6.

5.6. Credit Card Surcharges

We welcome the comments recently made by the Minister for Small Business in relation to credit card charges by certain businesses. RLC would support the introduction of regulation that sought to eliminate the imposition of unfair charges upon consumers for payments by credit cards.⁹ We note that in 2014, the ACCC is focusing upon 'drip-pricing' and other credit card fees and surcharges. These forms of fees and surcharges often have a more significant impact on vulnerable consumers.

5.7. Financial Exclusion

RLC commends the work done by NAB and the Centre for Social Impact in measuring Financial Exclusion in Australia.¹⁰ The findings of their 2013 report include:

1. That the cost of basic financial services forms a severe impediment to a significant proportion of the Australian population in gaining access to mainstream financial services. For 9.2% of the population, the cost of a basic bank account, low cost credit card, basic motor vehicle and home contents insurance would amount to over 15% of their annual income. For a further 9.1% this would represent between 10-15% of their annual income.
2. Young people aged 18-24, students not in employment, people born in a non-English speaking country and people earning between \$20,000 and \$25,000 have dramatically higher rates of exclusion. Although 18-24 year olds and students are likely to have lower demand for credit and insurance, their lack of access to mainstream products makes them vulnerable to predatory lending products and to the loss of uninsured assets. Other groups have a higher demand but face significant barriers in relation to the cost and complexity of financial products.

Case Study

Jane was a student. She was driving a motor vehicle and was involved in an accident with a high-end vehicle. Jane thought she had paid for car insurance but found out that she had only paid for the mandatory 'green slip' CTP insurance, which did not include third party property damage. The other driver's insurance company, who claimed damages of \$40,000, pursued Jane. Jane had a limited income through some casual work and some support from her family at home. She had no capacity to repay the amount of damages claimed by the insurance company. Her car was also written off and she had no means of transport. Jane was very worried about this situation and considered abandoning her studies and leaving the country. Jane came to RLC for assistance.

RLC helped Jane explain her situation to the insurance company and prepare a detailed statement of her financial affairs. RLC helped Jane to negotiate a reduced settlement figure with the insurance company. The insurance company accepted they would realize a significant loss, but that this debt would be otherwise unrecoverable. Jane was able to

⁹ Unfair credit card surcharges may lead to regulatory intervention, says Small Business Minister Bruce Billson, Amy Bainbridge, 19 March 2014, <http://www.abc.net.au/news/2014-03-19/minister-warns-companies-on-credit-card-surcharges/5331116?pfm=ms>

¹⁰ 'Measuring Financial Exclusion in Australia', National Australia Bank and the Centre for Social Impact, June 2013 at http://www.financialliteracy.gov.au/media/465159/nab_csi_measuring_financial_exclusion_in_australia_2013.pdf

obtain a loan to pay out a proportion of the damages. She was also able to continue her studies in Australia with a view to finding professional employment, which would help her repay this loan more quickly.

3. There is a significant unmet need for insurance products and issues such as cost and the complexity of products and product disclosures and descriptions are common barriers to obtaining or keeping insurance. Our observation is that consumers often have limited knowledge of the range of insurance products that may apply to their circumstances and may have the wrong insurance and/or not have intended cover.
4. Low levels of insurance tend to be in inner city areas of the large capital cities, or in extremely remote areas around Australia.
5. While there are a number of initiatives aimed at addressing financial exclusion, such as basic banking, matched savings, access to credit and financial literacy, many of these programs are relatively modest in scale, and subject to funding and sustainability pressures. There is an absence of initiatives designed to improve access to insurance.

5.8. Access to unbiased information in the best interests of the client

As the market place becomes more complex with varied products, and at the same time individuals may become self-managers of superannuation funds or gain access to those funds on retirement, consumers need to be able to access advice, which will be open and can be trusted free from by conflicts of interest. Otherwise, the aims of government to encourage people to save money for the purposes creating funds for investment, and of avoiding large Social Security obligations in the future, are likely to be defeated by those taking advantage of the unsophisticated market place.

5.9. Complaints and disputes

Consumers must be able to readily access affordable dispute resolution processes. RLC's clients have clearly demonstrated that companies marketing products to them make the process of 'signing-up' a minimal effort. Unfortunately this same ease of transaction does not generally occur when problems arise. At that time it can be difficult to reach anyone who can resolve a problem, access being only to a call-centre with limited scope to resolve matters. Advocates may be put through significant hurdles of obtaining authority to deal on behalf of the client. It is only once a matter has got to one of the External Dispute Resolution scheme, such as the Financial Ombudsman Service, that there are real prospects of getting the individual circumstances of a matter resolved.

The financial service provider is a large corporation with skilled knowledge about its products and the market place and resources to wait out a dispute. Consumers on the other hand, particularly low-income consumers, are at significant disadvantage when trying to deal with financial matters when they go wrong. They cannot afford private legal representation, they cannot afford court filing fees and they often cannot afford the time taken in the courts. The repercussions are hardship on the consumers (and frequently anyone in relation with them), further disadvantage to the consumer and exclusion from financial services. This in turn leads to further distrust and inefficiencies within our financial system.

Conclusion

These findings accord with the experience of RLC and its clients. The lack of access to appropriate and affordable financial services is our prevailing concern.

We **recommend** that the FSI comprehensively investigate the approaches to basic banking, microfinance products, financial literacy and financial counselling. We applaud the excellent work undertaken in this field by organisations such as Good Shepherd Microfinance. Further support of these initiatives by the government, and by industry participants, can make significant inroads in addressing financial exclusion in Australia today.

We hope that the FSI will work towards ensuring that all users can equitably enjoy the rewards of our prosperous and efficient financial system.

