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ABSTRACT

Despite calls by consumer advocates for Australia's governments and financial services institutions to provide consumers with resources to help them understand how the financial services sector operates, financial education remains something that most Australians gain by default. Research conducted in the United Kingdom and United States, has identified the social and economic factors that have necessitated financial literacy, documented the problems faced by disadvantaged and illiterate consumers in dealing with the financial services sector, and provided information for the debate about consumer education and financial literacy. Australia's deliberate government policy of deregulation and economic rationalism, poor educational resources, and lack of concern on the part of the financial services sector have all been key factors in generating the conditions necessary to create social exclusion and alienation. The following groups are particularly susceptible to the financial exclusion that stems from illiteracy and lack of financial literacy: low-income consumers; older consumers; consumers from non English speaking backgrounds; consumers with disabilities; consumers with literacy difficulties; and indigenous consumers. Given all the reasons for financial exclusion in Australia, a protracted effort must be instituted whereby Australian government, industry, and communities will learn to recognize the central role that access to literacy plays in the communities' and individuals' well-being. (69 references) (MN)

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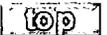
Abstract

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If you do not have informed, motivated, committed and involved citizens or consumers, the best systems will atrophy. (Ralph Nader)

This paper seeks to provide the conference with a description and analysis of the affect of poor literacy and innumeracy on consumers. The paper will show how poor literacy and access to information conspire to further aggravate the well being of disadvantaged communities and individuals. The paper seeks to draw a link between economically rationalist government policies, disadvantaged communities, individuals, regions and the decline in access and equity within the area of financial services. Further still, the paper will demonstrate that poor literacy and numeracy are key factors in exacerbating social exclusion and alienation.

Consumer Education & Literacy



In total contrast to the United Kingdom, there is currently very little debate about the role of financial literacy within our education system. In Australia, it is taken as a virtual given that financial literacy is something that is gained through 'hands on' experience in earning and spending money. Necessity is deemed as the only educational tool available. It expected that financial education will occur when an individual or family purchase a home, take out a large loan, or as a result of experiencing some financial crisis. That said, financial education is something that more or less is gained by default.

The consumer movement in Australia has for a long time been calling upon governments and financial services institutions to provide resources which provide consumers with some basic understanding of the manner in which the financial services sector operates. Governments have virtually ignored this plea whilst financial services providers have invested large sums in providing a range of educational materials, though most are designed to promote certain products and are a sort of 'disguised marketing'. That said, the aims of consumer education in financial services are to:

- Assist consumers to make informed and appropriate choices
- Improve consumer confidence in financial services
- Provide practical information about the use of financial services
- Increase use of financial services
- Protect consumers from risk
- Inform consumer of their rights, and the availability of redress

The first key to understanding the effectiveness of consumer education in achieving these aims is to accept that there are vast differences in general literacy, financial literacy, access to information, access to technology and language skills. Educational materials and methods that may be affective with one group may not be effective for others.

According to research conducted by the National Association of Citizens Advice Bureau^[1] in the UK, the social and economic factors that have influenced the heightened requirement for financial literacy include the following:

- a vastly extended range of consumer credit products as a consequence of financial deregulation, industry innovation, and consumer take-up;
- successive governments have encouraged consumers to take greater individual responsibility for personal pension and insurance provision;
- increasing consumer willingness to use credit and debt to finance current consumption;
- an extended range and choice of mortgage products as increased competition amongst lenders has combined with the growth in home ownership and extension of right to buy;
- the development and extension of the second charge mortgage market;
- more 'middle' income consumers needing to consider the effects of inheritance tax to reflect increased property prices;
- the introduction of choice into the consumer utilities sector;
- increased graduate debt following the introduction of student loans;
- a more complex interaction between the social security and income tax systems;
- increased demand for travel insurance products as an ancillary requirement to foreign travel;
- higher demand for residential care reflecting increased life expectancy
- introduction of telephone and Internet banking;
- taxpayers being required to take a far more active role in the calculation of tax liability following self-assessment;
- the development of e-commerce.

Research conducted by the Financial Services Consumer Policy Centre^[2] reveals that whilst Australians are increasingly expected to participate in a wide range of complex financial services, very little effort has been expanded by government and industry to provide practical and accessible educational materials and campaigns. According to the report, there has never been any major studies which focused on the educational needs of Australian financial services consumers.

The report found that most of the materials for Australian consumers are either dense or are disguised forms of marketing. The report found that government provided almost no resources for consumer education and that the occasional media (educational) campaigns which had been funded by government were always made to coincide

with the political counsel of the government of the day.

Financial illiteracy carries a considerable amount of detriment. As will be discussed later in the paper, financial literacy is particularly critical in the current and foreseeable economic future. This comes as a result of increasingly complex financial products becoming virtually mandatory for all consumers. Consumers with poor literacy will:

- find it difficult to identify the financial service or product that best meets their current and future needs, lifestyles and aspirations;
- fall victim to abusive practices from financial service companies and their agents;
- respond to financial difficulties in a manner that results in even greater problems; and
- is unconfident and unsure about how best to access and evaluate independent financial advice

[3]

Very few of the financial products on offer are sold directly to the public, instead financial institutions rely on an army of sales staff and advisors who are paid by commission on the total number and value of sales. This method of buying financial products is very expensive as it is usually accompanied by what is known as a trailing commission. This commission is a fee paid to the advisor or sales person who sold the product to the given consumer. Normally a trailing commission may last for the duration of the product's lifetime. With this in mind,

it is quite common for those sales people and advisors to try and sell products which deliver them the highest commissions as opposed to selling products which are in the best interest of the consumer. The complexity of products such as life insurance, superannuation, managed investments, income protection insurance and bundled products tend to make understanding their use difficult for most consumers, however, consumers with poor literacy tend to be the most vulnerable. This vulnerability comes in the form of a 'lack of informed consent'.



According to the Communication Law Centre, the lack of informed consent to acquire particular products can manifest itself in a number of ways:

inappropriate products;

the sale of insurance products to cover risks for which the insured already has cover (eg life insurance and sickness cover which most consumers have as a result of their superannuation policy) or income insurance where the gap between the insured's income and the Centrelink payment they would receive without the insurance is smaller than the premium the consumer pays;

the sale of high risk investment products to people who need secure investments;

consenting to the acquisition of a product but not fully understanding the nature of associated products which are also acquired (finance and insurance accompanying the sale of a motor vehicle, the terms and conditions of a bank account required to be opened as part of a mortgage agreement). This can raise a number of selling practices problems, particularly where the full arrangement is presented as a 'fait accompli'. For example:

the sale of the finance and insurance is overshadowed by the purchase of the car because the buyer is focused on the car and not the additional products;

the convenience of the 'one stop shop' takes buyers' minds away from the fact that they can shop around.^[4]

The experience of disadvantaged consumers in the United Kingdom and the United States are virtually identical to their Australian counterparts. This is in view of the fact that we share an identical economy and have similar

cultures and most importantly identical selling practices. Unfortunately though, Australia lags considerably behind in attempting to solve some of problems faced by disadvantaged consumer.

With the election of the Labour government in 1995 came a realisation that virtually no consumer education campaigns had taken place over the previous twenty years. With this in mind, the government decided to pour hundreds of millions of pounds into various community based organisations to educate consumers on their needs, rights and the law. The initial process involved community based organisations conducting 'stock takes' of the available resources and the key issues affecting consumers. Much of this work was conducted by Citizens Advice Bureaux. The Financial Services Authority took on many of the recommendations and have to date produces a number of reports dealing with issues of consumer protection and education.

After an exhaustive and lengthy process, the Financial Services Authority came up with a set of recommendations for consumer protection and education that it would invest large sums to implement. In the area of financial literacy, the Financial Services Authority sought to:

Provide individuals with the knowledge, aptitude and skills base necessary to become questioning and informed consumers of financial services and manage their finances effectively. The FSA will develop, the facilities the development the development of, educational programs and materials for learners in schools, adult community education, further and higher education and the workplace. Learners need to be given the opportunity to:

develop numeracy, literacy and IT skills in the context of personal finance;

develop an understanding of the nature and use of money in its various forms, including credit and debit;

learn how to access, interpret, question and evaluate financial information and advice;

learn about consequences of financial decisions and about consumer rights and responsibilities; and

learn how to weigh up risks and benefits in order to choose appropriate solutions to particular financial needs.^[5]

The debate about consumer education in the United States has focused on incorporating financial literacy training into the education system. A recent Senate Banking Committee hearing has heard that the poor financial literacy of American consumers is forcing them to pay for products and services they don't know and understand. As a result American consumers are paying:

High interest rates on short-term 'pay day' loans and high cheque cashing fees - averaging 9.3 per cent - paid by an estimated 10 million adults who don't have a bank or credit union;

Between \$US3 billion and \$4 billion from high fees and unfavourable exchange rates charged to Latin American immigrants who send money home;

Double digit interest rates on credit card debt, which averages \$US8123 per family;

For money lost in investment scams on the Internet.^[6]

Accordingly, the current American administration supports the incorporation of financial education into the classroom. Its intended that economics and mathematics teachers would be provided with the extra training necessary for them to provide young students with a solid foundation in the area of financial management. However, unlike the debate in the UK, the US administration's philosophy on this questions stems from it

wanting to eliminate as many of its social functions as possible. Hence much of the language used revolves around 'free markets, free enterprise, individual empowerment...'. As a result of this attitude, financial illiteracy is only viewed through a narrow prism of economic policy as opposed to it being a critical social welfare matter.

Foundations of Social Exclusion



Over the past two decades, Australian consumers have increasingly been forced to pro-actively engage in a range of financial services and matters which traditionally had been limited to those rich and affluent. Superannuation, managed investments, share trading, day trading, property speculation and negative gearing are some of the unlimited range of investments that so-called mums and dads need to take into consideration if they are to look forward to a financially secure future.

The hype surrounding financial security began in the early eighties when the governments of industrialised countries began adopting economic rationalism as a way of managing their economies. The dramatic effect of this new way of managing the economy was the down scaling of the role of government. The new ethos was of smaller governments with diminished responsibilities permeated every facet of society. A reduced taxation base meant that governments had less to spend on education, health care, pensions, public transport, housing and other services which had traditionally formed the foundation of the 'welfare state'.

This new way of managing the economy has been a key factor in undermining the traditional responsibilities that governments had toward their disadvantaged constituents. Increasingly, governmental discourse shifted from a rights based society to one rooted in reciprocal responsibility and mutual obligation. Privatisation has become the centre piece of good governmental fiscal practices. Political leaders increasingly see this as a 'shareholder society' as opposed to a 'civil society'. Traditional governmental roles such as regulating business and capital were made redundant by a rush toward deregulation and self regulation. Business was given a free hand and the so-called 'invisible hand of capital' became the dominant paradigm of governmentality.

In a radical rethink of the role of government and its social welfare institutions, increasingly governments in Australia and elsewhere in the industrialised world are promoting the notion of total individual responsibility. Governments merely see their role as facilitating the free operation of markets. Vulnerable communities and individuals are expected to fend for themselves. Governments take the view that even those vulnerable individuals and communities should be able to harness the potential of a deregulated financial services sector.

Governments are making it increasingly attractive for affluent people to supposedly self fund their retirement by offering significant tax breaks, yet seek to apply these same principals to poor people who do not have the capacity to save large chunks of their incomes. This in turn acts as a divisive societal instrument serving the interests of the affluent who increasingly view the payment of tax as optional. In turn this exacerbates government's inability to fund social infrastructure such as education, health care, transport, pensions and housing. The most immediate and insidious manifestation of this cycle is the entrenching of social disadvantage, exclusion and alienation.

Harnessing the potential benefits of the new economy is difficult. The system is set up for people with high levels of education and hence advanced literacy and numeracy. Little investment has been put into helping disadvantaged consumers to better understand 'how the system works'. Vulnerable consumers with poor literacy are frightened by constant rumours that no one will look after them in old age. Wealth creation shows on television are amongst the highest rating programs and are directed to appeal to as many people as possible. The financial counsel emanating from those programs are virtually identical to what is being constantly preached by government and the financial sector; which is that no one will look after you in old age. Communities and individuals of all social and economic classes are told to invest invest invest.

Within the confines of such a pressured environment, it is not surprising that disreputable financial services outfits would seek to profit from unsuspecting consumers with poor literacy and access to information. The Australian Securities and Investment Commission regularly investigates and publishes the details of large and small financial institutions who prey on poor communities.

The Assyrian community provides a germane example of the manner in which disreputable financial institutions can potentially wreak havoc within a community. In this instance, an unlicensed and unregistered company had convinced thousands of members of the small and tight knit Assyrian community to invest in a range of 'pyramid schemes' which recently triggered a 65 million dollar collapse. The scheme which was directed at people with very limited English literacy and numeracy promised annual returns of 500 per cent and more. An elaborate hoax was spun from one household to another and even by church priests that this is a remarkable investment. Given that it had a pyramid set up, those who entered the scheme early were able to show to the rest of their families the fantastic returns that they had so quickly generated. Indeed, within the mainstream this would have immediately been identified as an unlawful scheme and most likely ignored. Unfortunately, this was not the case within the Assyrian community who most likely would never have heard of a pyramid scheme. The collapse of the scheme has cause carnage and the lives of thousands of members of the Assyrian community are in tatters. Families are disintegrating and a once tight knit community is now amidst a vicious cycle of recrimination and blame.

Likewise a number of aboriginal communities had been targeted by several financial planners after a quick profit. In this instance, life insurance and burial policies had been sold on mass to several aboriginal communities which were economically impoverished and which also had very low levels of literacy. The planners in this instance had used psychologically stressful methods and virtually no disclosure of fees and charges to sell their products which guaranteed the planners massive commissions and delivered no benefits to those vulnerable communities. What was even more disturbing is the fact that those planners had been authorised representatives of AXA which is one the world's largest financial services providers.

The two examples above demonstrate that whilst governments' tax concessions and deregulated approach may have the potential to enrich and empower a critical mass of educated and empowered consumers. Lack of government attention to the needs of millions of disadvantaged consumers has and will keep providing nefarious operators seeking to profit from the critical mass of consumers with opportunities to 'rip off' the poor and disadvantaged who have been scared into believing that they must do something about their future financial needs immediately.

Financial Exclusion and its Impact



Recent evolution in financial services in Australia have tended to induce a 'flight to quality'. That is, discrimination against the poor and disadvantaged in favour of the rich and well off.

Geographic considerations: new patterns of credit creation emerge as money and credit is redirected away from poorer to wealthier (ie safer) groups. As well, new patterns of financial infrastructure develop as financial institutions restructure their operations over space to bring them into line with new flows of credit and debt.

In the wake of the recession and economic crisis of the early nineties, the financial services industry has made a typical response. Firstly, a redirection of credit away from poorer social groups and towards richer groups as part of a strategy of 'risk avoidance'. Secondly, there has been a process of financial structure withdrawal. That is, financial capital is retreating to the middle class heartland, a process not dissimilar to the process whereby capital retreated to rich countries from poorer ones as witnessed in the early eighties.

Likewise it is becoming increasingly difficult for citizens to gain access to the financial system. Without access, the conduct of everyday life within contemporary society can be very difficult. Indeed, employees may find it hard to get paid if they do not have a bank account. Workers prefer electronic means of payment as it is more efficient and much safer. Indeed, any quantitative assessment of the credit worthiness of low income customers would reveal that as an aggregate they are credit worthy.

Once a community's infrastructure is in place, continued growth and prosperity requires financing, albeit of a different character. Residents and businesses within the community have an ongoing need for financial services. Further, residential development itself does not disappear, but changes qualitatively: it becomes intensive rather than extensive... Credit is necessary for rehabilitation and property improvements; mortgage credit allows

property turnover . Business require working capital, and then expansion financing as they mature. These credit flows, along with readily available banking services, facilitate continued growth in a maturing community.

This so called 'flight to quality' in Australia and elsewhere threatens to have severe social and economic consequences for those groups and localities which are at the wrong end of the process of financial exclusion. These developments signal an insidious and relatively un remarked-upon assault by financial capital upon the poorer and disadvantaged groups.

This section reviews the relevant Australian and international literature concerning financial exclusion and its impact. The starting point is to attempt to define financial exclusion:

"Financial exclusion refers to those processes that prevent poor and disadvantaged social groups from gaining access to the financial system. It has important implications for uneven development because it amplifies geographical differences in levels of income and economic development. In recent years the financial services industry has become increasingly exclusionary in response to a financial crisis founded in higher levels of competition."^[7]

Social exclusion as a modern phenomena is in many respects at the fore of the problems that need to be addressed by policy makers. 'Dropping out' of conventional social circles and economic structures is the most stark manifestation of social exclusion for individual Australians.

Social exclusion is engendered as a result of a number of different factors which include race, class, gender, health and sexuality. However, key to our study is the analysis of 'financial exclusion' and how it affects communities and individuals.

For this purpose, financial exclusion can best be described as the lack of access to financial services by individuals or communities due to their geographic location, economic situation or any other 'anomalous' social condition which prevents people from fully participating in the economic and social structures of mainstream communities.

Accordingly, financial exclusion is a key policy concern since the options for operating a household budget without mainstream financial services are more expensive, often unregulated and very limiting.

Recent studies conducted in the United Kingdom^[8] argued that financial exclusion is not just about changes to physical access caused by the changing geography of financial services provision. The study pointed out that exclusion from financial services has a number of other critical dimensions and identified them as:

Access exclusion: The restriction of access through the process of risk management;

Condition exclusion: Where the conditions attached to financial products make them inappropriate for the needs of some people;

Price exclusion: Where some people can only gain access to financial products at prices they cannot afford;

Marketing exclusion: Where some people are effectively excluded by targeted marketing and sales; and

Self exclusion: Where some people decide that there is little point applying for a financial product because they believe they will be refused. Sometimes this is a result of having been refused personally in the past, sometimes because they know someone else who has been refused, or because of a belief that 'they don't accept people who live round here'.

As a starting point for discussion of financial exclusion, the following items are key in our efforts to understand the effects of financial exclusion:

Financial exclusion is a complex and dynamic process. Some people experience short episodes of exclusion, maybe more than once in their lives. For a small number, however, it can be long term, perhaps even life long;

The majority of people without financial products are excluded by a combination of marketing, pricing and inappropriate product design; and

Financial exclusion depends mainly on who you are, but where you live is also important. Those at highest risk of suffering financial exclusion include people on low incomes who are in receipt of social security benefits (including pensioners and unemployed), with low education, and living in depressed economic areas or rural and regional areas.

The following are the groups that will most likely fall outside of the financial services system^[9]:

Households and individuals who have never had a secure job;

Elderly people who are part of a cash only generation;

Young people and households who have not yet made use of financial services;

People on low incomes;

Women who become single mothers at an early age; and

People and communities from non English speaking backgrounds.

According to past research in the United Kingdom, people stop using financial services either due to a drop in income, or, for women, the loss through separation or death of a partner who held all the household's financial products. Similarly, following a drop in income, some people choose to disengage from financial products in order to keep tight control over their money. Others however, only do so once they have fallen into financial difficulties and may have facilities withdrawn by financial services providers. Some women without financial products choose not to apply for replacements, while others apply but are turned down or do not apply fearing that they will be turned down. However, most of these people will resume using financial services once their income increases^[10].

Accordingly, large numbers of individuals and households are not denied access to financial products, but neither have they made an unconstrained choice to opt out. Instead, most face barriers which constrain their use of financial services. These include:

Products being too expensive, for example, high home content insurance for people living in economically disadvantaged regions;

Conditions attached to products, such as limited transactions, expensive cheque accounts and prohibitive fees and charges; and

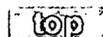
Financial institutions are generally not keen on attracting low income customers; hence there is virtually no marketing of their more affordable products such as basic bank accounts^[11].

In Australia, access to a bank account is in effect compulsory. Any given individual must have a bank account in order to receive their pay, pension and allowances. Failure to access a current account virtually deprives an individual of income. This is especially the case for many indigenous communities who are likely to reside in outback Australia and be heavily dependent on government benefits. While there are no particular policies which prevent the most disadvantaged from having access to an account, it is also the case that structural and procedural matters sufficiently disenfranchise an individual (including matters such as minimum account

balances, a fixed address, identification criteria and physical access in areas where bank branches have closed).

Without a current bank account households are forced to deal entirely in cash. This complicates the process of bill paying, may result in cash charges and prevents those individuals from utilising the convenience and cost effectiveness of electronic commerce. Lack of access to a bank account also creates difficulties for people wanting to either issue or cash a cheque.

Research



There have been major studies undertaken in the United Kingdom on the scale and impact of financial exclusion, and some smaller studies undertaken in Australia, the United States, Canada and New Zealand.

The main United Kingdom reports have considered the scale and impact of financial exclusion^[12], its possible link to education^[13] and options to improve financial inclusion both at the national^[14] and local level^[15].

Other research has looked at:

Redlining^[16] practices in mortgage lending;^[17]

Redlining practices in insurance;^[18]

Closure of bank branches in low income areas;^[19]

The rise of money lenders resulting from financial exclusion in urban areas;^[20] and

The rise of pay day lenders resulting from financial exclusion in urban areas.^[21]

Regulatory and policy responses to the problem of financial exclusion have only recently been developed in those jurisdictions, and the Australian debate can benefit from a study of these international developments.

Causes of Financial Exclusion



Most commentators and researchers who have considered the causes of financial exclusion conclude that it is a natural symptom of the larger forces of change affecting the financial services industry – globalisation and competition.

Pierre Agnes, for example, believes that financial exclusion is the result of several worldwide developments, all taking place simultaneously:

"During the past decade, the consumer financial services industry in Australia (and indeed in other OECD nations) has experienced substantial changes associated with several interrelated processes of global economic restructuring including deregulation, growing competition, the expansion of electronic banking, the rationalisation of bank branch networks, and the shift in service offerings by banks away from transaction accounts towards investment-based financial products such as superannuation and insurance."^[22]

Does this mean that financial exclusion is inevitable? Governments around the world have not been prepared to accept that financial exclusion cannot be addressed, and have recognised that the strength of financial exclusion depends on the actions of individual players within the industry and the reactions of government and the community. If the natural drift in the marketplace is towards financial exclusion, then this is an argument in

favour of intervention, rather than an argument against, as is sometimes assumed.

The main causes of financial exclusion for individuals can be grouped into one of two fields: affordability and access.

Affordability



The question of affordability needs to be carefully considered. It is not the contention of this paper that all financial services are unaffordable, or even that they are less affordable than previously. Clearly some financial services have become more affordable for particular groups. However, those financial services products which are essential for low income and disadvantaged consumers – bank accounts for daily transactions, consumer credit products and basic insurance products have generally become more expensive. Gizycki and Lowe have commented, by way of example, on the uneven distribution of affordable products and some of its causes:

"The growth of non-interest income over the second half of the 1990s is largely explained by growth in fee income, particularly from services provided to the household sector. The most notable examples are the introduction of mortgage fees and account service fees; for example it is now common for banks to levy monthly servicing fees of \$4 on transaction accounts and \$8 on mortgage accounts, whereas in 1990 such fees rarely existed. The introduction of these fees is part of the unwinding of cross subsidies that has followed the downward pressure on lending margins. While, in aggregate, consumers of financial services have benefited from this process, the benefits have not been evenly distributed, with some consumers of previously heavily subsidised services clearly worse off."^[23]

The motivation for the removal of cross subsidies and the drift towards full cost recovery on certain products is not entirely clear. The amount of extra income earned is marginal compared to the vast revenues raised by other bank activities (eg interest margins on lending products and fees from managed investments). Tripe contends that the motivation is merely to change customer behaviour:

"Account fee income is thus nowhere near enough to compensate for the reduction in banks' interest margins. Even if account fees were increased to somewhere near the cost of providing transaction services to customers, it is still unlikely that the revenue generated would make a large difference to banks' incomes... indications are that account fees are designed to change patterns of customer transaction behaviour rather than collect revenue."^[24]

Another motivation for the setting of fees is the desire to cherry pick profitable customers. Wealthy consumers (people with mortgages, people with term deposits or other investments, and members of professional associations) all receive generous fee exemptions and no attempt is made to recover the costs of individual transactions from such customers. This means that poorer customers who do pay fees subsidise their wealthier counterparts on a per transaction basis, although the banks would argue that the banks still make more income from their wealthy customers through their other business with the bank, despite the lost fee revenue.

Still another motivation is to exclude certain types of customers by discouraging them through high prices. This motive is rarely admitted in Australia although it is acknowledged quite frankly overseas^[25]. Occasionally an Australian bank will acknowledge this motive in very limited circumstances. In March 2001 the ANZ Bank introduced a new fee for cash advances on one of its popular credit cards. It noted that it was designed to discourage cash advances because their data showed that consumers who utilised cash advances were more likely to default on repayments^[26]. There was no link to recovering the costs of the transaction itself, which was well covered by an existing fee plus the fact that interest is calculated from the time of the cash advance, negating all interest free periods.

Other attempts to determine the extent to which banks deliberately price out some customers have not

succeeded, as bank staff have been unwilling to discuss the matter on the record. One review of this issue concluded:

"For banks, the issue of customer management and segmentation throws up emotive questions about social responsibility and shareholders' returns. Culling unprofitable customers, whether by stealth or not, goes against the first but improves the second."^[27]

While it is difficult to assess the exact motives of banks when they set their fee structures, the outcome of these fee structures is much more easily determined. Affordability becomes a barrier in a number of ways.

The bank fee poverty trap



Consumer organisations have argued for many years that banks, whether acting deliberately or not, have created a "bank fee poverty trap"^[28] from which their poorer customers are unable to escape.

The trap works in this way:

Banks charge account keeping fees on many accounts, including accounts specifically designed for disadvantaged consumers like pensioner deeming accounts, if a minimum balance is not maintained. Both the size of the fee and the size of the minimum balance required increase on a regular basis;

Banks waive all fees for consumers who have home loans, term deposits, or other investments with the bank. These waivers are almost always out of reach of low income and disadvantaged consumers;

Banks waive all fees and provide other discounted services for members of professional associations (such as lawyers). These waivers and discounts are not available to low income and disadvantaged consumers;

Banks increase fees on those transaction channels utilised by low income and disadvantaged consumers, especially over the counter transaction fees. Fees for electronic channels and Internet banking are usually lower, but low income and disadvantaged consumers have difficulty accessing those channels;

Banks impose severe restrictions on accounts designed for low income and disadvantaged consumers. Most do not pay interest. All will limit the amount of free transactions. Many will charge high fees after the number of free transactions has been exceeded. This is in contrast to the waiver accounts for wealthier customers which pay interest and are unrestricted^[29]; and

Banks impose very heavy fees for any form of default. These include slipping into overdraft temporarily, bouncing a cheque, receiving a bounced cheque, failed direct debits where insufficient funds have been available and late payment of credit cards. Interest and penalty interest may also apply to some of these situations.

This situation develops into a bank fee poverty trap because it is so difficult for a poorer person to move into a more affordable account. They are unlikely to earn interest and continual fees mean that they are unlikely to meet minimum balance requirements – especially on fixed incomes like social security benefits. Any temporary defaults will set them back substantially and often lead to a cycle of other fees. Even if low income consumers do gradually progress to the stage where they may avoid paying some fees, the fee structure at most banks changes every one to two years and may price them out again.

Of course it must be remembered that consumers caught in this trap are already disadvantaged to begin with. While the fee structures described above are not as advanced in the United Kingdom, research there has

recognised the 'double whammy' of being poor and paying higher fees for financial services:

"Affordability is a major obstacle to use of financial services among people with low disposable incomes. Not only do people on low incomes have little discretionary income for savings, insurance, credit or pensions, but it is also often the case that they pay more for financial services than others that are better off."^[30]

This fee structure is designed to attract and retain a different type of customer: The annual survey of the financial services industry by KPMG regularly reports on this issue:

"Fee structuring is also used by the banks to influence customer behaviour. Low-profit or loss-making customers are encouraged to use cheaper distribution channels, whilst highly profitable customers are rewarded with waived or reduced fees."^[31]

In the end, the bank fee poverty trap acts to entrench the position of low income customers. The only options for customers on fixed incomes are to qualify for a special 'basic' account, forgo interest and conduct as few transactions as possible, or to access electronic banking channels, which have particular expenses of their own.

Inappropriate accounts



Another cause of financial exclusion linked to affordability is the number of people who are in inappropriate accounts. This seems to arise from:

- Poor consumer understanding of the different account choices available;
- Lack of promotion of specialist accounts (eg for social security recipients);
- The complexity of current bank fee structures;
- Difficulties (perceived and real) in changing accounts; and
- Lack of consumer confidence that another account will actually be more affordable.

Of course, these arguments presume that appropriate accounts are actually available for all consumers, and this is definitely not the case. For example, it has taken years of advocacy to convince the bank with the most pensioner customers (the CBA) to offer an account to pensioners which offers at least one free over the counter transaction per pension pay day^[32].

However, good accounts exist in some categories with some banks, especially for youth, students and people receiving disability benefits.

It is clear that the complex system of fee waivers and fee rebates offered by Australian banks is not working effectively to ensure that banking services are affordable to all Australians.

Most banks offer total fee waivers on transaction accounts for any customer with a home loan, many customers who have other business with the bank, and some professionals. They also offer tailored transaction accounts with limited free transactions and rebates for some consumers who fit into specific categories of disadvantage. The result of this jigsaw puzzle, according to the Chairman of the Australian Bankers' Association is as follows:

"It costs a bank like the National around \$200 a year to run the average transaction account. About half of bank customers don't pay any fees (because of other business they have with the bank) and the other half pay an average of \$120 per year. So in essence, banks don't recover the cost of

running the account.^[33]

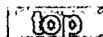
This shows that the banks recover just \$60 on average per account on their own figures, yet remain very profitable. This figure is backed up by evidence before the Joint Statutory Committee on Corporations and Securities Inquiry into electronic bank fees (the Chapman Inquiry)^[34] which showed that banks only recovered one third of their costs through present fee structures^[35]. Unfortunately not everyone pays \$60 per account, and those people who do pay fees bear a disproportionate burden of the costs incurred by banks. They will not be wealthy customers, as those customers have the simplest and most comprehensive fee waivers.

A survey^[36] of members conducted by the Australian Consumers' Association in 2000 found that 35% of respondents benefited from a fee exemption. The reasons for the exemption included:

- 60 % because they had other business with the bank;
- 17 % had exemptions because they were pensioners;
- 1 % because they were students; and
- 1% because they had a disability.

Unfortunately this type of information, extended to the entire population, is not available to the public. It is therefore difficult to assess what type of customers benefit from waivers. The banks have only made information available about the aggregate number of consumers who receive waivers, without any demographic break-down^[37]. There has been no independent survey of general consumers on this issue.

Access



The most critical development in the banking industry over the past ten years has been the method of delivering and accessing financial services. Changes in technology have meant that traditional methods of delivering those services are quickly phased out. Face-to-face banking transactions are no longer a prerequisite for delivering financial services. Australian banks have been aggressive in their rush to reduce customer dependency on traditional banking methods. The new methods of operation include telephone banking, Automatic Teller Machines (ATM), the EFTPOS system and Internet banking.

The evolutionary shift from traditional face to face banking to electronic has also been responsible for facilitating systematic re-assessment of costs among mainstream financial institutions and has ushered in a period of cost-reduction and a redirection of resources to maximise profits. Accordingly, the maintenance of traditional banking services, including branch networks, was seen as too costly by the banks. Over the past ten years, Australian consumers have had to endure a massive spate of bank closures fuelled by this supposed drive to greater efficiency as well as market consolidation through a further spate of bank mergers.

Branch closures

Branch closures are not a new phenomenon and have been the subject of expert commentary for many years.^[38] However, the period 1993 to 2000 seems has seen a substantial increase in the rate of closures. During this period there have been more than 2000 branch closures – more than 700 of which were in rural and remote areas.^[39] The pattern of branch closures has been spatially uneven, focusing on remote communities and deprived urban areas, populated by people on low incomes. Leyton and Thrift have described a similar process in the UK as 'financial desertification'. This is in view of some regions and suburbs suffering a complete physical withdrawal of financial services.

The National Farmers Federation has estimated that there are around 600 communities in rural and regional

Australia without any access to financial institutions^[40]. It seems that Australia-wide, towns with populations of less than 1000 account for over 50 per cent of towns where banks have closed their only branch in town - towns with populations of less than 600 account for nearly 44 per cent.

New technology



Access to new technology financial services, especially Internet banking, is subject to extremely high barriers to access. The National Centre for Social and Economic Modelling (NATSEM) research carried out in 2000 found that significant sections of Australian society do not enjoy access to online services^[41]. They found that access barriers were not geographical - they were more likely to be the result of low income or low levels of education.

The costs for a person to use Internet banking will often outweigh any benefit that might result from the lower fees generally charged for Internet banking transactions. These costs include the costs of obtaining a PC and modem; dial up or permanent connection costs and per hour ISP charges.

While the number of Australian households with regular Internet access is increasing, there are still more than 50% of households with no access, and poorer sectors of the community will not have effective access to Internet banking for many years. The latest ABS statistics on Internet access^[42] show that the growth in access has varied to a great degree each year and may now be slowing. The growth in household access to a personal computer is beginning to plateau:

| | 1996 | 1997 | 1998 | 1999 | 2000 | 2001 ^[43] |
|--|------|----------------------|------|------|------|----------------------|
| Households with Internet access | 3.3% | 12.5% | 19% | 25% | 37% | 50% |
| <i>Metropolitan</i> | | | 22% | 30% | 40% | |
| <i>Regional</i> | | | 13% | 17% | 32% | |
| Growth | | 378% ^[44] | 52% | 31% | 48% | 35% |

| | | | | | | |
|----------------------------------|-----|-----|-----|-----|-----|--|
| Households with Computers | 26% | 34% | 47% | 50% | 56% | |
| Growth | | 30% | 38% | 6% | 12% | |

This trend is extremely worrying for financial exclusion because it may mean that a particular segment of the community will continue to require traditional access to financial services, yet the banks are pursuing electronic banking as their primary means of access. The entrenched section of the community who will remain without Internet access will be extremely difficult to service in the future if branch networks are not maintained and, indeed, upgraded. It is clear that access to new technology will be the next significant barrier to access to financial services.

Language

Language has been raised as a significant barrier to accessing financial services in research conducted in the United Kingdom:

"Several studies point to language and cultural barriers. This is especially the case for first generation immigrants with poor levels of literacy in English and little prior experience of financial services. These language and cultural differences act as barriers in their own right, restrict levels of knowledge of financial services and fuel mistrust of UK financial service providers."^[45]

Unfortunately no large scale research has been conducted on this issue in Australia. However, two smaller reports – both studying the experience of migrants in banking in Melbourne - have been undertaken^[46].

Education



Education emerged as a significant barrier to accessing financial services in the United Kingdom research^[47]. The most recent UK research suggests that there is a direct link between financial exclusion and childhood education^[48].

In Australia, the Australian Securities and Investments Commission has undertaken a Stocktake of Consumer education in Financial Services and has published a discussion paper on educating financial consumers. Both these documents draw attention to the lack of consumer education in financial services in Australia, and are discussed in more detail in Chapter 3.3.7.

The National Centre for Social and Economic Modelling research on Internet access also noted that lack of education was a major barrier to Internet access, finding that consumers with an undergraduate university degree were 2.3 more times likely to have Internet access than those with only primary education.^[49] The implications for access to electronic banking are significant.

Ability



Access for people with disabilities to some forms of financial services can be problematic. While the issues are similar for many other services, there has been a particular emphasis on the interaction between people with disabilities and ATMs. This is because in a situation where no human interaction is possible, the location and design of the ATM becomes paramount in ensuring appropriate access.

In 2000 the Human Rights and Equal Opportunity Commission (HREOC) published its final report on barriers to access to electronic commerce for people with disabilities and older persons^[50]. This study included a specific survey of Automatic Teller Machines selected by the banks as their 'most accessible' which found significant access problems for people with disabilities^[51].

The Australian Bankers' Association and community organisations representing older persons and people with disabilities have been involved in an ongoing process to establish an industry wide disability action plan.

It is expected that the plan will be announced in early 2001. Therefore this report does not consider those issues in greater detail.

Opening requirements



The opening requirements for consumers wishing to establish a general transaction account in Australia are not stringent. There is usually no minimum balance^[52] and proof of employment is not required. These two barriers to access have emerged as significant factors overseas.

However, the identification requirements may be difficult for some consumers, and are certainly perceived as difficult by many in the community and that perception alone may act as a barrier to access.

The identification requirements are contained in regulations under the Financial Transactions Reporting Act 1988. These establish the well known 100 point test for evidence of identity required to open a bank account. Major identification documents such as passports and drivers' licences score heavily in the test, and it can be difficult to reach the 100 point limit for some consumers without these documents.

However, it is possible to obtain a reference from Centrelink worth 100 points and this is suitable for most consumers receiving any form of social security benefit. Unfortunately the availability of this service does not appear to be widely known, leading to the perception that opening an account can be impossible or difficult for many disadvantaged consumers.

This barrier to access is therefore one which could easily be addressed by Centrelink and bank education programs and assistance.

Groups of Consumers Affected by Financial Exclusion



The international research and this report's analysis of the Australian situation indicates that there are specific groups of consumers who are affected by financial exclusion.

Regional and remote communities

Probably the most obvious form of financial exclusion is where there is simply no form of physical access to financial services. It is therefore no surprise that the leading categories of financial exclusion in all jurisdictions, but especially in Australia and Canada, are based on geography.

In Australia the communities with the least access are those in regional and remote areas. The House of Representatives Committee on Economics Finance and Public Administration Regional Banking Inquiry (the EFPA inquiry) considered these communities in some detail. The National Farmers Federation submitted to the EFPA inquiry that there were more than 600 communities in regional and remote Australia without physical access to a financial institution. This figure was unchallenged in the inquiry and remains the most relevant to date^[53]. The figure may be slightly higher now since the pace of branch closures has outstripped the opening of Rural Transaction Centres^[54] (discussed in Chapter 5).

Urban depressed communities

Less consideration has been given to the level of financial exclusion in metropolitan areas, particularly in urban depressed and urban fringe communities.

The Minto case study contained in Appendix 1 sets out some of the issues relating to financial exclusion in urban areas. Unfortunately there has been no general quantitative research in Australia on financial exclusion in urban areas to date.

Low income consumers



In Australia, there appears to be a particular emphasis on affordability as a cause of financial exclusion. Other barriers to access seem to be more prominent in the United Kingdom, but this may be because they have much lower fees than in Australia. Indeed Australian bank accounts appear to be very expensive when compared to international products. Appendix 3 considers this issue in more detail.

Low income consumers therefore bear the brunt of financial exclusion in Australia. However, some commentators have noted that the forces of financial exclusion affecting low income consumers today will gradually have an impact on other consumers:

“In the 1990s, as the financial services industry follows a strategy of retrenchment and exclusion, we can anticipate that the problems affecting the poorest and most disadvantaged groups in society will intensify. Moreover, they will also begin to spread to less poor and less disadvantaged groups, with the result that the problems associated with low levels of access to financial services will develop in new geographical areas and among new social groups.”^[55]

Older consumers

It is probably too broad a claim to suggest that older consumers in their entirety suffer financial exclusion. There are too many variables within the group. However, older persons have low levels of access to online services and often low levels of mobility. These two factors alone contribute to financial exclusion, but when combined with the low (and often fixed) income levels of many older consumers, sections of the group certainly suffer from financial exclusion.

Consumers from Non English Speaking Backgrounds



Consumers belonging to Non English Speaking Background communities tend to be amongst the most disadvantaged in the community.

According to the most recent census, a very large proportion of people from NESB live in poorer parts of Australia's major cities. Consequently, they tend to suffer the double disadvantage of being of NESB as well as living in areas which are already less affluent and hence suffering from a degree of financial exclusion.

A study of banks and migrants found that migrants are marginalised as a result of bank neglect. Migrants, according to the report by Supriya Singh^[56] are an “untapped market”. The report generally found that NESB communities have been very poorly served by the financial system and hence disadvantaged. The report found that:

- Banks and non-banks are not effectively competing for the business of the poor;
- Nearly four-fifths of NESB consumers have been with the same bank since their arrival in Australia; and
- Nearly one in ten did not have a bank account.

Consumers with disabilities

As discussed above, access to financial services by people with disabilities is the subject of an ongoing review by the Human Rights and Equal Opportunity Commission^[57], and is not discussed further in this report.

Consumers with literacy difficulties

There has been no study of financial literacy in Australia. However, the conduct of such a study was a major recommendation of the Australian Stocktake of Consumer Education in Financial Services^[58] and a study of financial literacy is being considered by the Australian Securities and Investments Commission^[59].

The Australian Securities and Investments Commission also lists “improving financial literacy for adults” as one of

its priorities^[60]. While there is no data available on financial literacy, Australian data on general and numerical literacy is not encouraging. The Australian Bureau of Statistics literacy survey in 1996 found that 20% of Australians aged 15-74 had "very poor" literacy skills and 28% had "poor" literacy skills.^[61]

In the United Kingdom there has been extensive research on financial literacy and its link to financial exclusion:

"There is an extensive research literature on financial literacy, which shows that consumers generally often lack the information they need to make decisions about the purchase of financial products... For a minority of people lack of knowledge is a barrier to the use of financial services at all. Here it is not just a matter of feeling confident about buying the right product, but more that they either do not know what sort of products are available or where to go to buy them."^[62]

Obviously efforts to address financial literacy are difficult and require long term planning. It will be important to ascertain the level of financial literacy in Australia and any links between financial literacy and financial exclusion as soon as possible. This factor has emerged as very significant in other jurisdictions.

Indigenous consumers

This report has not considered the impact of financial exclusion on indigenous consumers and their communities. That topic requires further detailed research and consultation with those affected. However, it is highly likely that indigenous communities will be affected by financial exclusion owing to geographic, economic and social factors.

There have been no large scale studies of financial exclusion amongst indigenous communities in Australia, although some general research has touched briefly on problems with indigenous access to credit and insurance.

^[63]

Consequences of Financial Exclusion



Financial exclusion as we understand it, is a permanent feature of the financial landscape. The consequences of not having an affordable bank account are more serious now than they were in the past. On the whole, the options for operating a household budget outside the mainstream financial services sector are far more costly and often unregulated. Further still, where whole communities have limited access to financial products, the process becomes self-reinforcing and an important contributor to social exclusion more generally.

Being without banking facilities has become increasingly problematic as the majority of people now make heavy use of a bank account and the facilities for automatic transactions that this provides. Lack of access to a bank account and banking facilities can make money management more complex and time consuming, more costly and less secure. UK researchers have noted that we are entering a period where financial exclusion has mattered more than in any previous era:

"Ironically, as the number of excluded households falls, the problems they face become more severe. Being without a current account, insurance or long term investments or a pension is more important because these products are so much more common among the majority of households. Indeed, lacking financial products can contribute to more general social exclusion and most households in this position identify key areas of unmet need."^[64]

It is important to recognise that the consequences of being without banking facilities do not simply apply to those who have no current account at all. They can be equally relevant to people who have basic bank accounts, but are not given access to additional banking and financial services such as direct debits, cheques, and credit or debit cards. These consequences impact on three main areas of people's lives:

- Handling cheques and cash;
- Paying bills; and
- Access to short-term credit facilities and other financial products that require ownership of banking facilities.

UK research^[65] has found that the top priority need for financial products that has been identified by the financially excluded is for an account to receive income and make payments. The same research found that needing to cash or issue a cheque can be very problematic for people without a bank account. These people also have problems if they receive or need to make cheque payments. With most cheques being 'not negotiable' for obvious reasons, people without a current account have to have the cheques made in a friends' or relatives' name and hence depend on the trust of the third party. Other excluded people have to rely on using the fast expanding network of cheque cashers with very high fees and charges who often require the provision of security.

Lack of access to a bank account also requires those people to keep money at home or carry it until they are ready to spend it. This compromises their safety and security, deprives them of interest earnings and from establishing a savings record for future reference.

Within the Australian context, possession of a bank account is often a portal to the provision of other important financial products. Amongst those is access to short term credit facilities such as credit cards. Accessing non credit card loans is also a very difficult process as access to any given loan is often based on a set criteria which amongst other things, includes having a bank account through which the customers' financial transactions are monitored in order to establish whether he or she is a worthy credit risk.

Credit facilities are generally used in two ways. Shorter term credit, such as a credit card is often used to ride out peaks and troughs in a person's or family's household budget. Other longer term products such as personal loans are used to purchase larger items such as consumer durables or cars.

A current account is often the 'passport' upon which a bank, credit union or building society depend to approve a loan. Failure to own an account often leads to those same consumers having to look for other less reputable means to meet their credit needs. Studies in the United States^[66] show that these people fall into two groups. First, people with poor credit records or a history of bad debt, who are forced to turn to non-traditional lenders to meet their credit needs. Secondly, people living on low incomes who often have to look to alternative credit providers, such as money lenders and pawnbrokers.

Both these groups of people are particularly vulnerable, as they have no option but to borrow from lenders operating outside the mainstream credit industry, some of whom are less principled in their mode of operation. Pay day lenders for example may charge interest rates which, depending on the length of the period, range between 500 and 2000 per cent.

This report divides the consequences of financial exclusion into three categories: personal consequences, business consequences and community consequences.

Personal consequences

The personal consequences of financial exclusion in Australia are similar to those of the international experience as set out above, with two important differences.

The first is that Australia does not have the same proportion of persons without access to a bank account as abroad. Our social security system which relies heavily on the direct deposit of benefits into an account has resulted in a comparatively high level of penetration of accounts. Whether or not these accounts are accessible or

affordable is another matter, but compared to overseas Australia does not have the problems associated with large sectors of the community who are "unbanked". The major personal consequence in Australia appears to be the high cost of personal banking, and the financial strain which this places on low income consumers.

A small minority of consumers do not have bank accounts and make special arrangements with their local Centrelink provider for the payment of benefits.

The second distinctive feature of the Australian experience is that geographic factors play a more significant role (although the issue is similar in regional and remote areas of Canada).

The personal consequences of financial exclusion as a result of geographic factors have been considered briefly in Australian research. Beal and Ralston, writing in 1998, found that the main personal consequences of exclusion as a result of a bank branch closure were:

- Reduced savings;
- Increased size of cash withdrawals;
- Reduced investment income;
- Reduced access to and increased cost of finance; and
- Reduced access to financial planning.^[67]

The EFPA inquiry found several additional consequences from its consideration of the submissions made to it:

- Increased travel requirements;
- Increased security risks; and
- Increased need for credit from local businesses.^[68]

Community consequences

The consequences of financial exclusion on communities in urban areas are well set out in the Minto case study described in Appendix 1. The main consequences are:

- Increased travel requirements;
- Higher incidence of crime;
- General decline in investment;
- Difficulties gaining access to credit;
- Decreased choice in local shops and businesses; and
- Increased unemployment.

The consequences of financial exclusion on communities in regional and remote areas are, again, considered by Beal and Ralston:

Financial drain from the community, as people travelled to larger centres to do their banking and shopping, with 88% of respondents reporting that their expenditure locally had decreased;

Loss of financial investment, with 30% of respondents indicating that the new financial environment had persuaded them not to proceed with undertaking a loan; and

Loss of confidence in the community, with 90% of respondents indicating they were now more pessimistic about the future of their community and 39% reporting that they would leave if they could. [69]

Conclusion



This paper has demonstrated that access to financial services has become central to any individuals' or communities' ability to integrate within the wider community. The paper has shown that a deliberate government policy of 'deregulation' and economic 'rationalism' have been key factors in generating the conditions necessary to create social exclusion and alienation. This paper acknowledges that the provision of housing, health care, transport are critical factors in engendering social exclusion, however, it stresses that the combination of economically rationalist government policy, poor educational resources and an lack of financial sector concern for educating its consumers have been critical in creating zones of social and geographic exclusion whereby the disadvantaged position of many Australians is further exacerbated. This paper has established that given all the reasons for financial exclusion, a protracted effort must be instituted whereby government, industry and community will learn to recognise the centrality of access to literacy to the total well being of community and individual.

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