

I have a dream....

(Paper on regulatory possibilities to address financial exclusion and foster a CDFI industry in Australia, presented to the Australian Microfinance Network on Friday 28 November by Therese Wilson, Senior Lecturer, Griffith Law School)

Introduction

In this paper I will outline the current state of microfinance activities in the third sector in Australia, which operate on a small scale and do not provide effective competition with the high cost, exploitative forms of credit available to low income Australians. The focus will be on small, community-based credit unions, community development financial institutions and community organisations.

This will be compared with the third sector in the US and UK, where supportive regulatory regimes have placed these organisations in a far better position to assist governments in effectively addressing financial exclusion.

The paper will conclude with recommendations for regulatory reform in Australia.

Microfinance in the third sector in Australia

Small, community based credit unions

Regulatory pressures arising out of ‘one size fits all’ regulation for Authorised Deposit Taking Institutions in Australia have driven many credit unions to merge and effectively become quasi-banks in order to survive. Notwithstanding that, some small, community-based credit unions have managed to survive in their original form, and have made significant contributions to the financial well-being of their communities and to the financial inclusion of low-income consumers in those communities.

Fitzroy and Carlton Community Credit Union, situated in the inner northern suburbs of Melbourne, Victoria, started in 1977 in the back of a pizza shop, with money literally going in and out of a cardboard box. It currently has 4500 people who bank with it and 80 per cent of its customers are welfare recipients. The General Manager

of Fitzroy and Carlton says that the credit union primarily services disadvantaged and low-income people in the community- people who would otherwise be excluded from access to financial services, particularly small, low-cost loans.¹ The credit union provides small loans to members (who have to have been banking with the credit union for three months before being eligible for a loan) for such things as whitegoods, clothes, rent, bonds and cars. The credit union also offers a budget service at a cost of \$10 per month, under which the credit union works out a budget for its members and attends to payment of bills for customers out of their accounts, so that they know that what is left in their account is available for spending. The General Manager of the credit union has observed that someone receiving \$400 per fortnight in welfare benefits will find it extremely difficult to save in order to improve their position. On the other hand, by being given a small loan (always by way of third party cheque and never by cash) and receiving the support of the credit union in terms of budgeting, people are actually able to achieve goals and improve their positions.²

Fitzroy and Carlton makes no money from its members, but manages to meet regulatory requirements including capital adequacy requirements which will be discussed below, by means of an innovative model. It provides book-keeping and payroll services to community organisations at break-even cost. The community organisations in turn invest their government grants with the credit union at call. Fitzroy and Carlton derives an income for itself through the investment of those funds.³ There is no doubt that a credit union such as this could benefit greatly from regulatory structures such as those in the US and UK, which encourage external investment in, or provide government funding for, 'community development credit unions' or 'low income credit unions'.

Similarly to Fitzroy and Carlton, the Macaulay Credit Union was established in the late 1970s to provide a savings and loans service to low income earners denied access to mainstream services. Its priorities were stated to be "providing services and modern affordable banking to low-income families and non-profit organisations".⁴

¹ Fitzroy and Carlton Community Credit Union interview.

² Fitzroy and Carlton Community Credit Union interview

³ Fitzroy and Carlton Community Credit Union interview.

⁴ Macaulay Credit Cooperative, *Welcome to Macaulay Community Credit Cooperative Limited* (2007) <<http://www.macaulay.com.au>> at 30 August 2007

Unfortunately, it was unable to survive current regulatory conditions and has now become a part of MECU, Victoria's largest credit union.⁵ The explanation for the transfer to MECU was that:

Following discussions with the Australian Prudential Regulatory Authority (APRA) and CUSCAL (the Credit Union peak industry body) the Board of Macaulay Community Credit Cooperative Limited has been in negotiations with MECU to arrange a transfer of business...The Board of Macaulay recognised that increased competition and a more challenging regulatory environment in the Australian financial services sector has heightened the need for it to ensure the long term sustainability of the credit union...⁶

Unlike the stated priorities of Macaulay, the web site of MECU, while espousing a commitment to 'low cost, socially and environmentally responsible' lending, does not anywhere refer to a commitment to lending to people on low incomes.⁷

Another credit union which is very different to Fitzroy and Carlton, but which has nevertheless managed to maintain its small community-based focus and survive, is the Maleny Credit Union (MCU) in Queensland. It commenced operations in 1984 when a group of people from the local community got together and pooled resources to form the credit union, which was initially staffed by volunteers. Its Operations Manager in 2006 referred to the MCU's members as 'very loyal' to the credit union, and as viewing the credit union 'very much as their credit union'. The MCU lends to welfare recipients in the community. The Operations Manager noted that 'a lot of banks wouldn't lend to them and the credit union has always been there to support and assist them.'⁸ Unlike Fitzroy and Carlton, MCU is situated in an area with a diverse range of wealth, and has had no difficulty in attracting investment from its membership in order to assist it in meeting capital adequacy requirements.

⁵ MECU, *What happened to Macaulay Credit Co-op?* (2008) <<http://www.mecu.com.au/About-mecu/News-and-Media/Macaulay-Community-Credit-Cooperative-Ltd-has-transferred-business-to-mecu-Ltd.html>> at 5 November 2008

⁶ MECU, *What happened to Macaulay Credit Co-op?* (2008) <<http://www.mecu.com.au/About-mecu/News-and-Media/Macaulay-Community-Credit-Cooperative-Ltd-has-transferred-business-to-mecu-Ltd.html>> at 5 November 2008

⁷ MECU, *Loans* (2008) <<http://www.mecu.com.au/Borrowing/Loans/Overview.html>> at 5 November 2008

⁸ Maleny Credit Union interview

Additionally, the MCU was able to raise over \$1 million in December 2005 by an issue of preference shares. Its general manager at the time, John Ford, said that notwithstanding the issue of preference shares, the member focus of the credit union was able to be maintained through only making the issue available to existing members, and through attaching no additional voting rights to the shares.⁹

Unlike Fitzroy and Carlton, credit unions which have formed more recently in order to address communities' financial needs, have not been able to do so with a cardboard box in the back of a pizza shop. The hurdles associated with obtaining a licence to operate as an ADI, which will be discussed below, have meant that considerable external support is required. The Traditional Credit Union was incorporated in December 1994, with initial capital of \$147,000 from the Arnhem Land Progress Association, a grant of \$400,000 from the Aboriginal and Torres Strait Islander Commission and \$28,000 from the Northern Territory government.¹⁰ The Traditional Credit Union has branches in remote parts of Australia and serves a membership predominantly comprising indigenous people on low incomes. Its services include savings, budgets and Christmas club accounts, clan accounts for joint saving, personal loans of up to \$10,000 and small business loans of up to \$15,000. The anecdotal evidence is of economic renewal and positive improvements to members' lives through the availability of these services.¹¹

Another example of credit unions working to improve access to financial services is through the Creditcare initiative, which commenced in July 1995 and continued until 2000. It was a joint initiative of the Commonwealth government and Credit Union Services Corp (Australia) Limited (CUSCAL), and was:

⁹ Michael Walsh, 'What's Happened to my Credit Union?' (2006) 57 *Ethical Investor* 10, 12.

¹⁰ Neil Westbury, 'What's In It for Koories? Barwon Darling Alliance Credit Union and the Delivery of Financial and Banking Services in North-West New South Wales' (Working paper no 7/2000, Centre for Aboriginal Economic Policy Research, 2000), 28.

¹¹ Bev McMillan, *Traditional Credit Union- Access to Financial Services* (undated) <http://www.indigenousforums.nt.gov.au/dcm/indigenous_policy/forums/pdf/Bev%20McMillan.pdf> at 17 June 2005

...established to help rural communities help themselves re-establish financial services, where access to these had been lost through bank closure, by attracting a 'host' institution, ordinarily a credit union, to a town.¹²

Under the program, cooperative ventures were developed between local councils and credit unions, whereby the council would provide such support as rent-free or subsidised premises, and the credit unions would establish a branch in that local area. Credit unions were seen as the best form of financial institution to achieve the program's goals, given that:

...a credit union is a democratic 'self help' institution whose primary purpose is service to member-owners, not profit in pursuit of self-interest.¹³

The involvement of credit unions in such a program was regarded by some as 'a return to credit union traditional roots, addressing financial needs through cooperative ventures at the community level.'¹⁴ It is the mutual natures of credit unions, at least in the case of small community based credit unions, which perhaps makes them so well suited to addressing financial exclusion.

A fledgling CDFI

Foresters Community Finance Limited models itself on the CDFI model as that model is understood in the UK.¹⁵ The CDFI defines CDFIs as follows:

CDFIs are independent financial institutions that provide finance and support to help individuals and organisations develop and create wealth in disadvantaged communities or under-served markets. Community development finance delivers innovative financial products primarily aimed at

¹² Gary Lewis, 'Laughing All the Way to the Credit Union' (Australian Centre for Cooperative Research and Development, 2001) , 1.

¹³ Gary Lewis, 'Laughing All the Way to the Credit Union' (Australian Centre for Cooperative Research and Development, 2001) 16.

¹⁴ Gary Lewis, *People Before Profit: The Credit Union Movement in Australia* (1996), 343.

¹⁵ Foresters Community Finance Limited interview

entrepreneurs in disadvantaged areas, but also addressing increasing personal debt in poorer communities.¹⁶

Much of the lending undertaken by CDFIs is microenterprise, or business, lending, however many CDFIs also engage in personal microfinance.¹⁷ Members of the CDFFA are predominantly what one would call a 'social enterprise'. There are various definitions of 'social enterprise', including:

An organization that is driven by particular social and community values, whilst aiming to operate effectively and sustainably within a competitive business framework i.e. helping the community as well as maintaining a viable business.¹⁸

...the use of nongovernmental, market-based approaches to address social issues...an increasingly popular means of funding and supplying social initiatives...¹⁹

Social enterprises- defined simply- are organisations seeking business solutions to social problems.²⁰

Essentially, for the purposes of this paper, social enterprises will be defined as 'third sector' organisations in the sense that they are both not-for-profit and non-governmental, which generate some or all of their own funding through business enterprise. Importantly, the profits as a result of that enterprise are not paid to business owners or shareholders, but rather are used to support the organisation's social purpose or mission. They have alternatively been referred to as 'social purpose organisations', which are 'nonprofit organisations engaged in mission-supporting

¹⁶ Community Development Finance Association, 'Annual Review: Building Community Development Finance' (2008), 1.

¹⁷ Community Development Finance Association, 'Annual Review: Building Community Development Finance' (2008)

¹⁸ Janelle Kerlin, 'Social Enterprise in the United States and Europe: Understanding and Learning from the Differences' (2006) 17 *Voluntas* 247, 250 quoting the West Midlands Social Economy Partnership.

¹⁹ Janelle Kerlin, 'Social Enterprise in the United States and Europe: Understanding and Learning from the Differences' (2006) 17 *Voluntas* 247, 247.

²⁰ John Thompson and Bob Doherty, 'The Diverse World of Social Enterprise' (2006) 33(5/6) *International Journal of Social Economics* 361, 362.

commercial activity'.²¹ Importantly, and unlike most business enterprises where support for social ends can generally only be justified on the basis of corporate social responsibility, in the case of social enterprises:

Social ends and profit motives do not contradict each other, but rather have complementary outcomes, and constitute a 'double bottom line'.²²

This is about so much more than corporate social responsibility, in the sense that the social enterprise's whole rationale for existence is its social purpose. Social enterprises constitute the:

... growing number of creative enterprises that focus on the public good as part and parcel of their business mission.²³

Not all 'third sector' organisations are social enterprises, in the sense that many third sector organisations are community organisation that rely on government, industry or philanthropic funding, and do not generate their own income to any significant extent.

A key benefit of the social enterprise model is the ability to be less reliant on external sources of funding, and so less vulnerable to political or economic changes, such as a change in government and in government policy; a change to the CEO or board of directors of a corporation that had previously been sympathetic to and financially supportive of a particular organisation but which is no longer; or a change in economic environment making philanthropic funds more difficult to source. It is the social enterprise based, CDFI model which offers the greatest opportunity for sustainability and scale in offering safe, affordable small amount finance, because of its decreased reliance on external sources.

There are contradictory views as to the ability of CDFIs to make microfinance activities in developed countries fully self-sustaining without external support. There

²¹ Janelle Kerlin, 'Social Enterprise in the United States and Europe: Understanding and Learning from the Differences' (2006) 17 *Voluntas* 247, 247.

²² Nelarine Cornelius et al, 'Corporate Social Responsibility and the Social Enterprise' (2008) 81 *Journal of Business Ethics* 355, 355.

²³ Jim Hightower and Susan DeMarco, *Swim Against The Current: Even a Dead Fish Can Go with the Flow* (2008), 29.

is a view that financially sustainable microfinance models in the developed world will not be possible,²⁴ although CDFIs should continue to strive for financial sustainability²⁵ and may be able to do this through cross subsidisation of activities that is, engaging in more profitable activity to support microfinance work.²⁶ Contrary to this, Faisal Rahman, CEO of Fair Finance UK, expresses confidence that Fair Finance's small amount lending will be financially sustainable within the next five years.²⁷ Fair Finance describes its social purpose in the following way:

Fair Finance exists to bring affordable loans and money advice within reach of poor people in the East End. Low-income families and minority communities are most at risk of exploitation. Clients typically have bad or no credit history and may not even have bank accounts. Fair Finance bases its assessments on ability to repay rather than credit checks.²⁸

Fair Finance lends to new clients at an interest rate of 35% per annum and to existing clients at 28% per annum. Over a three year period, Fair Finance has loaned money to approximately 4500 people.²⁹ Loan amounts range from approximately £100 to £3,500.³⁰ Fair Finance provides a financial counselling service which is funded by UK housing associations; however the rest of Fair Finance's work, comprised of its lending activities, is currently self-sustaining to the extent of approximately 60% with 40% of the business still relying on government funding and charity.³¹ That said, it could be argued that the externally-funded financial counselling service provides an important role in the organisation's lending activities, assisting clients to budget,

²⁴ Interview with Michele Giddens, former chair of the CDFI and previous employee of Shorebank Corporation, in London, 2008.

²⁵ Interview with Bernie Morgan, CEO of the CDFI, in London, 2008.

²⁶ Interview with Michele Giddens, former chair of the CDFI and previous employee of Shorebank Corporation, in London, 2008, noting that this is the model used by Shorebank Corporation to support its microfinance activities.

²⁷ Presentation by Faisal Rahman at Foresters in Brisbane, 2008.

²⁸ Fair Finance UK, *Fair Finance Celebrates 1st Anniversary with Promise to Invest 1 Million Pounds to Tackle Unfair and Expensive Lending in East London*. (2008)
<<http://www.fairfinance.org.uk/mediacentre/New%20Fair%20Finance-1st%20BDAY.doc>> at 15 August 2008

²⁹ Presentation by Faisal Rahman at Foresters in Brisbane, 2008.

³⁰ Fair Finance UK, *Fair Finance Celebrates 1st Anniversary with Promise to Invest 1 Million Pounds to Tackle Unfair and Expensive Lending in East London*. (2008)
<<http://www.fairfinance.org.uk/mediacentre/New%20Fair%20Finance-1st%20BDAY.doc>> at 15 August 2008

³¹ Interview with Faisal Rahman, CEO of Fair Finance, in London, 2008.

providing an opportunity for relationship building, and thus reducing the risk of default. Rahman claims to have no problems with loan defaults, as a result of educating people through the lending process, and tailoring payment schedules to fit welfare payments. Further, Fair Finance has a flexible system where payments can be postponed if the client notifies Fair Finance as to a problem with payments that week. Rahman says that people's circumstances need to be taken into account, and if necessary, variations to the loan should be made, such as extending the loan repayment term to accommodate circumstances as they arise.³²

Shorebank Corporation is an example of a highly successful CDFI in the US, operating as a community development bank. A small part of its activities include personal microfinance, as part of its community development credit activities.³³ Shorebank commenced operations in 1973 and was profitable by 1975. It is a deposit-taking institution which uses those deposits for regeneration of the communities in which it operates.³⁴ In recent times it has been actively involved in 'rescue loans', refinancing mortgages for homeowners at risk due to subprime lending.³⁵ Shorebank's mission is:

...to provide well-designed, responsible credit and other financial products and services to lower income communities, businesses and consumers.³⁶

In 2006, Shorebank loaned more than US\$202 million in conservation loans, US\$365million in community development loans, US\$134 million in combined conservation and community development loans; and at the end of 2006 had US\$2.1 billion in total assets and an annual profit of US\$5.2 million,³⁷ reducing to US \$4.2 million in 2007.³⁸ Shorebank has not achieved these heights by focusing on personal microfinance, however it is able to sustain microfinance activities through cross-

³² Interview with Faisel Rahman, CEO of Fair Finance, in London, 2008.

³³ ShoreBank, 'ShoreBank 2007 Annual Report ' (ShoreBank, 2007)

³⁴ Jim Hightower and Susan DeMarco, *Swim Against The Current: Even a Dead Fish Can Go with the Flow* (2008), 59-62.

³⁵ ShoreBank, 'ShoreBank 2007 Annual Report ' (ShoreBank, 2007)

³⁶ Ellen Seidman, 'Testimony of Ellen Seidman, Director, Financial Services and Education Project' (Paper presented at the Committee on Financial Services, United States House of Representatives, Washington DC, 13 February 2008)

³⁷ Jim Hightower and Susan DeMarco, *Swim Against The Current: Even a Dead Fish Can Go with the Flow* (2008), 65.

³⁸ ShoreBank, 'ShoreBank 2007 Annual Report ' (ShoreBank, 2007)

subsidisation, that is, through engaging in larger scale, more profitable but still socially driven, lending and deposit taking activity.

Due to problems of financial viability, Foresters has had to put its microfinance activities on hold while it builds other areas of its business, which may in time be able to subsidise microfinance programs. The organisation certainly plans to resume microfinance lending in order to provide genuine competition for high cost exploitative lenders, in the near future.³⁹ Foresters is currently focused on building social investment products and providing finance to third sector organisations to enable them to asset build and better serve their communities.⁴⁰

Until recently, Foresters has fostered the development of savings and loans circles in Queensland, whereby small groups of people meet regularly and contribute savings to a pool (often initiated with seed funding from a community organisation). The pool is available to members of the group after a certain period of time in the form of no interest loans.⁴¹ Foresters also offered microfinance through a 'financial distress fund' which involved members of the fund making 'contributions' and then being entitled to apply for loans from the fund for certain purposes. This has been described as a 'donor contribution-based rotating loan system'⁴² and as a model that:

...enables people to have access to credit services which are non-exploitative and directed at alleviating their poverty rather than profit generation.⁴³

The key challenges currently facing Foresters in being able to provide safe, affordable credit to low income Australians, are the need to generate sufficient income from other activities to subsidise microfinance activities; to find a model of microfinance lending such as that being undertaken by Fair Finance UK, which will be at least partially self-sustaining and enable such expansion and scale of microfinance lending as to provide genuine competition in the market to exploitative high cost lenders; and

³⁹ Foresters Community Finance Limited, *Response to Today Tonight Story* (2008) <<http://www.forestersana.com.au/News/ResponsetoTodayTonightStory.aspx>> at 18 November 2008

⁴⁰ Foresters Community Finance Limited, *About Us* (2008) <<http://www.forestersana.com.au/AboutUs.aspx>> at 18 November 2008

⁴¹ Ingrid Burkett, 'Microfinance in Australia: Current Realities and Future Possibilities' (2003), 38.

⁴² Ingrid Burkett, 'Microfinance in Australia: Current Realities and Future Possibilities' (2003), 33.

⁴³ Ingrid Burkett, 'Microfinance in Australia: Current Realities and Future Possibilities' (2003), 33.

to source government or industry support to subsidise these activities to such an extent as may be necessary, at least in the initial stages of these activities.

Community organisations

The No Interest Loans Scheme (or “NILS”) was established by Good Shepherd Youth and Family Service in 1981⁴⁴ and there now exists a NILS network providing microfinance throughout Australia through 250 community organisations.⁴⁵ One example is Queensland based Kyabra Community Association, which offers a range of community services. Through its Community Finance Initiative, it is able to offer access to no interest loans to its clients accessing other services who are experiencing financial exclusion. Funding for its NILS program has until now been provided by the Brisbane City Council, the Ian Potter Foundation and a Zonta club.⁴⁶ Further funding will now be provided by National Australia Bank (“NAB”) pursuant to NAB’s recent commitment of \$10 million capital to NILS over a three year period, which forms part of NAB’s overall \$30 million commitment to microfinance in Australia.⁴⁷ This is capital for on-lending, while state governments have provided funding to assist community organisations in their states with infrastructure costs associated with providing NILS loans: the Victorian state government has contributed \$4.7 million, the New South Wales state government \$840,000, and the Queensland state government \$1.2 million.⁴⁸ NILS is a relatively well supported and well resourced microfinance program, yet it does not appear to go anywhere near meeting the needs of low income Australians for small amount personal loans. One indication of this is the growth of the fringe credit industry. A current estimate of the size of the fringe credit industry in Australia, using US market estimates and projecting them onto the Australian market, is that the ‘potential domestic market flow’ for micro-lending in Australia is likely to stand at \$10 billion in transactions annually. This means that

⁴⁴ Valerie Ayres-Wearne and Janet Palafox, 'NILS. Small Loans- Big Changes' (Good Shepherd Youth and Family Service, 2005)

⁴⁵ NAB, *No Interest Loan Schemes (NILS)* (2008)
<http://www.nab.com.au/About_Us/0,,94883,00.html> at 21 October 2008

⁴⁶ Kyabra Community Association, *Annual Report 2007* (2008)
<http://www.kyabra.org/uploaded_files/Annual%20Report.pdf> at 24 November 2008

⁴⁷ NAB, 'Corporate Social Responsibility Report ' (2006), NAB, *No Interest Loan Schemes (NILS)* (2008) <http://www.nab.com.au/About_Us/0,,94883,00.html> at 21 October 2008

⁴⁸ NAB, *No Interest Loan Schemes (NILS)* (2008)
<http://www.nab.com.au/About_Us/0,,94883,00.html> at 21 October 2008

Australian consumers, who will predominantly be low income, financially excluded consumers,⁴⁹ will be paying high costs for \$10 billion worth of credit every year. It is clear that the demand for small amount, non-mainstream personal loans far exceeds the current capacity of charitable schemes such as NILS to meet that demand based on current available capital in the vicinity of \$10 million over three years.

Apart from the NILS network, some community organisations are also participating in low interest loans schemes in partnership with banks. Two of these have been referred to in chapter three in terms of the voluntary exercise of corporate social responsibility by some banks. The Brotherhood of St Laurence commenced a pilot of the 'Progress Loan' in partnership with ANZ Bank in 2006, under which loans of between \$500 and \$3000 are offered to people on low incomes to assist in the purchase of essential household items. An interest rate of 12.7% per annum applies, and the loan repayment term is flexible to suit borrowers' needs ranging from between 6 months to 3 years.⁵⁰ In terms of eligibility for a 'Progress loan', borrowers must be Centrelink⁵¹ healthcare cardholders, have lived in the same residence for more than 6 months, and be up to date with utility bills. In terms of risk assessment, ANZ states that its uses 'specifically designed loan assessment criteria recognising typical spending patterns of people on low incomes.'⁵² The program operates on a small scale. In the 2007 to 2008 financial year, 262 people received Progress loans.⁵³

Good Shepherd Youth and Family Service has been offering a 'StepUp loan' in partnership with NAB since 2004. It is currently offered in select locations in Victoria, Western Australia, South Australia and New South Wales. These loans are for amounts between \$800 and \$3000, with a current applicable interest rate of 7.24% per annum. The loan term ranges from 6 months to 3 years. The loans are, again, for essential household goods as well as second hand cars, car repairs, medical expenses

⁴⁹ Chant Link and Associates, 'A Report on Financial Exclusion in Australia' (ANZ, 2004)

⁵⁰ ANZ, *Progress Loans* (2008) <http://www.anz.com/aus/values/community/progress_loans.asp> at 21 October 2008, ANZ, *Progress loans- features and eligibility* (2008) <<http://www.anz.com/aus/values/community/features.asp>> at 21 October 2008

⁵¹ Australian Social Security, see Centrelink, *What is the Maximum Gross Income to Qualify for a Health Care Card?* (2008) Australian Government <http://www.centrelink.gov.au/internet/internet.nsf/payments/conc_cards_iat.htm> at 12 August 2008

⁵² ANZ, *Progress loans- features and eligibility* (2008) <<http://www.anz.com/aus/values/community/features.asp>> at 21 October 2008

⁵³ Brotherhood of St Laurence, *Annual Report 2008* (2008) <http://www.bsl.org.au/pdfs/BSL_ANNREP08_e.pdf> at 27 November 2008

and training course fees. As with the 'Progress loan', to be eligible for a 'StepUp loan' the borrower must be a Centrelink healthcare cardholder.⁵⁴ Again, this program operates on a small scale. Between 2004 and 2007, 599 'StepUp loans' had been made.⁵⁵

Both Brotherhood of St Laurence and Good Shepherd Youth and Family Services are well-established, well-funded, Victorian-based community organisations⁵⁶ which have managed to attract the support of major banks in their microfinance activities. The majority of community organisations operate on a smaller scale and may currently find it difficult to attract sufficient government and industry support to fund their microfinance activities. Shelter Housing Action Cairns ("SHAC") is one organisation which is particularly involved in providing crisis housing in the Cairns region in North Queensland, and which has attracted some industry support. It has been able to offer low interest loans, known as the 'CSB Advance' to some of its client base through a partnership with Community Sector Banking.⁵⁷ There are many organisations, however, which rely on government and philanthropic funding to support microfinance activities, and struggle to obtain adequate funding to provide both loan capital and infrastructure. A community finance worker with one such community organisation in Queensland noted in 2007 that:

In Queensland the State government is sorely lacking in responses to these kinds of programs and models...they don't address infrastructure cost...traditionally these microcredit funds have been run by volunteers, but we also know in the sector that the volunteer base is dropping so that is where I would strongly identify the gap- the state government's commitment to

⁵⁴ NAB, *StepUP Loans* (2008) <http://www.nab.com.au/About_Us/0,,82040,00.html> at 12 August 2008

⁵⁵ NAB and Good Shepherd Youth and Family Service, 'StepUP Loan: A Step In The Right Direction?' (2008), 4.

⁵⁶ See Brotherhood of St Laurence, *Annual Report 2008* (2008) <http://www.bsl.org.au/pdfs/BSL_ANNREP08_e.pdf> at 27 November 2008, Good Shepherd Youth and Family Service, *Annual Report 2006-7* (2006-7) <<http://www.goodshepvic.org.au/www/385/1001127/displayarticle/1002409.html>> at 27 November 2008

⁵⁷ Community Sector Banking, *Shelter Housing Action Cairns* (2008) <<http://www.csbanking.com.au/about-us/community-engagements/75-shelter-housing-action-cairns-shac>> at 25 November 2008

supporting the development of not only those micro-credit programs but other alternative arrangements for folks to access.⁵⁸

While state governments have now committed funds to infrastructure costs associated with NILES, there have been no broader commitments to microfinance infrastructure. There should be a government commitment to facilitate, through funding, the making of low interest loans or simply small amount loans provided on non-exploitative terms, to inject genuine competition into the market as against the high cost loans currently available to people on low incomes.

The regulatory framework in the US and UK

Credit Unions

In the US and UK smaller community based credit unions are separately defined and recognised, and given different regulatory treatment as compared with larger credit unions.

- **‘Community Development Credit Unions’ and ‘low income credit unions’ in the US**

In the US, the Community Development Credit Union (‘CDCU’) category is a broader one than that of ‘low income credit unions’. CDCUs are defined by their focus on community development, one important aspect of that being access to affordable credit, recognised as ‘critical to the health of communities’.⁵⁹ ‘Low income credit unions’ must be designated as such by the National Credit Union Administration in the US, on the grounds that the majority of their members earn less than 80 per cent of the average wage or have an annual household income that falls below 80 per cent of the median household income in the US.⁶⁰ Low income credit unions in the US currently number approximately 800.⁶¹ Low income credit unions enjoy the benefits of a sympathetic and encouraging regulatory structure.

⁵⁸ Interview with community organisation 3, 2007.

⁵⁹ Lehn Benjamin, Julia Rubin and Sean Zielenbach, 'Community Development Financial Institutions: Current issues and Future Prospects' (2004) 26(2) *Journal of Urban Affairs* 177 177, 180.

⁶⁰ Pat McGregor, 'Credit Unions and the Supply of Insurance to Low Income Households' (2005) 76(3) *Annals of Public and Cooperative Economics* 355 357.

⁶¹ Office of the Comptroller of the Currency, *Community Development Financial Institution and Community Development Bank Resource Directory* (2008) <<http://www.occ.treas.gov/cdd/cdresourcedir.htm>> at 4 November 2008

In recognition of the fact that it can be difficult to build necessary capital when relying upon the deposits of a low-income member constituency, designated low income credit unions in the US are the only credit unions authorised to accept non-member deposits, for example from larger credit unions or banks wishing to improve their *Community Reinvestment Act* ratings.⁶² The *Community Reinvestment Act* ratings system whereby banks are rated on the extent of their servicing of the credit needs of low and moderate income neighbourhoods⁶³, has been of significant benefit to Community Development Financial Institutions ('CDFI's) including CDCUs, in the sense that organisations servicing those low income communities have been the beneficiaries of bank investment and support.⁶⁴ The benefits of encouraging such investment through legislation will be revisited below.

Low income credit unions also have access to technical assistance grants and a Revolving Loan Fund administered by the National Credit Union Administration, which is a federal government agency that charters and supervises federal credit unions.⁶⁵ The Revolving Loan Fund aims to provide low cost funds to credit unions to support their services, designed to meet the needs of low income communities. The interest rate is set at between 1% and 3 % per annum, and for the year ended 30 September 2008, loans of over US\$12 million had been made to credit unions.⁶⁶

Low income credit unions are also able to treat secondary capital, or subordinated loans, as part of their net worth for capital adequacy purposes. Because subordinated loans are not repayable until a credit union's other debt has been paid, the amount of those loans is regarded as being available to cover any insolvency of the credit union,

⁶² Pat McGregor, 'Credit Unions and the Supply of Insurance to Low Income Households' (2005) 76(3) *Annals of Public and Cooperative Economics* 355364.

⁶³ William Apgar and Mark Duda, 'The Twenty-Fifth Anniversary of the Community Reinvestment Act: Past Accomplishments and Future Regulatory Challenges' (2003) 9(2) *Economic Policy Review-Federal Reserve Bank of New York* 169, 169.

⁶⁴ See discussion generally in John Taylor and Josh Silver, 'The Essential Role of Activism in Community Reinvestment' in Gregory Squires (ed), *Organizing Access to Capital. Advocacy and the Democratization of Financial Institutions*. (2003) 169, 170-173; and in Peter Dreier, 'Protest, Progress, and the Politics of Reinvestment' in Gregory Squires (ed), *Organizing Access to Capital. Advocacy and the Democratization of Financial Institutions* (2003) 188, 193, 200, 202.

⁶⁵ Office of the Comptroller of the Currency, *Community Development Financial Institution and Community Development Bank Resource Directory* (2008)
<<http://www.occ.treas.gov/cdd/cdresourcedir.htm>> at 4 November 2008

⁶⁶ National Credit Union Administration, *Credit Union Development Programs* (2008)
<<http://www.ncua.gov/credituniondevelopment/Programs/FinanceGrants.htm>> at 10 November 2008

and can therefore be accorded capital treatment.⁶⁷ In Australia, all credit unions may be able to include subordinated debt in their capital calculations, however only as ‘tier 2’ capital which can only comprise less than 50% of a credit union’s capital base, and the ability to include subordinated debt is any event subject to regulatory approval.⁶⁸

- **Recognition of credit unions as part of the ‘third sector’ in the UK**

In designing a regulatory framework for credit unions in the UK, the government has been mindful of credit unions’ mutual characteristics, referring to them as ‘third sector lenders’⁶⁹ which is an acknowledgement that credit unions are traditionally social enterprises which conduct their business for a social purpose as opposed to conducting a business motivated by returning profits to shareholders.⁷⁰

While in Australia credit unions have been regulated by APRA since 1998,⁷¹ in the UK credit unions have similarly been regulated by the same regulatory body as banks, the Financial Services Authority, since 2002. The credit union industry in the UK has generally been pleased to receive the same regulatory treatment as banks, in order to attract depositors and ‘grow effectively’ in order to compete with banks and building societies.⁷² There has been a desire expressed by some credit unions to cast off the shackles of being ‘referred to as a poor person’s bank’ and of being ‘heavily associated with fighting financial exclusion’.⁷³ As discussed above, however, the difficulty with credit unions growing and becoming more competitive with banks is that they will no longer be of an appropriate size and nature to tackle financial exclusion. Fortunately, and in stark contrast to the position in Australia, the UK government has distinguished between large and small credit unions and has devised a regulatory framework to assist CDCUs to survive and function well. In doing so, it

⁶⁷ Office of the Comptroller of the Currency, *Community Development Financial Institution and Community Development Bank Resource Directory* (2008)

<<http://www.occ.treas.gov/cdd/cdresourcedir.htm>> at 4 November 2008

⁶⁸ Australian Prudential Regulatory Authority, *Prudential Note 4-2-Credit Unions* (2008)

<<http://www.apra.gov.au/ADI/Prudential-Note-4-2.cfm?RenderForPrint-1#5>> at 11 November 2008

⁶⁹ House of Commons Treasury Committee, 'Financial Inclusion: Credit, Savings, Advice and Insurance' (Twelfth Report 2005-06), 3.

⁷⁰ John Thompson and Bob Doherty, 'The Diverse World of Social Enterprise' (2006) 33(5/6) *International Journal of Social Economics* 361362.

⁷¹ Brenton Goldsworthy, David Lewis and Geoffrey Shuetrim, 'APRA and the Financial System Inquiry' (Australian Prudential Regulation Authority, 2000), 1.

⁷² Howard Davies, 'Speech' (Paper presented at the Association of British Credit Unions Limited Annual Conference and AGM, 3 March 2000)

⁷³ Nicholas Ryder, 'Credit Unions and Financial Exclusion' (2002) 24(4) *Journal of Social Welfare and Family Law* 423, 425.

has expressed a commitment to work to ‘understand the needs of credit unions, and to take account of their particular circumstances’, and to ‘ensure the regime is proportionate, sensitive, and credible.’⁷⁴

As in the US, but applying to all credit unions not just low income credit unions, credit unions in the UK are able to include subordinated debt in their calculation of capital.⁷⁵

There is then a distinction made between ‘version 1 credit unions’ and ‘version 2 credit unions’ for capital adequacy purposes. A version 2 credit union must have initial start up capital of at least £5,000, and must then maintain at all times a risk-adjusted capital to total assets ratio of at least 8%.⁷⁶ However, a different regime applies to version 2 credit unions, defined as credit unions which have a limitation on their deposit-taking licence meaning that they must not lend more than £15,000 in excess of a member’s shareholding.⁷⁷ A less onerous set of capital adequacy requirements applies to such credit unions: a version 1 credit union must have initial start up capital of £1,000, and must ‘at all times maintain a positive amount of capital’ so that its ‘assets will at all times exceed its non-capital liabilities’.⁷⁸ Further, it must not make a loan of an amount greater than £7,500 in excess of a borrowing member’s shareholding unless it has a capital to total assets ratio of at least 5%, and it must maintain that capital ratio while it is owed such a greater amount by a member.⁷⁹

Credit Unions which lend to people on low incomes may also have the benefit of access to funding through the Growth Fund. The Growth Fund was established by the UK Department for Work and Pensions in 2006, with a first tranche injection of £36

⁷⁴ Ruth Kelly, ‘Speech by Economic Secretary to the Treasury, Ruth Kelly MP to the Association of British Credit Unions’ (Paper presented at the Association of British Credit Union’s Annual Conference, Blackpool, 4 April 2002)

⁷⁵ Financial Services Authority, *FSA Handbook Online* (2008)
<<http://fsahandbook.info/FSA/print/handbook/CRED>> at 4 November 2008, CRED 8.2.1R(4)

⁷⁶ Financial Services Authority, *FSA Handbook Online* (2008)
<<http://fsahandbook.info/FSA/print/handbook/CRED>> at 4 November 2008 CRED 8.4

⁷⁷ Financial Services Authority, *FSA Handbook Online* (2008)
<<http://fsahandbook.info/FSA/print/handbook/CRED>> at 4 November 2008

⁷⁸ Financial Services Authority, *FSA Handbook Online* (2008)
<<http://fsahandbook.info/FSA/print/handbook/CRED>> at 4 November 2008, CRED 8.3

⁷⁹ Financial Services Authority, *FSA Handbook Online* (2008)
<<http://fsahandbook.info/FSA/print/handbook/CRED>> at 4 November 2008, CRED 8.3.12R

million of capital.⁸⁰ In 2008 there has been a second tranche injection of capital into the fund, of £38 million.⁸¹ The fund is available upon application by ‘third sector lenders’ including credit unions and CDFIs, to be used for on-lending to low income customers. Low income customers are defined according to net weekly income level, for example, included in the definition will be a single person with net weekly income of £136 or a couple with two children with a net weekly income of £340. Between July 2006 and May 2008, loans totalling £36.6 million were made out of that fund.⁸²

Essentially what must be noted in relation to the rhetoric around and the regulation of credit unions in the US and UK, is the recognition of differences; a recognition that credit unions, or at least certain categories of credit unions, have an important role to play in tackling financial exclusion, and should be facilitated in that role. It is that recognition that is very much lacking in the regulation of credit unions in Australia.

The CDFI and community sectors

In both the UK and the US the CDFI sector is well-developed and recognised. Both the CDFI and community sector organisations engaging in community finance models are well-supported.

- **US *Community Reinvestment Act* , the CDFI Fund and the New Markets Tax Relief scheme**

The *Community Reinvestment Act* provides an interesting model, and one that has fostered significant investment in CDFIs and the community sector in the US. The CRA is credited with reducing the ‘power imbalance between financial institutions and the communities they serve’.⁸³ It is said that as a result of the CRA ‘community-based organizations [have] found it vastly easier to line up financing and equity

⁸⁰ Department for Work and Pensions, *What is the Growth Fund?* (2008) <<http://www.dwp.gov.uk/advisers/growthfund>> at 6 October 2008

⁸¹ Department for Work and Pensions, *Minister's Speeches: Mind Annual Conference- James Plaskitt MP* (2008) <<http://www.dwp.gov.uk/aboutus/2008/17-06-08a.asp>> at 6 October 2008

⁸² Department for Work and Pensions, *What is the Growth Fund?* (2008) <<http://www.dwp.gov.uk/advisers/growthfund>> at 6 October 2008

⁸³ John Taylor and Josh Silver, 'The Essential Role of Activism in Community Reinvestment' in Gregory Squires (ed), *Organizing Access to Capital. Advocacy and the Democratization of Financial Institutions*. (2003) 169, 171.

investments for their projects'.⁸⁴ The purpose of CRA's enactment was to require banks to 'serve the credit needs of [their] entire communit[ies], including low-and-moderate-income neighbourhoods.'⁸⁵ The four federal agencies that enforce the CRA have focused their attention on residential mortgage lending, but there has been a call for greater focus on the more general provision of banking services to people on low incomes to overcome reliance by those people on fringe credit providers.⁸⁶ In 2007 it was announced that banks that provide affordable small loan products, involving interest rates of 36% per annum or less, with a steady reduction of principal and financial counselling for frequent borrowers, will be rewarded in terms of their CRA rating.⁸⁷ Under the CRA, banks are rated on the extent of their lending to borrowers at different income levels, and the provision by them of community development loans. Large banks, with assets above US\$1 billion, are also rated on an investment test, concerned with community development needs; and a service test based upon the range of services provided by the bank including technical expertise given to nonprofits.⁸⁸ A poor CRA rating can affect a bank's application for deposit-taking facilities including applications for mergers with and acquisitions of deposit-taking institutions. CRA ratings are also taken into account in the approval process for opening or closing bank branches and banks must have a satisfactory CRA rating to be allowed to engage in extended financial activities such as insurance and securities.⁸⁹ Further, the CRA rating can impact upon a bank's reputation.

CRA ratings are an important part of a bank's public image. Many banks would rather be judged to be outstanding than satisfactory in reinvesting in their community. A high CRA rating is an important part of the bank's public

⁸⁴ Gregory Squires, 'Introduction: The Rough Road to Reinvestment' in Gregory Squires (ed), *Organizing Access to Capital: Advocacy and the Democratization of Financial Institutions* (2003) 1, 1.

⁸⁵ William Apgar and Mark Duda, 'The Twenty-Fifth Anniversary of the Community Reinvestment Act: Past Accomplishments and Future Regulatory Challenges' (2003) 9(2) *Economic Policy Review-Federal Reserve Bank of New York* 169, 169.

⁸⁶ William Apgar and Mark Duda, 'The Twenty-Fifth Anniversary of the Community Reinvestment Act: Past Accomplishments and Future Regulatory Challenges' (2003) 9(2) *Economic Policy Review-Federal Reserve Bank of New York* 169, 183.

⁸⁷ Center for Responsible Lending, 'FDIC Pushes for Affordable Loans: Regulator Offers CRA Incentive for 36% Interest Rate Cap and Other measures' (2007) *Center for Responsible Lending NewsBrief*

⁸⁸ Richard Marsico, 'The 2004-2005 Amendments to the Community Reinvestment Act Regulations: For Communities One Step Forward and Three Steps Back' (2006) 39 *Clearinghouse Review* 534, 535-536.

⁸⁹ Michael Barr, 'Credit Where It Counts: The Community Reinvestment Act and its Critics' (2005) 75 *New York University Law Review* 101, 105.

relations strategy, and banks often issue press releases bragging about their 'outstanding' reinvestment records.⁹⁰

The result has been a positive one for CDFIs and community-based organisations.

Banks have channelled significantly more credit into low incomes and minority neighbourhoods than they ever did before the passage of the CRA...many banks are now much more proactive in forming partnerships with community-based organizations and in making credit available in previously neglected neighbourhoods.⁹¹

The CRA is not without its critics in the US.⁹² Indeed, the CRA has been blamed in some circles for the 2008 sub-prime mortgage crisis.⁹³ Seidman argues that:

This is patent nonsense. The sub-prime debacle has many causes, including greed, lack of and ineffective regulation, failures of risk assessment and management, and misplaced optimism. But CRA is not to blame.⁹⁴

She further notes that 'CRA does not either encourage or condone bad lending.'⁹⁵ In fact, it requires 'safe and sound lending practices'.⁹⁶ It is important to distinguish between what Engel and McCoy refer to as 'legitimate subprime' lending⁹⁷ on the one

⁹⁰ John Taylor and Josh Silver, 'The Essential Role of Activism in Community Reinvestment' in Gregory Squires (ed), *Organizing Access to Capital. Advocacy and the Democratization of Financial Institutions*. (2003) 169, 181.

⁹¹ Peter Dreier, 'Protest, Progress, and the Politics of Reinvestment' in Gregory Squires (ed), *Organizing Access to Capital. Advocacy and the Democratization of Financial Institutions* (2003) 188, 193.

⁹² See discussion in Michael Barr, 'Credit Where It Counts: The Community Reinvestment Act and its Critics' (2005) 75 *New York University Law Review* 101, 107.

⁹³ Ellen Seidman, *No, Larry, CRA Didn't Cause the Sub-Prime Mess* (2008) New America Foundation <<http://www.newamerica.net/blog/asset-building/2008/no-larry-cra-didn-t-cause-sub-prime-mess-3210>> at 29 July 2008

⁹⁴ Ellen Seidman, *No, Larry, CRA Didn't Cause the Sub-Prime Mess* (2008) New America Foundation <<http://www.newamerica.net/blog/asset-building/2008/no-larry-cra-didn-t-cause-sub-prime-mess-3210>> at 29 July 2008

⁹⁵ Ellen Seidman, *No, Larry, CRA Didn't Cause the Sub-Prime Mess* (2008) New America Foundation <<http://www.newamerica.net/blog/asset-building/2008/no-larry-cra-didn-t-cause-sub-prime-mess-3210>> at 29 July 2008

⁹⁶ See discussion in Glenn Canner et al, 'Home Purchase Lending in Low-Income Neighbourhoods and to Low-Income Borrowers' (1995) 81(2) *Federal Reserve Bulletin* 71.

⁹⁷ Kathleen Engel and Patricia McCoy, 'The CRA Implications of Predatory Lending' (2002) 29 *Fordham Urban Law Journal* 1571

hand, which is simply responsible lending to people excluded from access to mainstream credit products, and which is encouraged under the CRA; and predatory lending on the other hand. I have referred above to Shorebank, as a successful US CDFI. Shorebank has continued through the 'subprime crisis' with a solid mortgage portfolio based upon responsible lending, and has launched a 'Rescue Loan Program' to assist borrowers in refinancing exploitative 'subprime loans'.⁹⁸ One commentator has strongly refuted any suggestion that the CRA is to blame for the sub-prime crisis:

Many of the biggest subprime lenders weren't banks, and thus weren't covered by the CRA. Nobody forced Bear Sterns to borrow \$33 for every dollar of assets it had, and Fannie Mae and Freddie Mac didn't coerce highly compensated CEOs into rolling out no-money-down, exploding adjustable-rate mortgages. Banks will lose just as much money lending to really rich white guys like former Lehman Brothers CEO Richard Fuld as they will on loans to poor people of color in the South Bronx.⁹⁹

The same commentator also made clear the role of CDFIs undertaking 'ethical subprime lending' in this economic crisis. These are the very CDFIs that have attracted financial support from the banking sector as a result of the CRA.

Community development banks, credit unions and other CDFIs- a mixture of faith-based and secular, for-profit and not-for-profit organizations- constitute what might be called the 'ethical subprime lending' industry. Even amid the worst housing crisis since the 1930s, many of these institutions sport healthy payback rates. They haven't bankrupted their customers or their shareholders. Nor have they rushed to Washington begging for bailouts. Their numbers

⁹⁸ Shorebank, *Interview with Shorebank September 18 2008; A Risk Worth Taking November 24 2008* (2008)

<http://www.shorebankcorp.com/bins/site/templates/child.asp?area_4=pages/nav/common/child_right.dat&area_7=pages/titles/news/news_landing.dat&norelay_place=here&objectid=C931C1B0&articletitle=Interview+With+Shorebank&norelay_ai=2BC49AF6546F47E08EE22883A0A37D7D&norelay_reset=false&NC=82X> at 27 November 2008

⁹⁹ Shorebank, *Interview with Shorebank September 18 2008; A Risk Worth Taking November 24 2008* (2008)

<http://www.shorebankcorp.com/bins/site/templates/child.asp?area_4=pages/nav/common/child_right.dat&area_7=pages/titles/news/news_landing.dat&norelay_place=here&objectid=C931C1B0&articletitle=Interview+With+Shorebank&norelay_ai=2BC49AF6546F47E08EE22883A0A37D7D&norelay_reset=false&NC=82X> at 27 November 2008

include tiny startups and veterans like Chicago's Shorebank, founded in 1973, which now sports \$2.3 billion in assets, 418 employees and branches in Detroit and Cleveland. Cliff Rosenthal, CEO of the National Federation of Community Development Credit Unions, notes that for his organization's 200 members, which serve predominantly low income communities, 'delinquent loans are about 3.1 percent of assets. In the second quarter, by contrast, the national delinquency rate on subprime loans was 18.7 percent.'¹⁰⁰

CDFIs in the US also enjoy the benefit of a CDFI fund and the New Markets Tax Credit administered by that fund, which encourages investment in 'community development entities' ("CDEs") that in turn invest in 'qualified low-income community investments'. The fund itself was established in 1994 using federal government resources to invest in CDFIs so as to enable them to provide financial services to under-served people and communities.¹⁰¹ The CDFI fund also allocates tax credits to CDEs who can in turn offer those tax credits to investors who invest in them.¹⁰² Those investors receive a tax credit representing 39 per cent of the cost of the investment, claimed over a seven year period.¹⁰³ To qualify as a CDE, an organisation needs to 'demonstrate a primary mission of serving, or providing investment capital for, low-income communities or low-income persons'.¹⁰⁴ As at October 2008, the CDFI fund had allocated authority to CDEs to in turn allocate a total of \$16 billion in tax credits, since the time of the first allocation in 2003.¹⁰⁵ Banks are attracted to this

¹⁰⁰ Shorebank, *Interview with Shorebank September 18 2008; A Risk Worth Taking November 24 2008* (2008)

<http://www.shorebankcorp.com/bins/site/templates/child.asp?area_4=pages/nav/common/child_right.dat&area_7=pages/titles/news/news_landing.dat&norelay_place=here&objectid=C931C1B0&articletitle=Interview+With+Shorebank&norelay_ai=2BC49AF6546F47E08EE22883A0A37D7D&norelay_reset=false&NC=82X> at 27 November 2008

¹⁰¹ House of Commons Treasury Committee, 'Financial Inclusion: Credit, Savings, Advice and Insurance' (Twelfth Report 2005-06), 23.

¹⁰² Ellen Seidman, 'The New Markets Tax Credit: A Valuable Tool for Economic Development' (Living Cities: The National Community Development Initiative, 2008)

¹⁰³ Community Development Financial Institutions Fund, *New Markets Tax Credit Program* (2008)

<http://www.cdfifund.gov/what_we_do/programs_id.asp?programid=5> at 4 November 2008

¹⁰⁴ Community Development Financial Institutions Fund, *New Markets Tax Credit Program* (2008)

<http://www.cdfifund.gov/what_we_do/programs_id.asp?programid=5> at 4 November 2008

¹⁰⁵ Community Development Financial Institutions Fund, *New Markets Tax Credit Program* (2008)

<http://www.cdfifund.gov/what_we_do/programs_id.asp?programid=5> at 4 November 2008

form of investment because it can be taken into account in relation to their CRA ratings.¹⁰⁶

- **UK establishment of Community Development Finance Association, Community Investment Tax Relief Scheme, voluntary disclosure and the Growth Fund**

The UK Department for Business Enterprise and Regulatory Reform funds the Community Development Finance Association (“CDFA”) which acts as a trade association for CDFIs in the UK. This means that CDFIs have the benefit of an advocate to liaise with government on their behalf, and to give them credibility as a sector, for example through the development of a Code of Practice.¹⁰⁷

CDFIs in the UK can access capital for on-lending through the Growth Fund which is referred to above in relation to credit unions. As is the case with credit unions, CDFIs can apply to the Growth Fund for capital to on-lend to people on low incomes.¹⁰⁸

In accordance with recommendations made by the Social Investment Task Force in 2000, banks are encouraged to provide voluntary disclosure in relation to their lending activities in under-served communities.¹⁰⁹ This has not been as successful as the CRA ratings system in encouraging investment and lending, with only two banks so far providing such disclosure, leading to calls for a mandatory disclosure regime.¹¹⁰

There is also the Community Investment Tax Relief scheme which is currently only available to CDFI’s undertaking micro-enterprise – as opposed to personal finance-lending. There has, however, been ‘widespread support...for an extension of the

¹⁰⁶ Office of the Comptroller of the Currency, *Community Development Financial Institution and Community Development Bank Resource Directory* (2008)

<<http://www.occ.treas.gov/cdd/cdresourcedir.htm>> at 4 November 2008

¹⁰⁷ Community Development Finance Association, 'Inside Out. The State of Community Development Finance.' (2007), Interview with Bernie Morgan, CEO of the CDFFA, London 2008.

¹⁰⁸ Department for Work and Pensions, *What is the Growth Fund?* (2008)

<<http://www.dwp.gov.uk/advisers/growthfund>> at 6 October 2008

¹⁰⁹ Social Investment Task Force, 'Enterprising Communities: Wealth beyond Welfare. A 2005 Update on the Social Investment Task Force.' (2005)

¹¹⁰ Barclays Bank and Natwest. See Fair Finance UK, *Disclosure- What Have the Banks Got to Hide?* (2008)

<<http://www.fairfinance.org.uk/mediacentre/November%20202005%20LAUNCH%20OF%20FAIR%20FINANCE%20DISCLOSURE%20REPORT.pdf>> at 27 November 2008

CITR scheme to personal lending to help third sector lenders attract capital.’¹¹¹The scheme offers tax relief to individuals or organisations that invest in CDFIs. The tax relief is 55% of the amount invested every year for 5 years, so that the total tax relief amounts to 25% of the amount invested.¹¹²

With such support, the CDFI sector in the UK continues to grow, most recent figures indicating that CDFIs have financed 15,000 businesses and households in the UK and sustained and created 33,000 jobs. The sector has been responsible for investing £330 million into the businesses and households that they serve, improving the net income of 210,000 households.¹¹³ Indications are that whilst significant support and funding is required to sustain microfinance programs in their initial stages, sustainability may be possible in the long term.

What we need in Australia

In short, Australia needs a regulatory regime that supports the start up and growth of CDCUs, CDFIs, and community organisations engaging in microfinance activities.

Such a regime will incorporate:

1. Regulatory exemptions from onerous regulation that inhibits the start-up and growth of CDCUs and CDFIs , acknowledging their particular social purpose;
2. Government funding to support CDCUs and CDFIs;
3. Tax incentives to encourage investment in CDCUs and CDFIs to enable them to lend to people on low incomes;
4. A CRA-like ratings system to encourage investment by banks in the CDCU and CDFI sector.

The most controversial of these suggestions is likely to be the introduction of legislation modelled on the CRA. Concerns will include the ‘perils’ of encouraging lending to people on low incomes on the basis that such lending is inherently irresponsible. Evidence from the US outlined above is that ‘ethical’ or ‘legitimate’

¹¹¹ House of Commons Treasury Committee, 'Financial Inclusion: Credit, Savings, Advice and Insurance' (Twelfth Report 2005-06)

¹¹² Community Development Finance Association, 'Community Investment Tax Relief: A Guide for CDFIs' (2003)

¹¹³ Community Development Finance Association, 'Inside Out. The State of Community Development Finance.' (2007), 5.

subprime lending by the CDFI sector is possible and not prone to lead to broader economic problems in the way that irresponsible, predatory, subprime lending has done.

Another concern may be that by mandating banks' activity in this area, all innovation and creativity currently being shown by a few banks, will be lost. The difficulty in relying on voluntary initiatives is that they are likely to remain on a small scale, and are tenuous in the sense that a change to a banking corporations' CEO or board could quickly see the demise of such programs. The positive impacts that legislation such as the CRA could have in facilitating the provision of affordable credit by the third sector in Australia is considerable. It is also likely that this could be achieved without stifling innovation. The CRA is an example of performance-based regulation, relying on standards rather than rules, and those 'standards are structured to encourage involvement in the process of regulatory interpretation by both citizens and the regulated entities themselves'.¹¹⁴ Such an approach is more likely to be effective, appropriate and less likely to stifle innovation than a more prescriptive, rules based approach. Regulators do not have a fixed requirement for banks to undertake a certain level of activity, but make a judgment about the institution's performance in the context in which it operates.

CRA standards permit banks to respond to local needs based on their institutional organisation, market assessments and business plans, without being judged on the basis of national norms,

which allows:

banks to help shape the content of the standard in CRA's application to them, in their local context, during their CRA evaluation and merger applications... This increases the likelihood that the performance will be

¹¹⁴ Michael Barr, 'Credit Where It Counts: The Community Reinvestment Act and its Critics' (2005) 75 *New York University Law Review* 101, 108.

analysed according to the regulated entity's view of an appropriate standard for the institution.¹¹⁵

Conclusion

In recent years in Australia, regulators have given considerable attention to fringe credit providers and how they should be regulated in order to protect consumers.¹¹⁶

There has not been enough emphasis on addressing financial exclusion by fostering and encouraging alternative forms of finance for low income Australians.

Government has a key role to play in providing as well as encouraging support and funding for microfinance activities by CDFI-like institutions and community organisations.

Specifically, consideration needs to be given to adopting the CRA model and linking ratings for authorised deposit-taking institutions in Australia to the provision of, or investment in, affordable small amount credit to people on low incomes.

Ramifications of poor ratings could include reputational effects and restrictions upon ADI licences.

The Australian government needs to take the issue of affordable credit for people on low incomes seriously. Support and funding for third sector CDCUs, CDFIs and community organisations in Australia is crucial to effectively addressing this issue.

¹¹⁵ Michael Barr, 'Credit Where It Counts: The Community Reinvestment Act and its Critics' (2005) 75 *New York University Law Review* 101, 183-184.

¹¹⁶ See for example Consumer Affairs Victoria, 'The Report of the Consumer Credit Review' (2006)

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<http://www.anz.com/aus/values/community/progress_loans.asp> at 21 October 2008
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