BE CAREFUL WHAT YOU ASK FOR

What Role Now for Credit Unions in Addressing Financial Exclusion in Australia?

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This article asks whether credit unions have a role to play in addressing financial exclusion in Australia. It considers the extent to which the current regulatory regime in Australia might hamper the ability of credit unions to contribute to financial inclusion, but then also asks whether credit unions in Australia do, in fact, have the ability to make that contribution, even under a less onerous regulatory regime. The focus on growth and the desire on the part of credit unions to be treated like banks for regulatory purposes may compromise the ability of credit unions to contribute meaningfully to financial inclusion in Australia, with the exception of small, community-based credit unions. Those credit unions do have a role to play, but will need to be granted appropriate regulatory exemptions to enable them to both start up and continue to operate as mutual organisations, focused on providing services to their members rather than generating profits.

Introduction

There is a suggestion, which will be explored in this article, that credit unions have a role to play in addressing the problem of financial exclusion in Australia. This article does not purport to address all possible solutions to financial exclusion — which might, for example include regulation of other mainstream financial institutions such as banks, and greater government and industry support for the work of community organisations in providing no-interest or low-interest small loans. This article is limited in its scope to focusing on any possible contribution that credit unions might make to address this problem. The article asks whether credit unions are hampered in their ability to make such a contribution because of onerous regulation. Applying the concept of ‘responsive regulation’, it might be argued that regulators need

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to take into account 'the conduct of those they seek to regulate in deciding whether a more or less interventionist response is needed'.¹ This involves commencing with the least interventionist regulatory response, moving only to a more interventionist one when that fails.² In short, regulatory theory would suggest that the regulatory rope should be loosened from the necks of those credit unions focused on providing savings and credit facilities for social purposes, on the basis of their 'conduct'. This would enable those credit unions to contribute to overcoming financial exclusion to the greatest extent of their potential. The question remains, though, as to whether credit unions in Australia do, in fact, have the ability to make that contribution, even under a less onerous regulatory regime.

It is interesting that credit unions have been viewed in recent history by policy makers in the United Kingdom as having 'an important role in tackling financial exclusion'.³ This may also be true of credit unions in Australia, a possibility that I wish to explore in this article. The concern, however, is that there are considerable regulatory barriers to this work — for example, in the treatment of credit unions more or less as banks for capital adequacy purposes, thus ignoring their mutual structures which impact upon possible capital raising methods, and in the obstacles to getting a licence to operate as an Authorised Deposit Taking Institution (ADI), which prevent people wishing to revitalise their communities through the establishment of a credit union from doing so without significant external support.

Credit unions have largely asked to be treated like banks for regulatory purposes. Whilst this has not in any way been the impetus for regulatory reform, and there is no suggestion that if credit unions had asked to be treated differently they would have been treated differently, it is interesting to note their willingness to be drawn into a 'one size fits all' model. The Wallis Inquiry reported in 1996 that:

The building society and credit union industries both made submissions strongly supportive of being brought under a single Commonwealth regulatory scheme, preferably within the same scheme of prudential regulation as applies to banks.⁴

This is in part explained by a desire to be able to compete with the banking sector on an equal footing in terms of community perceptions of security and stability,⁵ and also a wish to escape ever more onerous regulation following the establishment of the Australian Financial Institutions Commission in 1992.⁶ One consequence of this 'one size fits all' regulation

¹ Braithwaite (2002), p 29.

² Braithwaite (2002), p 30.

³ HM Treasury (1998), quoting Patricia Hewitt MP.

⁴ Wallis (1996), p 306.

⁵ Lewis (2001), p 36, quoting a submission made to the Wallis Inquiry by CUSCAL Public Affairs and Governance General Manager Dave Taylor.

⁶ Davis (1994), pp 35 and 37.

has been the creation of many large credit unions, often through mergers of smaller credit unions, which can be fairly described as 'quasi banks', and which arguably can offer little in terms of improving access to financial services by low-income consumers. One cannot help but wonder whether the credit union movement would have been better placed fighting for quite different regulatory treatment altogether, under a regime that recognised the inherent nature of a mutual organisation and enabled credit unions to fill the space in financial service provision for which they were designed.⁷

Race Mathews has noted that credit unions originated in postwar Australia because of a need for affordable personal loans for furniture and household appliances. At that time, a person seeking finance in order to purchase such goods was otherwise limited to applying for finance from exploitative money-lenders.⁸ We are at a point in history where, once again, there are Australians unable to access small personal loans from mainstream financial institutions in order to acquire essential household goods. If they are unable to access finance through community organisations,⁹ and lack informal support networks such as family and friends, they must turn to fringe credit providers such as payday lenders who often charge exploitative rates of interest.¹⁰ Unlike postwar Australia, however, those most in need of affordable personal finance today are low-income and socially disadvantaged groups, rather than middle-income groups. It seems logical, therefore, that such socially disadvantaged groups could become the focus of at least some credit unions in their role as providers of loans for social purposes. Visualising a continuum on which all credit unions sit, at one end are the small community-based credit unions which, it is argued, do have a role to play in addressing financial exclusion. At the other end are the large 'quasi bank' credit unions which would have little or no desire to participate in such a role. It is important that this distinction is made when discussing the role of credit unions and the need for regulatory reform.

In this article, I touch on the meaning of 'financial exclusion' in the Australian context, in terms of a lack of access to safe and affordable forms of credit by low-income consumers. I then examine the characteristics of credit unions as mutual organisations (as opposed to profit-driven corporations) which, on the face of it, make them suitable organisations to address this social problem. I describe the work of small community-based credit unions in Australia, as well as the 'Creditcare' initiative, as evidence of the positive contributions that credit unions have been able to make in ensuring adequate access to loans and other financial services in communities that would otherwise lack access.

⁷ See, for example, discussion in Mathews (2001).

⁸ Mathews (2001).

⁹ For example, No Interest Loans schemes or 'Step Up' Loans offered by Good Shepherd Youth and Family Service: see Ayres-Wearne and Palafox (2005).

¹⁰ I have written on the payday loan phenomenon elsewhere. See discussion in Wilson (2004).

This article will conclude by arguing that the transition from credit unions in their traditional form to 'quasi banks' in many cases may be such that it is too late to rely upon their industry as a whole to take up a role in addressing financial exclusion. Loosening the regulatory rope in relation to all credit unions may not be the solution to this, given that credit unions themselves seem to have asked for that rope to some extent. Perhaps it is time to foster and encourage, through more tailored and appropriate regulation, one class of credit union which I call the small community-based credit union. It may also be time to look to new innovative models whereby communities can work together to improve financial access.

Financial Exclusion in Australia

In this section, I give a brief account of financial exclusion in Australia; however, it is beyond the scope of this article to explore this phenomenon in any great detail.¹¹ The term 'financial exclusion' originated in the United Kingdom, and has been in use there since at least the mid-1990s¹², defined broadly as 'those processes that prevent poor and disadvantaged social groups from gaining access to the financial system'.¹³ Financial exclusion subsequently came to be viewed in the United Kingdom as lack of access to the *mainstream* financial system which includes banks, building societies and credit unions.¹⁴

A research report into financial exclusion in Australia undertaken in 2004 provides as a 'working definition' of financial exclusion in Australia: 'The lack of access by certain consumers to appropriate low cost, fair and safe financial products and services from mainstream providers.'¹⁵ Interestingly, the definition emphasises the cost and safety of available products, thus distinguishing between mainstream products and alternative products such as payday loans. It is people on low incomes in Australia who are most likely to be excluded from access to mainstream credit products, and who are most likely to turn to unaffordable and unsafe forms of credit and consequently find themselves in positions of financial stress and indebtedness.¹⁶ A report prepared in 2001 stated: 'In Australia, there appears to be a particular emphasis on affordability as a cause of financial exclusion ... Low income consumers therefore bear the brunt of financial exclusion in Australia.'¹⁷

Those living on low incomes and suffering exclusion from mainstream credit services are likely to turn to alternative credit providers such as payday

¹¹ I have written elsewhere on financial exclusion. See, for example, Howell and Wilson (2005).

¹² See, for example, Leyshon and Thrift (1995).

¹³ Leyshon and Thrift (1995), p 312.

¹⁴ Kempson (2000).

¹⁵ Chant Link and Associates (2004), p 58.

¹⁶ Australian Bureau of Statistics (1999–2000); McColl, Pietsch and Gatenby (2002); Eardley (2004).

¹⁷ Connolly and Hajaj (2001), p 22.

lenders to meet their credit needs.¹⁸ Given that such alternative credit products tend to be far more expensive than mainstream credit,¹⁹ reliance on such products only exacerbates problems of over-indebtedness.²⁰ This lends support to an argument in favour of mainstream credit providers 'filling the gap' and providing short-term consumer credit to low-income consumers on reasonable terms. This argument is often met with concern that extending *any* credit to low-income consumers can only worsen their financial positions. It is generally acknowledged, however, that 'while borrowing money to supplement a low income may not be desirable it may, in some circumstances, be unavoidable — either to buy essential household items or to make ends meet'.²¹

Greg Fisher of Fitzroy and Carlton Community Credit Union, which is one of the few mainstream credit providers in Australia²² willing to provide small loans to people on low incomes, including Centrelink²³ recipients, has observed in an interview with the author that someone receiving \$400 per fortnight in welfare benefits will find it extremely hard 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 position.²⁴

Exclusion of low-income consumers from access to mainstream credit products is one aspect of financial exclusion that 'unquestionably leads to the poor paying more',²⁵ and exacerbates problems of over-indebtedness which can have wide-ranging social consequences including burdens on the health system, burdens on legal aid, impacts on productivity due to stress and absenteeism, and child poverty.²⁶

So what is — or should be — the role of credit unions, as mainstream providers of credit, in addressing financial exclusion in Australia? Historically, credit unions have been the perfect vehicle for solving the needs of a community for affordable finance. The union was formed and members pooled their savings and were able to borrow from the pool at affordable rates. The

¹⁸ Kempson (2000), p 42.

¹⁹ One example being payday loans which, when the fees charged are converted to annual percentage interest rates, can involve interest between 235 and 1300 per cent per annum. In this regard, see Queensland Office of Fair Trading (2000).

²⁰ See discussion in Department of Trade and Industry (UK) (2003), p 77.

²¹ Kempson (2000), p 41.

²² ANZ Bank currently offers such loans in parts of Victoria as part of a pilot of the 'Progress Loan' being offered in partnership with Brotherhood of St Laurence; NAB offers the 'Step Up Loan' in parts of Victoria and New South Wales in partnership with Good Shepherd Youth and Family Service.

²³ Centrelink is the Australian social welfare office.

²⁴ Interview with Greg Fisher, General Manager, Fitzroy and Carlton Community Credit Union, 18 August 2006.

²⁵ Cartwright (2004), p 212.

²⁶ Department of Trade and Industry (UK) (2003), pp 77–78.

credit unions were established as mutual organisations in the sense of being owned by those who saved with and borrowed from them. Today, many credit unions behave more like banks than mutual organisations, and those which wish to operate in more traditional ways for the benefit of members face difficulties in meeting regulatory requirements. Certainly 'traditional' models of credit unions find it very difficult to 'start up' in the current regulatory environment. There is no doubt that credit unions have provided, and continue to provide, valuable services in the area of financial inclusion, although the credit unions working in this area tend to be those that have retained their traditional, small community-based character, often against the regulatory odds. In the next section, I explore the flaws in the argument that credit unions are the answer to financial exclusion.

Credit Unions: Part of the Solution?

The mutual nature of credit unions is central to their perceived role with regard to financial inclusion. Credit unions are a form of mutual organisation or cooperative institution, owned by their members. Each customer becomes a member through the purchase of one share, which carries an entitlement to vote at members' meetings.²⁷ The concept of mutualism involves people working together to improve their access to affordable financial products. Race Mathews explains that:

Mutualism is about self-help through cooperation — about resolute and principled households combining to bring about, through their shared efforts and enterprise, outcomes that would be unachievable for them in isolation from one another. Mutuals invariably emerge consequent on unsatisfied needs, as a means whereby access is obtained to goods and services that otherwise would be unavailable or unaffordable.²⁸

In asserting the inherent socially responsible nature of credit unions, the Credit Union Industry Association in Australia has made the point that:

As mutual organisations, credit unions are not driven solely by profit motives like most other corporations. Instead, they are dedicated to returning benefits to members. This typically arises in terms of fairer fees and product and service pricing as well as their contribution to their local community.²⁹

In the United Kingdom, credit unions have been regarded in the recent past as an important part of the solution to financial exclusion. Patricia Hewitt MP, Economic Secretary to the Treasurer at the time, said in 1998 that:

²⁷ Davis (1994).

²⁸ Mathews (2003), p 2.

²⁹ Credit Union Industry Association (2006).

Credit Unions have an important role in tackling financial exclusion. They provide savings facilities; a source of low cost personal credit and financial education and advice. Our approach to credit unions is to encourage the movement to grow, while retaining and strengthening its traditional focus on the poorer members of society.³⁰

There is a question as to whether the two stated goals of growing and retaining traditional focus are in fact compatible. Whilst credit unions in the United Kingdom have been asking for the opportunity to 'grow effectively' in order to compete significantly with banks and building societies,³¹ and to cast off the shackles of being 'referred to as a poor persons' bank' and of being 'heavily associated with fighting financial exclusion',³² there is the obvious risk that once they do that, they will no longer be of an appropriate size and nature to play that 'important role in tackling financial exclusion'.

Becoming bigger is not always necessarily better. It can be argued that such growth is only likely to lead to credit unions becoming 'quasi banks' that are no longer focused upon providing services to members, including those on low incomes, and where the sense of member loyalty to the credit union (which may be important in maintaining low loan default rates)³³ is lost. A case study on point is one undertaken in relation to the Derry Credit Union in Northern Ireland.³⁴ The empirical study involved interviews with the customers of Derry Credit Union, which demonstrated that the customers very much viewed the credit union as a financial institution which could provide low-cost loans, but did not see it as different to banks in any other real respect, and did not feel any particular sense of loyalty to it as an institution. It had grown from five founding members pooling their savings in 1960 to an institution with over 25 000 members, and so was highly successful on the face of it, but had lost its 'community character'. The authors of the study take an extreme view that mutualism is more or less dead in modern British society, asserting that:

After twenty years of Thatcherism and a prevailing ideology of individualism and promotion of the free market, concern for the wider community has diminished and priorities now revolve around individuals and their families. The notion of beleaguered communities pulling together through mutual aid and self-help appears to be a case of wishful thinking.³⁵

I would not be so ready to dismiss the ability and motivation of 'beleaguered communities' to 'pull together through mutual aid', but I argue

³⁰ HM Treasury (1998), quoting Patricia Hewitt MP.

³¹ Davies (2000).

³² Ryder (2002), p 425.

³³ Bosley (2006).

³⁴ Heenan and McLaughlin (2002).

³⁵ Heenan and McLaughlin (2002), p 258.

later in this article that forming a credit union may not be a suitable mechanism for doing so given the current regulatory environment which makes it difficult, if not impossible, for small community-based credit unions to survive, let alone start up.

It seems that in recent years, credit unions in the United Kingdom have been undergoing some soul-searching concerning how they wish to be structured and perceived. The movement as a whole seems to have leant towards the 'bigger is better', 'quasi bank' model, in the interests of being competitive.³⁶ Gary Lewis describes similar soul-searching in Australia between 1979 and 1983, with debates, for example, over whether there was a credit union 'movement' or 'industry'.³⁷ Lewis quotes Tom Kelly from the Railway Employees Credit Union as saying in 1978:

I believe we should rededicate ourselves to the slogan 'Not for profit, not for charity, but for service'. We have need to constantly remind ourselves that our very reason for existence as a credit union is to help our fellow men in encouraging thrift and helping them in times of financial need.³⁸

It was noted that the more credit unions became like other financial institutions, the more likely it was that they would lose special regulatory concessions, as did occur under the Financial Institutions Scheme launched by the Australian Financial Institutions Commission in 1992. Lewis quotes New South Wales minister Sydney Einfeld speaking in 1979 in this regard:

As members of the finance industry, is there a point at which credit unions go beyond their guiding philosophy? If there is, should credit unions continue to be granted special status? So, the movement in Australia could well be at a critical point in its development ...³⁹

Referring to Dermot Ryan, who was the founding director of the Australian Credit Unions Historical Cooperative Limited formed in 1985:

Ryan was convinced that the movement had forgotten its premises of thrift and pooled funds from which low-cost loans could be made, had forgotten the very people for whom it had been created. Loans should be based on need, character and an ability to pay and, Ryan warned darkly, current policies would eventually lead to a loss of support in parliament for such privileges as credit unions enjoyed, in particular taxation exemptions.⁴⁰

³⁶ Davies (2000).

³⁷ Lewis (1996), p 293.

³⁸ Lewis (1996), p 291.

³⁹ Lewis (1996), p 291.

⁴⁰ Lewis (1996), p 298.

Mr Ryan was indeed correct in his prediction. Following the commencement of the Financial Institutions Scheme referred to above, credit unions lost their exemption from tax on income derived from member loans.

From the point of view of many in the credit union movement or industry, change was inevitable following the deregulation of banking in Australia in the 1980s, which saw a heightened competition in financial services. This could not occur, however, without some impact on the essential nature of credit unions:

Deregulation meant credit unions achieving smaller margins, greater efficiency and applying costly technology and related investments. Continuing viability meant continuing growth. Competing successfully in the new environment, however, might reduce personal service, damage membership loyalty ... see credit unions converted into generic financial institutions.⁴¹

Given the positive impacts on disadvantaged communities achieved by small community-based credit unions, it is little wonder that the UK government seized upon the idea of credit unions being a large part of the answer to financial exclusion. However, the accompanying call for growth of credit unions in the United Kingdom may mean that credit unions will be in no real position to contribute to financial inclusion in the longer term. Australia has already seen considerable growth in the size of credit unions, largely as a result of mergers. One example is the Australian National Credit Union, which has taken seven mergers over 11 years and now contains 80 smaller credit unions.⁴² It has been suggested that such mergers have occurred largely due to the burden of regulatory compliance costs on smaller institutions which will be discussed below, which has resulted in a fall in numbers from 400 credit unions in 1990 to 155 at the beginning of 2006.⁴³ Nevertheless, some small community-based credit unions have managed to survive well, and have made significant contributions to the financial well-being of their communities and to financial inclusion of low-income consumers in those communities. The next part of this article describes the work of those credit unions to illustrate what can be achieved through the work of such credit unions. Unfortunately, as will be shown later in this article, it is virtually impossible under the current regulatory environment to start up such a credit union — for example, as a solution to a community's lack of access to financial services.

'Survivors': Examples of Credit Unions That Have Retained Their Small Community-based Status in Australia

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

⁴¹ Lewis (1996), p 296.

⁴² Williams (2004).

⁴³ Credit Union Industry Association (2006), p 4.

people who bank with it and 80 per cent of its customers are welfare recipients. Greg Fisher, 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.⁴⁴ In addition to providing 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 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 the customers know that what is left in their account is available for spending. Fitzroy and Carlton makes no money from its members, but manages to meet regulatory requirements including the capital adequacy requirements which will be discussed below, by means of a very 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.⁴⁵

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 their resources to form the credit union, which was initially staffed by volunteers. Its Operations Manager, Annette Bosley, refers to the MCU's local members as 'very loyal' to the credit union, and as viewing the MCU 'very much as their credit union'. The MCU has in the past lent, and still will lend, to welfare recipients in the community. Ms Bosley noted that 'a lot of the banks wouldn't lend to them and the credit union has always been there to support and assist them'.⁴⁶ 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. The MCU raised over \$1 million in December 2005 by an issue of preference shares. Its General Manager, 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.⁴⁷

Credit unions that 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 Authorised Deposit Taking Institution (discussed below) have meant that considerable external support is required. The Traditional Credit

⁴⁴ Fisher (2006).

⁴⁵ Fisher (2006).

⁴⁶ Bosley (2006).

⁴⁷ Walsh (2006), p 12.

Union was incorporated in December 1994, with initial capital of \$147 000 from the Arnhem Land Progress Association, a grant of \$400 000 from ATSIC and \$28 000 from the Northern Territory government.⁴⁸ 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.⁴⁹

The First Nations Credit Union was established in 1999, as a division of Australian National Credit Union, and is now a brand within Credit Union Australia. It is described as:

an Aboriginal initiative to create a Credit Union with national access that is owned and operated by indigenous people. The First Nations' vision statement is to 'assist members to take better control of their finances and economic futures'.⁵⁰

After its first four years of operation, First Nations reported 3500 members, deposits of approximately \$18 million and loans of approximately \$9 million.⁵¹

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:

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.⁵²

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 arguably the best form of financial institution to achieve the program's goals, given that:

⁴⁸ Westbury (2000), p 28.

⁴⁹ McMillan (2005).

⁵⁰ First Nations Australian Credit Union (2006).

⁵¹ Briggs (2003).

⁵² Lewis (2001).

a credit union is a democratic 'self-help' institution whose primary purpose is service to member-owners, not profit in pursuit of self-interest.⁵³

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 co-operative ventures at the community level'.⁵⁴

Unfortunately, significant regulatory barriers exist to the initial establishment and continued survival of small community-based credit unions in Australia, which I will consider in more detail in the next part of this article.

Regulatory Barriers to Small Community-based Credit Unions

Capital Adequacy Requirements

In July 1992, the Australian Financial Institutions Commission launched the Financial Institutions Scheme, under which Non-bank Financial Institutions, including credit unions, were required to comply with certain prudential standards including capital adequacy. Credit unions were actually required to hold 15 per cent of their assets in liquid form under this scheme, compared with the 6 per cent that banks were required to hold. This had significant impacts on the survival and possible establishment of small community-based credit unions. Small 'grassroots' credit unions were driven out of business, and new ones were prevented from forming.⁵⁵

The Wallis Inquiry reforms⁵⁶ saw the establishment of the Australian Prudential Regulatory Authority (APRA) on 1 July 1998, which became responsible for the prudential regulation of all Authorised Deposit-taking Institutions (ADIs) including banks, credit unions, and building societies.⁵⁷ Under this regime, all ADIs — including credit unions — must 'commit to a uniform set of capital adequacy and other prudential standards similar to those that have long been applied in the banking system'.⁵⁸

Capital adequacy requirements under this regime have been described as 'an affront' to the credit union 'tradition of providing finance for people — usually on low incomes — at low interest rates to those who have difficulty finding it elsewhere'.⁵⁹ This is because more 'risky' lending will lead to an increase in capital backing required by APRA.⁶⁰

⁵³ Lewis (2001), p 16.

⁵⁴ Lewis (1996), p 343.

⁵⁵ Lewis (2001), p 3.

⁵⁶ Wallis (1996).

⁵⁷ Goldsworthy, Lewis and Shuetrim (2000).

⁵⁸ Walsh (2006), p 10.

⁵⁹ Walsh (2006), p 11.

⁶⁰ While the minimum requirement under Prudential Standard APS 110, 'Capital Adequacy', is to maintain a risk-based capital ratio of 8 per cent at all times, APRA may require an ADI to maintain a minimum capital ratio above that.

Imposing the same capital adequacy requirements on credit unions as banks ignores the mutual nature of credit unions and their inability to attract external investment through issuing shares. One commentator on the capital adequacy requirements under the earlier AFIC regime wrote of cooperative financial institutions such as credit unions that:

Such institutions are unable to raise external capital to satisfy regulatory capital requirements and are thus forced to rely upon retained surpluses to generate capital. This, it is argued, creates an incompatibility between the regulatory structure and institutional form, imposes an arbitrary constraint on co-operatives growth and can induce a focus upon inappropriate financial targets by credit union management.⁶¹

The same commentator notes that, in a mutual organisation where the customers are the owners, the justification for capital adequacy requirements is reduced:

There is no separate class of shareholders separable from depositors. A loss in any one year reduces the wealth of the members held in the credit union, regardless of the institution's capital ratio.⁶²

As the Bananacoast Community Credit Union argued in its submission to the Wallis Inquiry:

It must be recognised that Credit Unions do not [because of their distinctive *mutual* nature and because of supporting statutory prohibitions] pay dividends on shares and consequently the retention of profits does not add any premium value to the proprietorship of the member/owners of the Credit Union.

and further that prudential standards can 'stultify growth through an emphasis on the maintenance of artificially high capital and liquidity ratios'.⁶³

It is argued that, by emphasising maintenance of capital, the central ethos of credit unions to provide service to members in the form of interest on deposits and low-cost loans, rather than make profits, is compromised:

To achieve a surplus appropriate for healthy growth a Credit Union is under pressure to lend at high rates of interest and pay a lower than market rate on deposits, which is counter productive in terms of attracting new business. Banks, on the other hand, can resort to new equity investment to capitalise on any new growth opportunities.⁶⁴

⁶¹ Davis (1994), abstract.

⁶² Davis (1994), p 37.

⁶³ Bananacoast Community Credit Union (1996), p 9.

⁶⁴ Bananacoast Community Credit Union (1996), p 14.

Barriers to Getting Started

While the guidelines on authorisation of ADIs provide that 'no set amount of capital is required for an authority to carry on banking business', they go on to provide that 'APRA will assess the adequacy of start-up capital for an applicant on a case-by-case basis'.⁶⁵

It is notable that the Traditional Credit Union referred to above was only able to be established with the assistance of significant external support, and that the First Nations Australia Credit Union, also referred to above, had to be 'incubated' by a larger credit union, and remains a brand within Credit Union Australia, obviously unable to obtain a licence to operate as an ADI in its own right.

The Creditcare program referred to did not involve the establishment of new credit unions in rural communities, but rather the establishment of branches of established credit unions in those communities. Starting up a new credit union in the sense of obtaining a licence from APRA to operate as an ADI is no easy task. As Sam Jeffries, Regional Chairperson of the Murdi Paaki Regional Council, said in relation to a proposed credit union for the Barwon Darling region in Northwest New South Wales:

It is the biggest crossbar on a set of goalposts that I have ever seen to now try and get a banking licence to establish a credit union which is owned by the people of the region.⁶⁶

The proposed Barwon Darling Alliance Credit Union was aimed at addressing the needs of Indigenous people in the area to access affordable loan finance. It was, however, unable to 'make headway' in achieving that goal due to regulatory barriers.⁶⁷

Given that a major barrier to starting up a new credit union to meet a community's financial needs is an inability to obtain a licence to operate as an ADI, a model such as the Creditcare model, whereby established credit unions opened branches in the relevant communities, is one way to address the problem. Similarly, Bendigo Bank has been able to overcome this obstacle with its trademarked 'Community Bank' model. Under this model, the community basically acquires the rights to operate a Bendigo Bank branch under a franchise arrangement. This has the important advantage that the bank is in effect contributing its licence to operate as an ADI. The community itself has to raise the funds as set by Bendigo (capital in the vicinity of \$500 000) to establish the local banking business. Bendigo currently lists 182 Community Bank branches on its website.⁶⁸ Race Mathews argues that this represents a 'second-best substitute for credit unions', and that regulatory reform is necessary to enable credit unions to in essence do the job for which they were created:

⁶⁵ Australian Prudential Regulatory Authority (2006), para 13.

⁶⁶ *Hansard* (2005).

⁶⁷ Lightning Ridge Information website (2005).

⁶⁸ Bendigo Bank website (2006)

What is needed is a recognition from government — preferably explicit — that credit unionism is about enabling ordinary people and communities to engage in self-help, and thereby is entitled to special consideration ... This means getting rid as much as possible of the statutory and regulatory requirements which are blocking the establishment of new credit unions, cramping the development of current credit unions or inhibiting them from striking out in new directions in response to new needs, and obliging communities which have been deserted by the major commercial banks to establish community banks as a second-best substitute for credit unions. It involves, among other things, recognising that one size does not fit all, and smaller credit unions differ in their regulatory requirements from larger ones.⁶⁹

The difficulty that I have with this very attractive suggestion for sweeping regulatory reform is that we may well have gone too far down the 'one size fits all' regulatory path in relation to financial services in Australia to turn back, particularly given the apparent support of many in the credit union industry for prudential regulation that treats credit unions in the same way as banks.⁷⁰ The argument is stronger if it is limited to regulatory reform with regard to the small community-based credit unions. There are, however, a number of prudential requirements that do attract complaint from the broad range of credit unions as being particularly burdensome to smaller financial institutions, and these are outlined below.

Other Regulatory Burdens

Where a 'one size fits all' approach is taken, the fact that aspects of the regulatory regime are likely to have greater impact on some institutions than others (particularly given differences in size) is often ignored. One example given by Greg Fisher at Fitzroy and Carlton Community Credit Union is in relation to Prudential Standard APS 221 enacted in May 2006, which provided that an ADI must limit its aggregate exposure to a 'counterparty' to 25 per cent of its capital base. This has meant that, with a small capital base of \$600 000 (because Fitzroy and Carlton are in the business of service, not profit), the largest loan they can now make is \$150 000. Mr Fisher explained that:

We had a whole mortgage portfolio of about \$2 million which was really helping us out and that's the other 20 per cent of our member base — the ones who are working, the ones who have got the money, who have the \$300 000 houses and stuff. What if someone comes and says 'I want to top up my mortgage'?

We're saying we can't do it, the government won't let us. So we lost half of our mortgage portfolio and now we can't build our mortgage

⁶⁹ Mathews (2001).

⁷⁰ For example, see National Credit Union Association Inc (1996).

portfolio because the only houses we can mortgage are up to \$150 000.⁷¹

The need to comply with Financial Services Reform legislation⁷² has also caused difficulties for some smaller institutions.⁷³ The need to provide product disclosure statements for all products and to provide extensive training for all staff as 'financial products advisers' was crippling in terms of cost for some institutions, and undoubtedly unnecessary given that those institutions offered only basic deposit products. For this reason, and as a sign that APRA as a regulator is prepared to be somewhat responsive to the lesser nature of the risk in smaller organisations such as community-based credit unions, exemptions from FSR requirements have been granted. These include exemptions from product disclosure statements and training requirements for financial product advisers in relation to both 'basic deposit products' and those staff advising customers in relation to them.⁷⁴

Credit unions have complained about the cost of complying with disclosure regulation under both the Uniform Consumer Credit Code and the Financial Services Reform legislation — which, it is argued:

generated an extraordinary amount of paper and disclosure material requiring a very large investment by industry in printing, freight, training, postage and time.⁷⁵

Such regulatory requirements are said to be particularly burdensome and onerous on smaller institutions:

The cost of implementing government regulation falls disproportionately on smaller financial institutions, as they are not able to achieve the economies of scale enjoyed by larger players. The credit union industry, although containing several larger players (akin to a small bank), is dominated by small to medium size institutions.⁷⁶

As indicated earlier in this article, the costs and other burdens of regulatory compliance are cited as reasons for the merger of small credit unions into larger ones. The concern here is that in merging, credit unions lose sight of their origins and community or industry bonds, and 'risk losing their *raison d'être*',⁷⁷ and probably their commitment to serving their members as a paramount consideration above profit.

⁷¹ Fisher (2006).

⁷² *Financial Services Reform Act 2001*.

⁷³ Bosley (2006).

⁷⁴ *Corporations Amendment Regulations 2005*, No 5, declared 15 December 2005.

⁷⁵ Credit Union Industry Association (2005), p 12.

⁷⁶ National Credit Union Association (2005), p 1.

⁷⁷ Williams (2004), quoting John Hensby, Chief Executive of Connect Credit Union.

Conclusion

This article has referred to the nature of financial exclusion in Australia in the sense of lack of access to affordable and fair small loans, and has examined the possibility that credit unions can be a part of the solution to financial exclusion. I have argued that the focus on growth and the desire on the part of credit unions to be treated like the banks for regulatory purposes may compromise the ability of credit unions to contribute meaningfully to financial inclusion in Australia. Whilst there have been calls for regulatory reform to loosen the regulatory noose from the necks of credit unions to enable them to fulfil their traditional roles as mutuals, I have questioned whether that is the answer given that credit unions themselves have indicated a desire to be regulated like banks. Credit unions may have travelled too far down the path of becoming 'quasi-banks' to turn back. There are notable exceptions in the form of small community-based credit unions which have adopted innovative techniques to ensure their survival, and it is, indeed, sad that they should be put at risk, and that the current regulatory environment makes it virtually impossible for new credit unions like them to start up. Regulatory reform — perhaps by way of certain exemptions for those credit unions — needs to be considered.

Given the current difficulties in starting up a credit union under a traditional model of communities pooling resources to create a fund from which low-interest loans can be made, perhaps the focus should now be on a different model. Foresters ANA Mutual Society Limited,⁷⁸ for example, 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.⁷⁹ Even this model is not without its regulatory difficulties. If an organisation such as Foresters sought to expand on the savings and loans model and administer the collection of savings and making of loans itself, it might be regarded as acting in breach of regulation by conducting an unauthorised deposit-taking business. Foresters have another model referred to as a 'distress fund', which involves members of the fund making 'contributions' (not defined as savings and therefore not characterised as deposits), 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',⁸⁰ and as a model that:

⁷⁸ Foresters ANA Mutual Society Ltd was formerly Foresters ANA Friendly Society Ltd. The author serves on the board of directors of Foresters ANA Mutual Society Ltd.

⁷⁹ See Foresters ANA website, www.forestersana.com.au, and the explanation of savings and loans circles in Burkett (2003), p 38.

⁸⁰ Burkett (2003), p 33.

enables people to have access to credit services which are non-exploitative and directed at alleviating their poverty rather than profit generation.⁸¹

This is a model that does not breach Australian Prudential Regulatory Authority regulations in that it does not amount to deposit-taking,⁸² and can easily be established without prohibitive structural and compliance costs.

It is not beyond the will and capacity of financially excluded people to act together to improve their positions by adopting the principles of mutualism. Small community-based credit unions may have a role to play in that, but they will need to be granted appropriate regulatory exemptions to enable them to both start up and continue to operate as mutual organisations, focused on providing services to their members rather than generating profits. Such exemptions should relate to capital adequacy, disclosure requirements and FSR regulation. It may also be necessary to consider whether new and innovative models, such as the 'distress fund' model referred to above, are the way forward. It is neither appropriate nor possible to require all credit unions including the large 'quasi bank' credit unions to travel backwards along a regulatory path that they have largely chosen.

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⁸¹ Burkett (2003), p 33.

⁸² Under the *Banking Act 1959* (Cth), s 8 as amended, only an Authorised Deposit-taking Institution (ADI) may carry on any banking business, which includes deposit-taking activity. Foresters ANA Mutual Society Ltd has received written confirmation from APRA that its distress fund model does not amount to deposit-taking activity.

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