

WHAT MAKES JANE SAVE?

Supporting low income
earners to adopt positive
financial habits

The Winston Churchill Memorial Trust of Australia
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Signed Corinne Proske

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Executive Summary

Jane¹ is 45 years old and recently bought a small block of land on the outskirts of town. Not able to afford to build, Jane lives in a converted bus on her block. Jane loves her home and is keen to install a septic tank system to make things more comfortable. Not eligible for a mainstream bank loan, Jane thinks it may take four years for her to save for the required \$3,000. Jane has never saved and is considering going without.

You're more likely find Jane living in the US, the UK or in Ireland, as Australia has fewer people in Jane's circumstances. However, an increasing number of Australians are facing hardship and exclusion from the mainstream banking industry.

In 2007 the fringe lending market in Australia was estimated to be between \$500m - \$800m per annum and is economically based on the premise that Jane should pay a premium for access to basic financial services. Community finance initiatives providing fair and affordable alternatives to people like Jane, will find financial sustainability a challenge given that we do not currently have the population to achieve economies of scale.

Increasing positive financial habits is as much about ensuring access to appropriate products as changing individuals' psychological relationship to money.

After visiting 10 organisations in the US, UK, Ireland and Canada, the following elements seem essential to achieving change:

- Local existence of fair and affordable product offerings
- Strong government support that provides a conducive regulatory environment as well as access to funding as projects are rarely sustainable
- Coupling financial education hand-in-hand with product offerings
- Personalised consumer interactions with a trained and trusted advisor
- Ongoing research and innovation to track outcomes and changing needs

Although present Australian work is based on limited research and ideological frameworks, on-ground service delivery and product offerings are leading edge. It is also comforting to note that although we have significantly fewer players involved, the program scale is larger than many of the programs visited overseas. For example, in 2010 NAB-supported programs will deliver over 15,000 microfinance loans and over 100 new savers. In contrast Fair Finance UK has a total book of 1,178 loans.

Whilst there are strong commonalities in the experiences of all indigenous people, the socio-economic gap between indigenous Australians and the general population appears to be greater than between equivalent groups in the US and Canada. Whether due to lack of income, geographic isolation or a poor understanding of English, financial exclusion further exacerbates this socio-economic divide.

Based on overseas experiences, it is important that we are mindful that:

- **Effective and sustainable financial inclusion for indigenous people will take time** – the Bank of Montréal estimates that they are on a hundred year journey
- **Non-profit offerings such as microfinance and financial literacy need to be cross-subsidised** by profit making activities in these communities to ensure program longevity.

What is clear is that low income Australians need support to access basic financial services with dignity.

I would like to take this opportunity to thank all those who took the time to share their experiences with me. It has been invaluable and I hope in the future to be able to reciprocate this generosity.

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1 Not her real name, but based on a true story

Introduction

I currently manage the National Australia Bank's (NAB) microfinance program. The program offers low income Australians a variety of affordable personal and business lending products as well as insurance and incentivised savings. These programs are offered in partnership with community and government and aim to educate people about financial products and services through a positive experience. A total of \$130 million in capital has been allocated to invest in microfinance.

According to research commissioned in 2007 by the Australian Council of Social Service (ACOSS) and the Social Policy Research Centre at the University of NSW 2.2 million or 11.1% of Australians live in poverty (that is, have insufficient income to cover food and basic household expenses²). In this group, Aboriginal Australians are significantly over-represented.

In 2008, an average 17 year life expectancy gap existed between Indigenous and non-Indigenous Australians³. This trend is also mirrored by other socioeconomic indicators such as income, employment, housing, education and health.

A consequence of living in poverty or on low income is that individuals are often excluded from accessing mainstream financial services. Financial exclusion plays a key part in the creation and amplification of poverty, and often results in those with the least income paying the most. Unfortunately there is also a strong correlation between those financially marginalised also experiencing levels of social exclusion, and poor health.

In 2007 the fringe lending market in Australia was estimated to be between \$500m - \$800m per annum⁴, although it seems likely that the true market is probably much greater. Similar to the mainstream market, the fringe sector meets the credit needs of those on low incomes or with a poor credit history. The key difference is however that interest rates, fees and loan terms are often onerous (if not predatory) and poorly explained and documented. The growth in the local fringe market very much reflects trends seen in the US, UK and Canada.

In addition to not being able to access appropriate and affordable financial products, people living on low incomes often have a limited understanding of the financial system itself including their rights and obligations. This may be due to poor literacy, language barriers, or simply never asking how the system works. Given that financial decisions are often behavioural rather than rational, the psychological mindset of low income people must also be considered. Evidence suggests⁵ that short term decisions are easy to consider and often more relevant (eg securing the

next meal). Making long term savings or financial change is often difficult to achieve alone.

In the last 10 years, Australian not-for-profits, corporate and increasingly government (State and Federal) have commenced investing in programs that are focused on reducing financial exclusion and thus aim to reduce poverty. In the last three years we have seen significant innovation and growth in this market segment.

The aim of my Churchill Scholarship is to benchmark Australian practices, better understand overseas markets and where possible identify new innovations that can be implemented locally to help make low income individuals and families more financially stable – whether that be through appropriate product offerings or techniques to influence behaviour change.

It must be noted that this report only provides a limited snapshot of what is happening in the US, Canada, UK and Ireland and the activities undertaken by the organisations visited. Recommendations on how these experiences may apply or contrast to Australia are included on page 16.

2 Please note that the measurement of poverty is an art rather than a science and is done differently by each of the countries I visited. This however does not change the experience of the individuals and the fact they have difficulty meeting everyday basic expenses and that many are excluded from mainstream financial services.

3 Based on the ABS/Australian Institute of Health and Welfare (2008)

4 *Jane Searle, 'Cash in Demand' BRW August 23-29, 2007, p 36-39

5 Maynard, Nick and Zinsmeyer Jeff, The Mind of Low to Moderate Income Savers, D2D Fund Inc

Organisations visited

Whilst overseas I visited the following organisations involved in supporting the financial needs of low income earners:

OWEESTA Corporation (Rapid City, South Dakota)

OWEESTA is a peak not-for-profit organisation that focuses on supporting Native Americans to accrue assets through programs that contribute to economic independence. OWEESTA do not undertake any direct client service delivery themselves but rather support Reservation-based agencies. OWEESTA provide support to Native community finance institutions, microbusiness programs and offer a train the trainer program in financial capability development.

NYC Department of Consumer Affairs – Office of Financial Empowerment – (New York City)

The Office of Financial Empowerment is an initiative undertaken by the local government of New York City to:

- Increase access to high quality, low-cost financial education and counselling
- Connect low-income households to safe and affordable banking and asset building products and services
- Enforce and improve consumer protection to enhance financial stability

Alternatives Federal Credit Union – (Ithaca New York State)

Alternatives is a community development financial institution that operates as a credit union. Established 24 years ago, Alternatives offer both mainstream financial services as well as a variety of community development programs that focus on personal and business needs of low income consumers.

Grameen America (New York City)

Based on the work of Professor Yunus in Bangladesh, Grameen America operates a peer-lending model for clients setting up a business. Grameen came to the US in 2008 (initially to New York) and since then has disbursed over \$5 million in loans to 2,500 borrowers across four branches.

D2D Fund Inc (Boston, Massachusetts)

D2D is a small not for profit think tank that seeks to expand access to financial services to low-income families by creating and then incubating innovative financial products and services. D2D has specifically focused on savings products and programs as well as studying the psychology of savers themselves.

US Federal Treasury (Washington DC)

US Federal Treasury is responsible for financial services as a whole and more specifically the management of community finance funding. They have also been responsible for the disbursement of US economic stimulus funds in the last year.

Bank of Montreal (Montreal, Canada)

One of Canada's largest commercial banks, the Bank of Montreal has a dedicated Aboriginal Banking Unit that has been operating since 1992 and caters to the personal and business needs of indigenous Canadians. The unit operates 13 branches in indigenous communities.

MABS (Dublin, Ireland)

Established in 1992, MABS is a government funded budgeting and debt counselling service that is offered over the telephone and through 53 MABS outlets. The vast majority of users are women living on low incomes.

Fair Finance (London, UK)

Fair Finance is a London-based community development finance institution (CDFI) that focuses on providing affordable financial products and services to people who are traditionally financially excluded. Launched in 2004, Fair Finance operates four branches with significant future growth plans.

Financial Inclusion Centre (London, UK)

The Financial Inclusion Centre is an independent, not-for-profit think-tank that promotes financial inclusion of consumers through market mechanisms. The centre achieves this through research, advocacy and consulting.

Refer to Appendix 1 for additional details on these organisations.

Understanding Poverty and Financial Exclusion in the USA

The latest US Census by the Bureau of Statistics found that in 2008 the poverty rate was 13.2%, the highest rate since 1997. This means that 39.8 million people receive insufficient income to be able to cover food and basic household expenses. Racial minorities – Blacks, Hispanics, Asians and Native Americans are well represented within this segment although Blacks and Native Americans are the most disadvantaged.

Given that in 2010 the unemployment rate has grown to 9.7%⁶ from 4.4% in 2006, it can be assumed that the poverty rate has also risen in the last few years.

US Financial Services Sector

The United States has the largest number of banks in the world: 8,430⁷ institutions and an estimated 82,000 branches. Many banks are regionally based with only one or two branches.

Mainstream banks in the US are not generally directly involved in delivering products or services to those financially excluded. This is partly due to existing regulatory frameworks which means that these services are delivered through alternate organisations.

A Community Development Finance Institution or CDFI is a financial institution, which provides financial products and services in conjunction with community development to moderate or low income earners. A CDFI may take the form of a bank, credit union, loan fund, or venture capital company.

It is estimated that over 800 CDFIs operate in the United States⁸. Since its creation, the CDFI Fund has awarded \$1.11 billion to community development organisations and financial institutions.

Government and Regulatory Context in USA

In 2008, at the height of the credit crunch, US Treasury provided a \$250 billion bailout to the country's largest banks in exchange for non-voting stock. As a result, the current regulatory framework is under review and it is expected that in the future government will demand greater control and transparency.

The Community Reinvestment Act 1977 (the CRA.) is a United States federal law designed to encourage commercial banks meet the needs of borrowers in all community segments, including low- and moderate-income households⁹.

One of the indirect outcomes of the CRA is the creation of a separate sector to address the needs of those marginalised, for example credit unions or CDFIs.

In February 2009, the Obama Administration announced an investment of USD100million to CDFIs; USD8million of this was specifically allocated to Native American institutions. The FY2010 budget proposes an additional USD244 million for CDFIs.

The US also operates an extensive fringe lending market that is considered by many consumers as a "friendlier" environment than mainstream banks.

One of these fringe markets is 'cheque cashing'. Cheques are a frequently used payment mechanism – some landlords require that rent be paid by cheque – and as such, a secondary market for cheque cashing has evolved. This is further exacerbated by the fact that it can be difficult for low income earners to open a transaction account.

A fringe market for the preparation for tax submissions has also emerged. Predatory tax preparers charge high fees or take a cut of the eligible refund for on the spot returns (refund loans). Refund loans can have annual percentage rates of 300-400%.

6 April 2010 US Bureau of Labour statistics

7 According to the FDIC as of August 22, 2008

8 Coalition of Community Development Finance Institutions <http://www.cdfi.org>

9 An institution's CRA compliance record is taken into account by the banking regulatory agencies when it seeks to expand through merger, acquisition or growing its branch network. No other penalties apply for non-compliance with the CRA.

Observations

Bank accounts are hard to get yet access to credit is easy

Within the US it is more difficult for individuals to open a transaction account than it is to access credit. Until recently, mainstream financial institutions did not offer any basic bank accounts targeted at low income earners, resulting in people becoming indebted through overdrawing their account. Although some banks now offer basic accounts, a significant portion of the low income population that do not hold a transaction account, do not trust banks.

In contrast, credit has been relatively easy to access with many low income earners possessing several sub-prime credit cards and store cards with up to 40 per cent interest being charged on purchases.

Changes to regulations around the management of overdrafts and the provision of credit are to be made in July 2010 which should reduce some of these practices.

Savings programs are primarily focused on large assets – the US government offers Individual Development Accounts (IDAs). An IDA is a matched savings account that enables low-income families to save and build assets. Matched IDA savings accounts are typically restricted to three uses:

- purchasing a first home
- pursuing post-secondary education
- starting or expanding a small business.

Most IDAs are offered through partnerships between local non-profit organisations and financial institutions. Participant's savings are usually matched at 1:1 or 1:2 rate over a two to four year period.

In New York (and other large cities), it is unrealistic for low income earners to aspire to purchase a home and instead more relevant programs are being developed.

Taxation is an important part of income maximisation – Taxation is a key focus as many family benefits are paid in an annual lump sum rather than progressively during the year. Families can access up to \$10,000 as a lump sum from the Federal government. Tax preparation is complex and expensive, meaning that families, who do not submit a return, miss out on a significant portion of their income. OWEESTA, OFE and Alternatives all run programs on understanding taxation and ensuring that recipients maximise their returns through accessing the correct deductions. Awareness campaigns as well as community based tax support programs are increasingly offered with skilled volunteers enrolled to help people work through their individual circumstances.

Tax refunds are coupled with matched savings – The Office of Financial Empowerment is piloting a program called SAVE NYC. Clients are asked to save a portion of their tax refund for a certain number of months in order to access a 50% matching of these funds (maximum of \$500 matching is available). The program does not require regular payments to be made but rather, maintenance of an initial contribution. The program is run in partnership with financial institutions and CDFIs and hopes to create a financial safety net for these families.

Innovative savings programs on the market – D2D has been involved with a series of programs aimed at increasing savings:

- Resurrecting government saving bonds which are simple to access, do not attract fees and have minimal interest income (but acceptable in the current economic environment) and attached to the tax refund so that funds can be quarantined prior to receiving the refund
- Piloting a 'prize to win' saving scheme whereby eight credit unions pooled \$100,000 as part of a competition to award to a saver participating in a savings challenge. The savings challenge was based on the premise that low income Americans are the primary purchasers of lottery tickets and love the thrill of the win. The pilot did increase levels of savings, with 10,000 participants generating savings of \$4.67million

Targeted marketing materials – D2D has undertaken research to better understand how low-to-moderate income earners respond to marketing material for targeted financial products and services. Working with consumers from twenty-two credit unions it was found:

- It is important that materials evoke an emotional response; utilitarian images such as piggy banks and coins do not work well with this segment
- Aspirational images around families, holidays, graduation and family closeness do resonate; this was particularly strong for consumers with dependents

- Language was also deemed critical; the simpler the explanation, the more trusted the offering
- The desire to save was strong, however many goals are short term and linked to consumption eg. purchase of a car or a holiday

Extensive use of social media but not electronic banking services – Social media are used extensively to promote initiatives whether it be through e-zines, twitter, facebook or other mechanisms. These mechanisms are used for discussion forums, feedback, updates as well as promoting products and programs. It is interesting to note that whilst being very technology savvy; people do not use electronic banking facilities (EFT, internet or mobile phone banking) and continue to prefer cheques or access to a branch. Nontransparent fee structures, as well as skepticism of electronic data security seem to be driving this behaviour.

Focus on working poor – Programs visited primarily focused on the working poor or families earning under \$40,000 per annum. Very little work is done with people solely receiving government benefits; in the US it is virtually impossible to survive on government benefits alone. If not working, many of these people would probably fall into the homeless category.

Users are predominantly women – As in Australia, it appears that women are the primary users of low income products and programs. The majority are financial decision makers within their households and are more than likely responsible for dependents. They also seem to be more driven to change circumstances and are more likely to access counselling or support services

One-on-one counselling is most effective in behaviour change

– both OFE and Alternatives are strong supporters of individual client consultation and believe that broader financial literacy programs do not actually result in changes in behaviour. Both organisations have significant waiting lists for their services (OFE employ 12 counsellors whilst Alternatives only has one).

Financial education is most effective when coupled with an appropriate product offering

– OFE, Alternatives and Grameen all strongly advocate that it is essential to couple financial education with an appropriate product (loan or savings program). This increases the attractiveness to clients and leads to better outcomes. The Alternative IDA program requires that individuals prepare a budget and then track their expenses for seven weeks prior to being able to access matched savings. Individuals are forced to understand their spending patterns, and where necessary, change them. Each program varies in its approach to education (Grameen – informal chats to Alternatives – formal classroom teaching).

Observations Specific to Native Americans

Geography is not as great a barrier

– Although many Indians do live on reservations, aside from in Alaska, most reservations are no more than 50km from the nearest town, making it easier to access employment and mainstream services where needed (and if appropriate).

Language is not a barrier – virtually all Native Americans speak fluent English. In addition, education standards seem to be on the improve. This makes financial capability programs easier to offer and permits the use of written materials.

Trade, business and money are part of the traditional culture – prior to colonisation, Native American tribes across the continent were heavily involved in trade, with some tribes using shells as currency. There continues to be a strong cultural understanding of the role of trade and business. Many families supplement income through home-based craft manufacture, contributing to a fertile microbusiness culture. Many of these enterprises are not externally financed even though loan funds are increasingly available.

Funding is sourced from gaming activities – many of the reservations have established casinos or gaming venues as a source of income to support community development, including CDFIs.

Understanding Poverty and Financial Exclusion in Canada

Of the four countries visited, Canada's social and economic landscape most closely resembles that in Australia. More recently Canada seems to have made significant inroads in actually reducing poverty; including poverty in aboriginal communities.

According to Statistics Canada, about 3.5 million people were living below what it calls the low-income cut-off line in 2004. That is a 1.1 million drop from 1996.

Several factors have led to this reduction in poverty:

- strong economic growth
- significant government investment in social security, public healthcare and public education
- a progressive income tax system
- minimum wage laws in each of the provinces and territories of Canada.

More recently, Canada appears to have survived the global economic downturn relatively well, only experiencing an unemployment level of 8.2 per cent in March of 2010 (down from 8.6 per cent in 2009).

Indigenous people in Canada are diverse and widely dispersed. The three main indigenous groups: Indians (First Nations and by far the largest group), the Inuit and the Métis.

Over a million people live across approximately 623 communities and speak more than 50 languages with one in four living on reservation and living in poverty ¹⁰.

However, as in Australia, the urban population is on the increase. Nearly 40 per cent of the indigenous population lives in cities.

Also like Australia, there is a significant life expectancy gap between Canadian Indigenous and non-Indigenous people. This trend is also mirrored in other socioeconomic indicators such as income, employment, housing, education and health, where indigenous people experience a greater likelihood of disadvantage.

Canadian Financial Services Sector

Banks play a key role in Canada's financial system and economic development. As of November 2009 the banking industry included 22 domestic banks, 26 foreign bank subsidiaries and 22 foreign bank branches operating in Canada ¹¹. The six largest domestic banks account for the bulk of the activity.

The Canadian banking sector is significantly more regulated than in the US and as a result has not been as impacted by the recent downturn. High-risk mortgage products were prohibited. Nevertheless, there are many who are excluded from mainstream products and in recent years, alternative sources of credit such as payday lenders have become established.

Regulatory Framework Impacting Aboriginal Access to Financial Services

The Indian Act (1876) outlines the management of registered Indians (that is, First Nations peoples only, not Inuit or Métis), their bands, and the system of Indian reserves. The Act defines who is an 'Indian' and contains certain legal rights and legal disabilities for registered Indians. For example, Indians are unable to access mortgages as they cannot legally have assets repossessed, and small businesses do not pay tax. These rights (and others) have created barriers to accessing mainstream financial services.

On April 20, 2007, Canada's Government announced that it would create the \$300 million First Nations Market Housing Fund (the Fund). This Fund was developed to facilitate and broaden the range of housing options for residents of First Nations communities.

¹⁰ http://poverty.suite101.com/article.cfm/poverty_in_canada

¹¹ Office of the Superintendent of Financial Institutions as of November 30, 2009

Observations

Mature mainstream strategy built on trust and longevity – the Bank of Montreal has operated a unit dedicated to indigenous banking needs for the last 18 years. The group has been successful through:

- Extensive stakeholder engagement to better understand the issues (including the complexities of the Indian Act)
- Taking the time to build trusted relationships
- Focus on retail banking needs, developing specific housing products and then opening 11 branches on reservations
- Support for reservation infrastructure funding
- A focus on the management of investment returns from commercial activities undertaken on native territories.

Comprehension of banking basics - As with Native American populations, the vast majority of indigenous Canadians are literate in English and understand financial system basics.

Aboriginal regulatory protection mechanisms have led to financial exclusion – the Indian Act, although designed to protect Indians (by not allowing repossession) has actually created barriers to accessing basic financial products such as mortgages, thus further excluding them as well as putting increased pressure on government housing.

Mainstream products are offered at Reservation branches – aside from the specific housing products, all Bank of Montréal offerings within the reservation branches are mainstream. Only employment and branding differentiate these branches from other branches.

Aboriginal businesses are the fastest growing small business segment in Canada – as a result, banks are involved in delivering extensive business literacy training. Loans however tend to be supported by native development funds rather than by banks.

Understanding Poverty and Financial Exclusion in Ireland

In 2006 6.9 per cent of the Irish population experienced 'consistent poverty'. This measure identifies those on low incomes (less than 60 per cent of median income) who cannot afford two or more essential goods or services. Over the last decade, this rate has only slightly improved. By contrast, 18 per cent of the population are deemed 'at risk of poverty' - that is living on less than 60% of median income.

The current economic crisis is responsible for the country falling into recession for the first time since the 1980s. The Irish government officially announced it was in recession in September 2008, with a sharp rise in unemployment occurring during the following months. The number of people claiming unemployment benefit in Ireland has risen to 12.7 per cent in February 2010. Of the countries I visited, Ireland appeared to be experiencing the most acute hardship.

There is however limited data on how many people within these groups actually suffer from financial exclusion. Surveys have found that over one quarter of households/individuals in Ireland are without a current account and 10 per cent of individuals are without any type of bank account.

Irish Financial Services Sector

The Irish banking sector is a major contributor to the local economy, contributing €18.2 billion, or about 9.6 per cent, of the gross value added/gross domestic product of the Irish economy in 2007. The retail market is dominated by a small handful of players (AIB, Bank of Ireland, Halifax, National Irish Bank, Permanent tsb, Ulster Bank Group)

After a period of rapid economic prosperity (1997 – 2007), Ireland has suffered an estimated GDP contraction of 14 per cent in 2010. The banking sector has been badly hit and has required government support. According to the Spring 2010 Quarterly Economic Commentary; the recapitalisation needs of the Irish banks are now likely to be at least €33 billion, assuming that the State investment in Anglo Irish Bank ultimately amounts to €22 billion

Traditionally, credit unions served the needs of low income consumers, however in recent times they too have not always lent responsibly and are suffering financially as a result.

Ireland also has a growing fringe lending sector. Those operating legal businesses have their interest rates capped at 200% APR (this is specifically to regulate small payday loans). There is anecdotal evidence of illegal lending practices, however no data exists on the size of this sector.

Irish Government and Regulatory Context

The Financial Regulator was established in May 2003 to regulate and provide financial services in addition to helping consumers make informed decisions about their personal finances. As a result of the losses incurred by the financial sector, the Irish government is in the process of reviewing the entire regulatory regime. It is too early to predict whether this will result in a more prescriptive system.

The Citizens Information Board is the statutory body which supports the provision of information, advice and advocacy on a broad range of public and social services. It provides the Citizens Information website which supports a voluntary network of Citizens Information Centres, as well as funding MABS.

It is also important to note that in Ireland, not paying a debt is legally a jailable offence. Although it is expected that this will be reviewed and changed in the future, it has been an impetus for government to work with the financial services sector to keep these matters out of courts and gaols. MABS has been instrumental in developing a protocol for resolving debts with the financial services sector to prevent legal proceedings.

Observations

Pedagogically sound training of advisors – MABS spends much time and effort in training its advisors so that they are equipped with the best educational tools and techniques when training people to develop financial skills, whether in a group or one-on-one. This ensures that the RIGHT message in the simplest form is passed on. The training also looks at the behaviour relationship people have with money, not just the technical details of products or budgeting. MABS is in the process of having their training formally accredited by a local university.

Understanding regional needs is essential to effective service delivery – through the debt counselling service MABS electronically collects client demographic and indebtedness data. The service uses this data to develop local profiles and tailor the delivery of education and advice. For example, in one location MABS identified a series of single mothers with debt issues. As a result a support group involving a local community agency, then in collaboration with MABS, offered basic budget training. The localisation of data ensures targeted responses; there is no point offering education when the problem is actually a lack of income or substance abuse. It also allows advisors to identify local players such as payday lenders, and be able to provide clients with practical solutions.

Maintaining impartiality by not offering financial products - MABS had decided that directly offering financial products would compromise their debt advisory capacity. They do however at times provide guarantees on behalf of their clients to other financial institutions. The client is often unaware that this has taken place as the arrangement is directly between MABS and the financial institution (often a credit union).

Target messages to different life stages – the education programs and advice always makes sure that the message is tailored to an individual's life stage, whether that be to young adults, families or retirees. Individuals must personally relate to the message otherwise nothing will change. In addition, MABS requires that all clients record their expenses for a week so that they can better understand their own behaviour.

Face to face counselling most effective – MABS offer a telephone line which does some of the initial triage, however for those on very low incomes or in significant hardship, MABS always requires a face-to-face interview. Face-to-face interviewing allows the advisor to better understand the circumstances and tailor the advice. It also increases the likelihood of the client taking action. It is however always clearly articulated that the advisor is just that, an advisor, and that the client is responsible for their own financial situation.

Clearly branded service – being an entity that carries its own brand that is neither community, government nor private, is powerful. This independence has allowed MABS to be significantly profiled in the media, as well as take on a strong advocacy role on issues relating to financial inclusion. This profile also gives clients the confidence that the service is independent and genuine.

Understanding Poverty and Financial Exclusion in the UK

The latest national statistics on Households Below Average Income (HBAI) produced by the Department for Work and Pensions were released on 7 May 2010. HBAI is defined as 60 per cent of the median UK income after housing costs have been paid.

The HBAI survey shows that 13.5 million people in the UK (23 per cent) are income poor. This is about one fifth of the population. Of those 13.5 million people:

- 53 per cent are in households which include at least one child
- 34 per cent are in households of people who are of working age with no children
- 13 per cent are pensioners.

HBAI has been on the increase and it is expected that the situation will have worsened in the current economic downturn, given that since 2008 unemployment has increased to 8 per cent¹² as at February 2010.

In addition, 2005 research by Devlin¹³ suggests that approximately 7 per cent of households have no current account and an additional 20 per cent live on the margins of financial services. As a result, a fringe lending sector has steadily grown to meet those excluded.

UK Financial Services Sector

The UK is the world's largest international banking centre, operating some 150 million accounts and contributing £50 billion annually to the UK economy¹⁴. For the decade until 2006, banking and finance growth had outpaced all other business sectors¹⁵ and it was estimated that it contributed 9.4 per cent to the UK's GDP. Since 2007 things have slowed down and following

the US, several UK banks showed signs of failing. In order to stop a complete collapse of the sector in October 2008 the UK government was forced to make £400bn available to rescue the banking system. The bail out was to initially make extra capital available to eight of the UK's largest banks and building societies, in return for preference shares in them¹⁶. Since then the sector has further consolidated, leaving five key players. It is still too early to really understand the full economic impact of these changes and what this means to low income consumers.

The UK also has an active CDFI sector offering finance for business, personal and social enterprises. All CDFIs use the income from lending activity for their running costs and loan offerings. They combine this with funding from a range of additional sources. Many are part-funded by Government departments and agencies, as well as the private sector and trusts.

The CDFA¹⁷ is the UK trade association for CDFIs and has for the last six years released an annual report on the state of the sector. The 2009 report 'Inside out -weathering the storm' found:

- CDFIs had made nearly 11,000 loans in 2009, compared to around 8,400 the previous year. The total value lent has increased by 50 per cent, from £76 million in 2008 to £113 million in 2009
- Demand for finance increased by £160 million – to £360 million this year; CDFIs were able to serve only one-third of this demand
- Loan/investment portfolios grew by 19 per cent in 2009, to £394 million

- CDFIs report a write-off rate of 13 per cent, but many believe this will rise over the next year as the impact of the recession becomes apparent.
- For the first time, earned and investment income made up over half of CDFI income, with less reliance on grant funding

UK Government and Regulatory Context

Financial inclusion has been on the UK government agenda for many years and in many respects the research and work done in the UK has led global thinking in this area. Under the current government, the area of financial inclusion falls under the jurisdiction of Treasury.

Since 2003 Treasury have had a Financial Inclusion Action Plan with a main aim of ensuring that all have access to appropriate financial services. In 2008 a second action plan was launched 'Financial inclusion: an action plan for 2008-11' which outlines how the Government will use the £130 million Financial Inclusion Fund to achieve its financial inclusion objectives from April 2008 to March 2011.

The Financial Services Authority (FSA) is authorised to deliver the Action Plan on behalf of the government. The FSA is the main statutory regulator for the UK financial services industry (and some of the larger CDFIs).

In April 2010 the FSA established the Consumer Financial Education Body (CFEB), an independent body designed to help consumers understand financial matters and manage their own finances better. Moneymadeclear.com is a website run by CFEB providing clear and impartial information on how to best manage your finances; from divorce to understanding credit.

12 Office for National Statistics - <http://www.statistics.gov.uk/ci/nugget.asp?ID=12>

13 Devlin F J., (2005) A Detailed Study of Financial Exclusion in the UK, Journal of Consumer Policy

14 British Bankers Association

15 National Statistics Economic and Labour Market Review

16 Abbey, Barclays, HBOS, HSBC, Lloyds TSB, Nationwide Building Society, Royal Bank of Scotland, Standard Chartered

17 <http://www.cdffa.org.uk>

The FSA also helps fund many organisations to deliver programs that increase financial inclusion.

With a Conservative coalition coming into power, there is some discussion as to whether the FSA will remain a standalone entity and how the banking sector will be regulated in future.

Observations

Focus on respectful customer service

Considering the customer is core to the Fair Finance model and a key differentiator between themselves and other financial service providers. This focus is seen throughout the model from the simplicity in marketing collateral, to the outlet layout as well as staff training and development; the focus is on better understanding customer needs and providing a respectful service.

Being ethical does not mean you are not commercial – Fair Finance is clearly aware that if they wish to operate an affordable service, they need to manage a focused business, minimising all costs. As such they have ambitious loan volume targets for lenders, in addition to careful management of arrears and commencing legal proceedings on debts outstanding for more than 180 days.

Build a strong and passionate team – Fair Finance is well aware that their services straddle the financial and community services sectors whilst only offering community sector wages. The organisation thus focuses not only on developing individual skills but also on creating an environment with strong values and a focus on advocacy. By engaging individual passion, the commitment to the work becomes ‘more than a job’ and helps deliver a high quality service.

Strong public and advocacy profile – For a small operator, Fair Finance has a large profile within the UK and internationally. This is largely due to the Director Faisal Rahman taking an active role in advocating on behalf of financially excluded consumers, and ensuring that issues are brought into the open as much as possible. Fair Finance is regularly profiled in the media and Faisal writes a monthly column in the Guardian that provides commentary on social welfare and banking issues whilst drawing upon very real client stories. Not only does this give Fair Finance a public presence, but it also helps drive employee passion, and gives the broader community an opportunity to engage with, or at least understand, the issues.

Loan capital is difficult to secure – Fair Finance is looking at expanding their current business across London however access to loan capital is currently a constraint. They have estimated that they could service much of London with additional capital of £3 million. Although some funds have been secured to date, capital is not easy to access.

Capacity building of the community of sector is necessary – we are increasingly asking the community sector to become involved in business initiatives, yet many do not have the requisite finance, business and governance skills to operate efficiently. UK institutions are currently working with the banking sector to try and take advantage of skilled volunteering opportunities to help share skills across sectors.

One-on-one counselling is most effective in behaviour change – again Fair Finance and the Financial Inclusion Centre both reiterate the importance of individual client consultation. Recent research on financial capability highlights that financial literacy programs tend to have limited impact if offered on their own.

Limited research on financial capability outcomes – research has just been completed on financial inclusion and financial capacity, however there is currently limited data available to assess whether various programs make a difference to the individual in the long term. One short term study on financial capability found little long term improvement. More rigorous research on program effectiveness is needed to better understand the impact on low income consumers.

The issue of financial inclusion is too important to be left to self regulation – the Financial Inclusion Centre are advocating for the introduction of legislation to manage financial inclusion. It is believed that the impact of financial exclusion is so great that it is essential to ensure that formal mechanisms are put in place. All consumers should be able to access a minimum standard in banking services. Given the recent UK election results it is unlikely that such a proposal will proceed under a conservative government.

Deposits should be a mainstream responsibility whilst credit should remain a responsibility of the community sector – Although credit can be easily offered by the non-banking sector, regulation around deposits is such that many such institutions cannot offer such services, meaning that within the market there is a strong split between credit and deposits. Furthermore, there is an argument that perhaps the ‘mainstream’ market should not be burdening shareholders with the high cost of offering credit alternatives.

Recommendations and Conclusion

Relative to the US, UK and Ireland, Australia has, on the whole, less people who suffer from financial exclusion. This is largely due to:

- The Australian social welfare system
- Regulation of the financial service sector (eg prohibition of 'black-listing' people from accessing a transaction account or offering sub-prime loans)
- Existence of a minimum wage
- Mainstream banks being actively involved in developing appropriate products and services
- Centerlink requiring a bank account for the payment of benefits

However this does not reduce the personal hardship that is faced by those who are excluded. Furthermore, community finance initiatives in Australia are unlikely to become financially sustainable given that we do not have the population to really achieve economies of scale and are geographically disbursed.

Based on my experiences overseas, I recommend that for low income consumers to have the greatest likelihood of developing positive financial habits, the following changes should be considered:

Structural level

- **Federal Treasury/ASIC consider financial exclusion as part of their mandate** to ensure that affordable and diverse market-based products and services can be developed. The focus needs to be on changing some regulatory constraints, offering incentives as well as actively funding initiatives. This market segment is not self-sustaining and will only flourish through strong government support. The alternative is a growing fringe market that maintains financial viability through either predatory practices or high interest rates.
- **The capacity and skills of the not-for-profit sector needs to be enhanced** if it is to successfully offer financial services to low income earners. Skills that are essential to effectively meet consumer needs are often limited (marketing, finance, customer service, IT). Services need to be professional and fast which can at times be unrealistic when working with organisations staffed by volunteers.
- **Need for research to measure whether initiatives are actually resulting in sound financial outcomes** either in the short or long term. Not all programs will result in positive change. It is important that we begin to map out what works locally, who is most impacted and whether there are flow-on effects to other members in the household. This will allow targeted and effective future investment.

Product/service level

- **Innovation in incentivised savings schemes** – whatever the means; whether Individual development accounts, government bond savings programs, tax refund saving schemes or prize to win programs, low income people can save in the short term if supported. These programs provide important safety nets for people who often live on the financial fringe.
- **Innovation and diversity in credit products** – one size does not fit all. There is a need to develop a diverse and dynamic suite of programs for the local market. Without alternatives, people will continue to be drawn to high cost fringe lenders.

Low income consumer behaviour change

- **One-on-one counselling is most effect** – experience in the US, Ireland and UK suggests that individual counselling results in the greatest level of behavioural change as individuals' specific circumstances are considered.
- **Financial education is most effective when coupled with an appropriate product offering** – US and UK experiences strongly suggest that it is essential to couple financial education with an appropriate product (loan or savings program). This increases the attractiveness to clients and leads to better outcomes.
- **Ensure that financial education can be understood by target consumers** through the development of practical and pedagogically sound financial information. Workers need to be trained to share clear and simple messages.

References

Indigenous specific comments and conclusions

Although there are strong commonalities in the experiences of all indigenous people, the socio-economic gap between indigenous Australians and the general population appears to be greater than in the US and Canada. As a consequence, the impact of financial exclusion whether due to lack of income, geographic isolation or poor English language skills, only further exacerbates this socio-economic divide.

Based on my observations overseas I recommend that:

- We understand that **effective and sustainable financial inclusion will take time** – the Bank of Montréal has taken 18 years to achieve their work to date, and they expect the journey to take another hundred years.
- **Non-profit services such as retail offerings, financial literacy and banking outlets need to be cross-subsidised** by profit making activities for these communities.

Going back to my work at NAB I will endeavour to share my experiences with key stakeholders from senior bank management to government and those involved in grassroots service delivery. Together we can refine our microfinance offerings to ensure that we are able to serve as many low income Australians as possible with a specific focus on the needs of indigenous consumers.

1. Altman J.C., Biddle N. and Hunter B.H. (2008) *How realistic are the prospects for 'Closing the gaps' in socioeconomic outcomes for Indigenous Australians?*, Centre for Aboriginal Economic Policy Research, The Australian National University
2. Armina Ligaya, Debate about Canada's Poverty Line (2007) <http://www.cbc.ca/news/background/economy/poverty-line.html>
3. Devlin F J., (2005) *A Detailed Study of Financial Exclusion in the UK*, Journal of Consumer Policy
4. Im L.and Busette C. (2010) *What Motivates Low Income Earners to Save Money?* Earn Research Brief.
5. Maynard, Nick and Zinsmeyer Jeff, *The Mind of Low to Moderate Income Savers*, D2D Fund Inc
6. NYC Department of Consumer Affairs - Office of Financial Empowerment, *A Progress Report on the First Three Years, 2006-2009*
7. Office for Social Inclusion – Ireland <http://www.socialinclusion.ie/poverty.html>
8. Pickering, Kathleen Ann (2004), *Lakota Culture, World Economy*, University of Nebraska Press
9. *Solving Native Poverty In Canada* (2005) <http://www.angelfire.com/on4/markis/politics/native.htm>

Appendix 1 - Organisations visited

OWEESTA Corporation

Rapid City, South Dakota, USA

OWEESTA was established in 1999 and is a Native community development financial institution (NCDFI) that is focused on helping Native American people accrue assets through the establishment of strong, permanent institutions and programs, contributing to economic independence.

OWEESTA is involved in:

- Support and development of Native Community Development Finance Institutions
- Training to help native organisations build their capacity to promote financial management skills and asset building
- Training to assist native organisations develop programs that can support entrepreneurs and enterprise development
- Policy and advocacy for Native Americans in the areas of financial literacy and the provision of appropriate financial services

OWEESTA's outcomes (since 2003):

- has helped 4 certified native CDFIs with over 60 more in the pipeline
- facilitated 498 training programs on financial literacy, with 33 financial education programs operational and 34 in the pipeline and 22 Native IDA programs in existence with an additional 28 in the pipeline
- run 23 training programs on entrepreneurship and enterprise development

OWEESTA is primarily funded by the Federal Government through the CDFI Fund but also receives funds from a variety of private companies and foundations.

For more information: <http://www.oweesta.org>

NYC Department of Consumer Affairs – Office of Financial Empowerment

New York City, USA

The Office of Financial Empowerment (OFE) is the first local government initiative in the US aimed at educating, empowering, and protecting those on low incomes, so they can build assets and make the most of their financial resources. OFE is implemented under the Centre for Economic as part of Mayor Bloomberg's efforts to fight poverty in New York City. More than 14.5% of working New Yorkers (nearly 750,000 adults) are living at or below the US poverty threshold¹⁸.

OFE experiments through leveraging partnerships, implementing innovative solutions, and targeting enforcement powers to support New Yorkers with low incomes. In the following areas:

Education:

- Launching and coordinating large-scale public awareness campaigns - including the Earned Income Tax Credit (EITC) Coalition Campaign which was a multi-media campaign distributing two million brochures in 12 languages throughout New York City.
- Establishing a dynamic network of financial education providers.

Empowerment:

- Identifying and implementing innovative asset-building practices - OFE partners with the City's many financial institutions to pilot safe and affordable products and services, including structured banking programs, such as the Opportunity NYC Basic Account and \$aveNYC Club Account, at the same time conducting rigorous research studies to evaluate their impact and capacity for scale.

Protection:

- Protecting New Yorkers with low incomes from unfair and predatory practices

Located within the Department of Consumer Affairs (DCA), OFE helps target strategic enforcement work to protect New Yorkers with low incomes from predatory and deceptive practices, including initiatives in debt collection, used car sales, and tax preparation. OFE coordinates both its enforcement and advocacy efforts with DCA's public awareness and education campaigns

Since inception in 2006, OFE has provided services to 114,380 clients. 51% earned less than \$10,000 pa. The majority are women and the average age is 44 years. 40% of clients were Hispanic, 37% black and 12% Asian or Pacific Islanders¹⁹.

For more information: <http://www.nyc.gov/ofe>

18 2008 – The CEO Poverty Measure: A working paper by the New York City Centre for Economic Opportunity

19 NYC Department of Consumer Affairs Office of Financial Empowerment – a Progress Report on the first Three Years 2006-2009

Alternatives Federal Credit Union

Ithaca New York State

Alternatives Group is made up of five businesses. The main business, Alternative Federal Credit Union is a community development financial institution that operates as a credit union.

Established twenty-four years ago, Alternatives offer both mainstream financial services as well a variety of community development programs that focus on both the personal and business needs of low income consumers. The organisation is focused on meeting local needs and very much promotes buying local and supporting local businesses.

The community development work is undertaken by one of the affiliates in the Alternatives Group and offers:

- Business literacy and mentoring programs
- One-on-one budget and financial counselling services
- An IDA program (matched savings) coupled with extensive financial literacy
- Not for profit support
- Taxation support program

For more information:
<http://www.alternatives.org>

Grameen America

New York City USA

Established since 2008, Grameen America is a microfinance non-profit organization that provides loans, savings programs, and other financial services to entrepreneurs living below the poverty line in the United States. Currently Grameen runs four branches – three in New York City and one in Omaha, Nebraska

Based on the work of Professor Yunus in Bangladesh, Grameen operates peer-lending models to empower clients achieve financial independence.

As of February 28th, 2010, Grameen America has disbursed over \$5 million in loans to 2,500 borrowers and maintains a repayment rate of over 99%.

For more information:
<http://www.grameenamerica.com>

D2D Fund Inc

Boston, Massachusetts, USA

Doorways to Dreams (D2D) is a small think tank (not for profit) that seeks to expand access to financial services to low-income families by creating, testing and deploying innovative financial products and services.

D2D emerged from research conducted in the late 1990s by Harvard Business School professor and Senior Associate Dean, Peter Tufano. In his study of financial innovation, Peter noted an emerging policy trend to provide structured incentives for saving and asset building by low-income families.

To date D2D has:

- developed financial literacy computer games or as they call it 'financial entertainment'
- an automated 'dashboard' to help low income families visualise and support them when making financial decisions
- innovative savings schemes – matched savings, savings bonds, prize linked savings, split savings and Online IDAs
- published research findings

For more Information:
<http://www.d2dfund.org>

Department of US Treasury

Washington DC, USA

The Treasury Department is the executive agency responsible for promoting economic prosperity and ensuring the financial security of the United States. The Department is responsible for a wide range of activities such as advising the President on economic and financial issues, encouraging sustainable economic growth, and fostering improved governance in financial institutions.

In particular Treasury are focused on:

1. Restoring confidence in U.S. financial institutions
2. Restarting markets critical to financing American households and businesses
3. Addressing housing market problems and the foreclosure crisis

The Treasury Department is also responsible for the activities of the Community Development Financial Institutions Fund (the CDFI Fund) which operates as a standalone agency. The CDFI fund provides funding for CDFIs as a way of ensuring that people have access to affordable credit, capital and financial services.

Since its creation, the CDFI Fund has awarded \$1.11 billion to community development organisations and financial institutions.

For more information:
<http://www.ustreas.gov>

Bank of Montreal (Aboriginal Banking Unit)

Canada

The Bank of Montreal is one of the largest Canadian banks with revenue of \$11.1 billion in 2009, 36,200 full time equivalent employees and a domestic branch network of 900 branches.

The bank's Aboriginal Banking Unit was created in October 1992 to contribute to the economic self-sufficiency of Aboriginal peoples across Canada. The aim of the unit is in partnership with Aboriginal communities develop and deliver to businesses and individuals a comprehensive range of financial products and services. 13 branches and community outlets operate in native communities offering both mainstream and a variety of native home ownership products some of which are backed by government. The bank is also involved in the provision of funds for reservation infrastructure financing it as well as the management of first nation's investments.

As at 2009, the total amount of business the Bank of Montreal was doing with Aboriginal peoples, businesses and communities had grown to more than \$1.4 billion.

The broader bank is also involved in

- An aboriginal employment program
- Supporting the University of Calgary's Aboriginal Lynx program which works with Aboriginal students throughout their academic careers to ensure a smooth transition from university to employment.
- The Ron Jamieson Scholarship and Internship Program, which provides paid summer internships for Aboriginal students.

For more information:
<http://www.bmo.com>

Money Advice & Budgeting Service (MABS)

Dublin, Ireland

The Money Advice & Budgeting Service or MABS was created in 1992 the government of Ireland following the release of a 1988 report "Moneylending and Low Income Families". MABS is a free and confidential service for people with debt problems and money management problems. There are 53 MABS services in Ireland, staffed by trained Money Advisers. Money Advisers will:

- Work on existing debts and help prepare a budget
- Ensure that all income entitlements have been secured
- Contact creditors with offers of payment

The government currently invests €2.9 million in MABS

In 2009, 22962 individuals used MABS services.

For more information:
<http://www.mabs.ie>

Fair Finance

London, UK

Established in 2004, Fair Finance is a social business based in London that offers a range of financial products and services designed to meet the needs of people who are financially excluded. Operating out of four East London locations and employing a team of 18 personnel, Fair Finance is trying to demonstrate that personal and business lending can be done at an affordable rate whilst supporting a sustainable business. In addition, the Managing Director of the organization is a strong advocate for ensuring that that financial exclusion as social policy issue is better understood.

Since 2004 Fair Finance has written a total of 2,178 loans to the value of £2,039,800. 92.6% of these loans were for personal purposes.

For more information:
<http://www.fairfinance.org.uk>

Financial Inclusion Centre

(London UK)

The Financial Inclusion Centre is an independent, not-for-profit think-tank that promotes financial inclusion of consumers through fair and inclusive but well-governed and accountable financial markets.

The Centre supports this work through:

- research and analysis to better understand the extent of financial exclusion as well as consumer behaviour and regulatory effectiveness
- developing and implement strategies and programs in partnership with other agencies for combating financial exclusion
- advocacy
- building capacity in the third-sector to help it play a more effective role in meeting the needs of excluded and marginalised consumers

The Centre is funded through revenue from projects and consultancy activities.

For more information:
<http://www.inclusioncentre.org.uk>

