GOOD SHEPHERD YOUTH AND FAMILY SERVICE

SUBMISSION TO THE FINANCIAL SYSTEM INQUIRY

(THE WALLIS INQUIRY)

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1. BACKGROUND TO THE SUBMISSION

1.1 INTRODUCTION

Good Shepherd Youth and Family Service welcomes the opportunity to share its expertise and knowledge of the Australian financial system and its impact on disadvantaged consumers, particularly those on low incomes. We believe our contribution provides valuable and constructive input as our comments and recommendations are based on our extensive experience in providing consumer and financial services to low income earners. In particular this submission draws on our thirteen years experience in providing no interest loans to low income earners. This submission is offered to the Financial Systems Inquiry as a representation of our strongly held views.

1.2 ROLE OF THE GOOD SHEPHERD YOUTH AND FAMILY SERVICE

Good Shepherd Youth And Family Service (GSYFS) is a community based service organisation working with low income individuals, families, young people and other disadvantaged groups. We provide services in the Western Suburbs, Mornington Peninsula and inner-Melbourne areas.

GSYFS is auspiced by the Good Shepherd Sisters and is dedicated to the promotion and establishment of a just society based on social justice principles. Working in partnership with the community, the goals of the agency are:

- to ensure that all have equity of access to the systems, structures and resources of society;
- to ensure that all are provided with the opportunity to achieve their individual goals and aspirations;
- to ensure that the right of individuals to exercise control over their lives is respected.

GSYFS affirms that all people, regardless of age, sex, nationality or religion have the right to access the basic resources which ensure the dignity of the individual. These resources include:

- adequate income;
- adequate shelter;
- adequate medical care, food, clothing and rest;
- adequate educational and employment options.

GSYFS undertakes advocacy over social justice issues on behalf of, and in conjunction with those who use our services.

2. DEREGULATION AND THE DISADVANTAGED CONSUMER: THE FOCUS OF THE GSYFS SUBMISSION

GSYFS shares the concerns of other consumer groups in regard to the impact of the deregulation of financial services on low income earners:

> “The benefits of greater access and flexibility have not been uniformly distributed among consumers - those with a low income and little education, the elderly, the young and women - have borne a disproportionate share of the increased costs of banking without benefiting from deregulation. Not only have some people been locked out of the banking system altogether, but there are many who have not benefited from the growth of electronic banking, or the greater banking options that are available. The unevenness of access to credit is particularly noteworthy.” (CFA 1995:40).

Although the rapid transformation of the Australian financial services industry following deregulation has contributed to the growth of the Australian economy and brought significant benefits to consumers, these benefits have not been shared equally by all Australians.

Initiated in the early 1980s by successive Liberal and Labor governments, deregulation and user pays (or cost reflective) pricing have resulted in low income consumers being priced out of access to banking services. A reality of the post-deregulation financial system is the disadvantage suffered by those who can least afford to pay and those least able to take advantage of the flexibility of choice in a competitive market. These problems have been evident for some time: “The proportion of low socio-economic groups amongst those with no access to the banking system has increased.” (Singh 1989:4)

GSYFS’s submission to the Financial Systems Inquiry argues that the rapid transformation and internationalisation of the Australian economy following financial deregulation has 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.

The GSYFS submission to the Financial Systems Inquiry seeks to provide an insight into the four following areas:

- the effects of the deregulation of the Australian financial system on low income earners and the most disadvantaged;
- the special obligation of banks to provide services on fair terms;

- the importance of government in constructing a regulatory framework which will ensure the right of access to a “basic banking service” including access to credit on fair terms;
- our insights and perceptions of the financial system gained through working with low income individuals, families and young people.

3. CAMPBELL INQUIRY AND THE MARTIN COMMITTEE: THE SOCIAL JUSTICE PERSPECTIVE

When the Campbell Committee of Inquiry made its recommendations in 1981, the principal underlying argument for deregulation was that if financial markets were allowed to operate more freely, in an environment of effective competition and with less direct government intervention, the community as a whole would benefit. Among other predictions, it made clear that one of the aims of deregulation was to reduce the cost of finance to low income consumers, who had previously been forced to borrow at high rates, particularly from finance companies.

The Campbell Inquiry acknowledged, however, that although increased competition and productivity would provide substantial benefits to the Australian economy and therefore the community, not all consumers would gain directly and some would lose in a direct sense.

The Consumers Federation of Australia identified the need for the Federal Government to take a direct role in ameliorating the unintended consequences of financial deregulation on some groups:

> “The Inquiry admitted that small depositors would potentially face high transaction costs and limited access to information. For those reasons the Committee identified that low income groups could require sectoral support and recommended that direct fiscal assistance through government was one way in which this could be achieved.” (CFA 1994:6)

GSYFS believes that the regulatory reforms which occurred progressively throughout the 1980s have failed to adequately assess or respond to the negative impacts on low income and disadvantaged consumers. “In 1990, a decade after the Campbell Inquiry, the Martin Committee suggested that deregulation happened too quickly. It suggested that neither the banks nor customers had been educated to cope with the changes in the allocation and pricing of risk.” (CFA 1995:40).

Financial deregulation has 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. GSYFS has witnessed the diminishing access and discriminatory pricing of banking services facing low income earners. Our experience is consistent with the findings of studies of these issues which have occurred since the mid 1980s: "Banks in a deregulated environment have not served consumers well, especially low income consumers. This situation bears witness to the need for some form of supervision” (Singh 1989:5)

We believe there must be a thorough assessment of the potential impact of further financial deregulation on disadvantaged consumers. Further, we strongly urge the Commonwealth Government to monitor the impact of future reforms on disadvantaged consumers.

4. ACCESS TO BANKING AND CREDIT AS AN ESSENTIAL SERVICE AND A FUNDAMENTAL RIGHT

GSYFS argues that adequate access to the full range of benefits available from the financial system is a fundamental right of all Australians. We share this view with other consumer, church and community organisations:

> "Access to banking services is an essential prerequisite to full participation in the community in the late 20th century, but the free market will not deliver banking services to all who need them." (CFA 1995:11).
>
> The availability of financial and physical security for consumer funds through bank accounts, bank payment systems and credit is a fundamental prerequisite for a stable, close-knit interactive community. It generates public confidence and facilitates the huge range of transactions, with the necessary speed and reliability, that are the lifeblood of our economic, social and cultural life. They are a public and not just an individual good. Whether a disadvantaged minority are to be denied access to those services and consequently denied full participation in the community is not merely an economic question, it is a social and political one.(CFA 1995:6)

The OECD has recognised that access to banking services, including electronic services, is "an absolute necessity" for day to day consumer transactions. Bank accounts provide security against physical loss and theft and to some degree against financial loss through inflation. The Commonwealth Government must ensure that the regulatory regime guarantees all Australians access to basic banking services and credit on fair terms.

According to the Prices Surveillance Authority (1995), a transaction account should be affordable to all in the community who require it. Such an account should provide the basic services of:

- a secure and accessible place for the storing of money;
- the facility to withdraw funds deposited at call, including the withdrawal of cash;
- a means of making payments to third parties.

In light of this GSYFS believes it would be inequitable if the price of transaction accounts prevented access to these necessary services.

The consumer movement has long argued that banks should provide, on reasonable terms, universal access to transaction accounts, via what has generically become known as a basic banking product. (CFA 1995:8).

While it is not possible to discuss options for how lifeline or basic banking services might be delivered, it is a question which the Federal Government must move to adequately address if greater equity is to be achieved, both in terms of consumer credit provision and in regards to the provision of banking services generally. Ultimately responsibility for decisions over such issues rests with government.

5. THE LOW INCOME CONSUMER: UNEQUAL ACCESS TO CREDIT AND THE MISCONCEPTION OF "HIGH RISK"

GSYFS operates a number of no interest loan schemes. These schemes provide small amounts of credit to low income earners at no interest for the purchase of household goods and other essentials. There are now over thirty schemes, based on the Good Shepherd model operating throughout Victoria and there is considerable interest in establishing schemes in other Sates. These schemes have been established in response to the decreasing access of low income earners to affordable credit from mainstream lending institutions.

The high cost of consumer credit provided to low income earners has been a recurring concern, expressed by welfare and consumer groups both in Australia and overseas. See for example: Caplovitz (1967), Sackville (1975), Williams (1977), Lupi (1978) Taylor (1986), Parker (1990), Chalmers & Prossor (1990).

> "There is clear evidence that credit available to poorer consumers is more expensive than that available to the more prosperous. In Australia this has meant credit from finance companies rather than that provided at lower rates of interest by banks and credit unions" (Ryan 1994:126).

High Cost Credit

The reasons why low income earners are forced to pay the highest rates for consumer credit are complex and relate to the regulatory environment governing the industry, the commercial interests of financial institutions and the financial vulnerability of low income earners. The fact that low income earners generally pay a significantly higher cost for consumer credit and financial transaction charges than those on higher incomes in this country is a cause for significant concern. This situation is an indictment on a society which prides itself on its egalitarian aspirations and governments in their endeavours to ensure that the financial system treats individuals fairly

For low income earners, access to credit on fair terms is a fundamental requirement for a decent standard of living. Access to some form of consumer credit is therefore an essential prerequisite in enabling individuals to exercise their right of access to basic household goods and other necessities. Access to credit on fair terms is an essential element in ensuring that low income and disadvantaged consumers are able to achieve full economic participation in society.

As it is virtually impossible for low income families to save the full cash price to purchase most essential household items, they are often reliant upon access to credit to obtain even the most basic necessities. In our experience, those on social security incomes are denied access to credit from mainstream lending institutions. Young people and sole parents face particular barriers in this regard.

The current methods of access to credit available to low income Australians can lead to financial exploitation by credit providers. For economic, social and cultural reasons, many low income consumers are "locked in" to particularly expensive non-mainstream forms of credit including pawn brokers, non-bank credit providers, high-cost retailer credit schemes and hiring of household goods.

The traditional response of the finance industry to its perceived "high risk" customers has been to charge higher interest rates, thereby minimising the risk of loss. In fact, the high rate of interest charged and the lack of repayment flexibility when this group of consumers are faced with unforeseen events, serve to compound difficulties in repayment and lead to default.

Despite the significant reforms to the financial system over the last two decades, low income consumers have a limited number of high cost options when accessing credit. Market forces, paradoxically, create a situation where those least able to afford credit are charged the highest costs.

These disproportionately higher financial costs and the associated hardships endured by low income groups when acquiring basic necessities through consumer credit, clearly demonstrate that the financial system delivers outcomes which are inequitable. The problems facing low income Australians are fundamentally linked to issues of poverty and inadequate incomes. The development of policies which lead to an improvement in access to affordable credit for low income Australians will contribute to the amelioration of the effects of poverty and financial disadvantage.

Regulation

Government regulation has played and continues to play a key role in regulating the financial services industry. A significant aspect of the development of this industry has been the stratification of consumers, based on economic status, which has occurred, historically, in terms of credit provision and increasingly in regard to banking transaction fees. This situation occurred, in part, as a consequence (although unintended) of the Federal Government's role in safeguarding the security and long-term viability of the banking sector through detailed and prescriptive regulation.

The current inquiry provides an opportunity to put in place effective mechanisms to improve the access of low income Australians to financial transaction accounts and credit on fair terms.

6. DEREGULATION AND BARRIERS TO LOW INCOME CONSUMER ADVANTAGE IN BANKING COMPETITION

While it is not possible to provide a detailed critique of the impact of financial deregulation on different social groups, it appears there has been a polarisation of outcomes in terms of the effects on those from low socio-economic groups when compared to higher socio-economic groups.

Six areas adversely affect the extent to which consumers, particularly low income families and young people, can benefit from the increased competition between banks following the deregulation of the 1980s. These are:

- the lack of availability of full information about bank products, services and credit options;
- the complexity of conditions and requirements of the range of accounts offered which make comparison and informed decisions difficult;
- the provision of financial advice from financial institutions and the question of impartiality;
- the difficulties low income consumers face in changing banks or opening new accounts;
- the difficulty of changing loans due to high exit and entry costs;
- the inequality of bargaining power between an individual consumer, particularly low income families, and banks. (CFA 1994:13)

Following deregulation, trends in banking towards service charges have had a significant effect on low income earners. Charges incurred include inward dishonour fees, duplicate statement fees and charges for overdrafts. One area of particular concern to low income earners is the concept of high cost transactions for “low net worth” customers.

The Prices Surveillance Authority inquiry (1995) into fees and charges imposed on retail transaction accounts clearly identified that low income earners pay disproportionately higher costs than middle and high income earners. GSYFS are pleased to note that the current inquiry has included consideration of “fairness” in its terms of reference. What constitutes fairness in terms of the operation of financial institutions is open to wide interpretation and debate. We believe the Federal Government must adequately define “fairness”. Further, a process of formal monitoring of the financial system must occur to ensure that the concept of fairness is translated into tangible benefits for consumers. Such benefits, in the form of appropriate and affordable services must be delivered to all consumers as an integral component of the financial system.

7. BANKING: THE OBLIGATION OF SERVICE PROVISION TO THE ENTIRE COMMUNITY

GSYFS shares similar views to other groups in regard to the importance of the financial system to society as a whole. We also believe that the Federal Government bears responsibility for ensuring that financial institutions provide services to all consumers.

> "With the intrusion of banking into so much of modern economic life, access to banking services has become a prerequisite for community participation - it has become an essential element in the preservation of the dignity and rights of the individual. (Farmer 1993:36)
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> "There is a broad obligation on the banking industry to serve the entire community through the provision of minimum level basic banking services. The free market will not deliver appropriate banking services to all who need them. Even highly competitive markets are not perfect and may fail to provide services, even when it may be profitable to do so...even when particular services are provided to particular sectors of the community, those sectors may have insufficient bargaining power to affect the terms upon which those services are provided, to ensure they are both suitable and on fair terms." (CFA 1994:11)

A historical bond has been forged between the government and the banking system since the spectacular failures of Australian banks in the late 1880s. Banks gain much implicit and explicit support from government which guarantees their ability to trade in a privileged position of security of equity. This ensures that the pre-eminent role granted to them in the payments system allows advantages from which banks derive tangible benefits. Without them, banks would be significantly less secure and less profitable.

Even when public policy seeks an openly competitive, deregulated financial market, banking institutions continue to receive important government support and should therefore continue to be subject to strict government regulation.

GSYFS supports the view that as a result of this level of government support, "it is appropriate to hold banking institutions to certain public benefit requirements in relation to community access to banking services and delivery of those services on fair and equitable terms". (CFA 1995:2).

In effect, such a duty extends to providing services to those sectors of the community which may not be adequately catered to as a consequence of market forces alone, and it is in the general public interest that these sectors are not excluded from the banking system. (CFA 199:17).

The Government must also recognise that it has a responsibility to ensure that social security recipients are treated fairly by financial institutions. The Government requires that all social security recipients receive their payments via a financial institution. In this regard social security recipients have no choice but to have a relationship with a financial institution. The Government must ensure that the regulatory regime does not allow the incomes of social security recipients and other low income earners to be diminished through the imposition of exhorbitant fees and charges by financial institutions.

8. THE REGULATORY ROLE OF GOVERNMENT

Governments have a responsibility to ensure that standards are set which protect individuals from suffering hardship. The right of individuals to a basic level of material wellbeing is meaningless without adequate mechanisms to give effect to such rights. "Deregulation does not mean no regulation" (Perkins 1994).

In the wake of deregulation, it must be recognised that government has a legitimate and fundamental role to play in the foundation and provision of an appropriate regulatory framework to ensure that all Australians have access to banking services and fair credit facilities. Given the importance of access to credit on fair terms by low income earners, government intervention in the market is paramount.

Through our experience, the assumption on the part of governments that the free market, through competition, will set appropriate terms and conditions for the provision of fair credit and banking facilities is false. In industries providing an essential service such as gas, electricity, water and housing, government regulation is vital to ensure that standards and benchmarks are adhered to. In the financial system following deregulation, government supervision and benchmark setting are just as necessary.

Self-regulatory responses have failed to deal with the inequities of the system. Clearly, therefore, the Federal Government has a strong basis on which to require banks and financial institutions to perform certain social obligations. Moreover, the Federal Government has a duty to ensure that certain groups are not unfairly disadvantaged due to the structure and operations of the financial system. To this end, the government must establish a benchmark which guarantees adequate access to credit and financial transaction accounts on fair terms.

9. TECHNOLOGICAL CHANGE AND ITS EFFECTS

> "The Prices Surveillance Authority considers that monitoring the RTA market in the financial services industry should include the monitoring of progress on initiatives to address issues relating to access to banking services arising from the structural and technological changes in the industry." (PSA 1995:23).

Rapid advances in technology have contributed to the growth of the consumer credit industry, particularly since the introduction of credit cards. Computerisation has enabled credit card and banking transactions to occur electronically, with administration costs for financial institutions being significantly lower than for previous methods of banking and credit provision.

The introduction of technology in the Australian financial system has produced a number of new problems and disadvantages for low income consumers. As changes in the delivery of banking services have been introduced, with new banking facilities such as EFTPOS and ATMs, the financial sector has strategically attempted to guide customers away from traditional forms of banking. These include inadequate staffing of banks, reduced hours, withdrawal of services through bank branch closures and the introduction of over-the-counter fees.

Access to banking services, particularly for disadvantaged groups, has been greatly reduced in the post-deregulation period. Affected groups include the elderly, who feel vulnerable accessing ATM's, NESB communities, consumers with disabilities and those with literacy problems.

10. RECOMMENDATIONS: BENCHMARKS AND PRINCIPLES

Attempts to ensure that low income Australians are not disadvantaged in the financial services arena must be based upon clear benchmarks. This must form the basis upon which social policy and legislative mechanisms are founded.

Below are listed the GSYFS recommendations to the Financial System Inquiry in setting a regulatory framework which aims to address the equity issues outlined in this submission

RECOMMENDATION 1:

That financial institutions, as a requirement of their licence carry out clearly defined community service obligations to ensure that all consumers can maintain access to financial transactions and consumer credit on fair terms.

RECOMMENDATION 2:

That the Federal Government establish clear benchmarks which act to identify a range of products and a level of service which all Australian consumers can expect from financial institutions. Such a process must be ongoing to keep pace with technological change and other developments which occur in the industry.

RECOMMENDATION 3:

That the Federal Government take responsibility for ensuring all Australian consumers can access affordable credit and financial transaction services. This may require direct government subsidisation of the costs associated in delivering these services or requiring financial institutions to bear part of this cost.

RECOMMENDATION 4:

That the Federal Government adequately define the concept of "fairness" and implement a process of formal monitoring of the financial system to ensure that this is translated into tangible benefits for consumers.

RECOMMENDATION 5:

That the Federal Government undertake a thorough assessment of the impact of future reform of the financial system on disadvantaged consumers.

RECOMMENDATION 6:

That the Federal Government form an advisory committee comprising representatives from consumer groups to provide ongoing input into the reform and monitoring of the performance of the financial system.

11. CONCLUSION

In working with low income families and young people, both in the period prior to deregulation and following its introduction, the GSYFS has witnessed firsthand the unequal distribution of benefits resulting from these changes.

While deregulation has delivered benefits for some consumers, low income earners are worse off, with limited high cost credit and retail transaction options and diminishing access to the banking system.

The Financial Systems Inquiry provides the Federal Government with the opportunity to address this imbalance with the introduction of an appropriate regulatory system which ensures equality of access and **fairness** for all Australians. This will accrue benefits not only to those who are currently disadvantaged as a result of deregulation, but to Australian society as a whole.

The Good Shepherd Youth and Family Services thanks the Financial System Inquiry for the opportunity to present our perspective. We sincerely hope that positive changes occur as a result of our input.

12. REFERENCES

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