Do you really want to hurt me?

Exploring the costs of fringe lending – a report on the NAB Small Loans Pilot

A report by NAB and the Small Loans Pilot Advisory Group (March 2010)

more give, less take

nab

Acknowledgements

The NAB Small Loans Pilot was an exercise in collaboration across a number of people from the community, education, government, and corporate sectors.

NAB would like to thank all members of the Advisory Group whose guidance proved invaluable throughout the pilot.

The Advisory Group was made up of:

- Australian Financial Counselling and Credit Reform Association
- Brotherhood of St Laurence
- CHOICE
- Consumer Action Law Centre
- Consumer Affairs Victoria
- Foresters Community Finance
- Good Shepherd Youth & Family Service
- Griffith University
- NSW Office of Fair Trading
- Queensland Department of Justice and Attorney-General
- RMIT University

We would also like to thank Therese Wilson of Griffith University and Roslyn Russell of RMIT University for their significant contributions to this research.

Special thanks goes to the team at Money Fast, who took a risk in running with this pilot and opening up their books for all to see.

Our thanks also go to the customers who brought the pilot to life; and to all who shared their experiences within the fringe lending sector as part of our survey and interview process.

And lastly, we would like to thank Richard Peters, former General Manager Community Finance & Development at NAB, whose strategic thinking, willingness to take a risk and commitment to microfinance brought this pilot to life.

These contributions are greatly appreciated.

Foreword

Since 2003, NAB has worked with a number of community sector and government partners to develop programs that help address financial exclusion and provide financial services to all Australians - including people who are in need.

These microfinance programs offer opportunity and a chance to people who are marginalised or excluded from mainstream financial services.

Successful microfinance programs require a whole-of-community approach, with collaboration from government, corporate and community groups to deliver the best outcome.

All of these programs are part of NAB's broad responsibility to give back to the community - none of these programs make us money (let alone cover their own costs); operational funding is vital; and demand can quickly outgrow the infrastructure in place to deliver them.

A major challenge for microfinance development in Australia is 'sustainability' of the programs. In this context sustainability is about ensuring the continuity of services and programs that make a positive and ongoing contribution to addressing financial exclusion – both financially and socially (Burkett and Sheehan, 2009).

As a part of the debate about sustainability of microfinance programs, the challenge was put to NAB at the Consumer Affairs Victoria consumer credit conference in 2007 to see what it would cost to offer small loans on a sustainable or breakeven basis. What would it take to really expand on a commercial level, what has so far been viewed to date as a "corporate social responsibility" undertaking.

To meet this challenge, in May 2008 NAB embarked on the Small Loans Pilot to explore the viability of a lending model that could operate within the fringe credit market and offer small loans over twelve months at a break-even rate.

When NAB first embarked on the Small Loans Pilot there was a level of curiosity as to why a leading financial services provider was interested in the working machinations of the fringe-lending sector.

For NAB, it made sense.

We are genuinely committed to addressing financial exclusion and providing Australians with safe and affordable lending and savings options.

We've been working with alternative, not-for-profit lending models for many years, collaborating with community groups and investing over $130 million in microfinance programs to support Australians living on low incomes.

We know that a great many Australians who we don't lend to are forced to borrow from fringe or payday lenders and for some, this lending experience can be marred by exploitative fees and interest rates.

This begged the question – what is the minimum interest rate you need to charge to have a sustainable lending program in the fringe-lending sector? Which led us to ask another – will knowing this information be helpful?

We believe it will – on two levels.

While not a commercial venture for NAB, the pilot tested the feasibility of an alternate credit provider's online model to offer safe and affordable small loans in the fringe market that meet regulatory requirements. We showed it was possible.

As an exercise – the pilot has also provided great insights about what it costs to offer credit in this market and has demonstrated it is feasible to provide greater choice for customers seeking credit from non-mainstream sources.

Secondly, our research findings will hopefully increase public attention on the fringe lending sector in general – particularly the more exploitative practices associated with some fringe lenders – around interest rates, fees and charges.

As one of many financial services providers in Australia, NAB also wants to see fringe lenders (as other providers in the market) be appropriately regulated.

We appreciate that while we have trialled only one model to lend credit in this fringe-market – a "one-size fits all" approach is not the answer. The diversity of customers, their needs, their circumstances, their preferences should drive choice in the market.

However, these differences should not be at the expense of a common customer experience based on safe, affordable and responsible lending.

And it is with this aim, of providing safe, affordable and responsible lending, that we are pleased to announce an extension of the pilot. As an alternate to our other microfinance programs, Money Fast Small Loans will be made available to Australians who qualify for Family Tax Benefit Part A for two years, commencing March 2010.

We hope that these new Money Fast Small Loans will further help us address financial exclusion in Australia.

Lisa Gray
Group Executive, Personal Banking
National Australia Bank

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Executive summary

NAB embarked on the Small Loans Pilot to explore the viability of a lending model that could operate within the fringe credit market and offer small loans over twelve months at a break-even rate.

As well as testing the feasibility of the model, NAB wanted the process to draw further attention to the exploitative tactics adopted by some credit providers in the non-bank lending market.

The pilot tested the minimum interest rate required to have a sustainable lending program in the fringe lending sector. It tested a specific market segment (loans between $1,000 -$5,000 over 12 months) and it did not lend to everyone who applied.

It showed it is possible to lend small amounts of money (around $2,900) in this market; make a modest profit and be well below government regulated interest rates of 48% per annum.

For loans of this size the pilot confirmed that a rate of 32.8% per annum (annual percentage rate of APR) needed to be charged to breakeven. To put it another way, this equates to $18.70 interest for every $100 lent. The economics of the pilot are detailed in Section 2 of this report.

On completion of the pilot, we believe there are benefits to having alternative lending products available on the market for those excluded from access to mainstream credit, provided the harms associated largely with high cost can be overcome. Clearly there is a demand for lending in this sector, and we recognise there is not a "one size fits all" solution to meet this demand.

"Fringe" credit is an important market for Australian consumers. It clearly provides a source of loans not being provided by mainstream lenders. However the interests of consumers require that "fringe" credit providers offer their products safely, responsibly and affordably.

However, from what we've discovered, we don't believe loans for less than an average size of $700 over periods shorter than a year can be offered sustainably in compliance with regulations in States with a 48% per annum cap.

This raises the question as to how lenders are meeting the need for these smaller loans in the community at the moment.

It is our view that greater attention needs to be brought to the alternative lending market - primarily around interest rates (in particular the technicalities around the term "annual percentage rate"): customers don't understand them, regulators are challenged by them which leaves some lenders in this market open to exploiting customers with rates well over regulated rates of 48% per annum.

In addition to the economics of the pilot, we also gained deep insights into consumers in this market – not just financial and demographic information but also financial behaviour and impacts of lending in the alternate credit market. These are detailed in Section 3 of this report.

We discovered an unexpected market for non-mainstream, short-term, small loans across Australia. The pilot customers were not low-income, and do not fit the stereotypical profile of a payday lender client.

Typically:

- They earned an average income of $859 per fortnight (the highest salary recorded was $4810; the lowest $304).
- Over a third (38%) have had defaults and bankruptcies.
- 19% are on a government benefit.
- Majority are employed in either full-time (87%) or part-time work (16%).
- Most rent their homes (67%), 17% pay board; 15% own.
- They have an average age of 32 years.
- They are evenly split between men and women.
- 51% are single, 26% married.
- Majority of applicants have no dependents (67%).
- Nearly 52% have stated they have no existing loans (car, personal or home) and no credit card.

Generally, the pilot customers appeared to have a grounding in financial literacy but may not have been behaving prudently when it came to spending or saving. This is very much in line with the behavioural economics view that we are all subject to cultural biases and norms that can lead us away from "rational" financial decisions-making (McAuley, 2009).

Pilot customers chose the Money Fast product for a range of specific reasons, including convenience, competitive price, ease and speed of the online application process with the majority seeking cash to manage bills. Many were financially excluded from mainstream loan options due to defaults on their credit records.

NAB's commitment to microfinance

Since 2003 NAB, in partnership with both local community agencies and government, has been developing microfinance solutions to help address financial exclusion and to help all Australians access fair and affordable financial services.

NAB's commitment, which is in excess of $130 million is focussed on delivering the following programs:

No Interest Loan Scheme (NILS®)

Developed by Good Shepherd Youth & Family Services 29 years ago, NILS is based on the concept of circular community credit.

Through NILS, low income consumers are provided with access to funds so they can purchase essential household items.

NAB with the help of Good Shepherd Youth & Family Service, is in the process of rolling out $15 million in loan capital to existing and new NILS programs allowing them to service a greater number of clients. There are currently over 280 NILS programs throughout Australia.

StepUP Loans

NAB in association with Good Shepherd Youth & Family Service designed StepUP Loan – a low cost credit product for financially disadvantaged Australians.

These safe, affordable, low interest loans of between $800 and $3,000 are for individuals or families to purchase essential personal, household and domestic goods and services.

Applicants participate in a face-to-face interview with a microcredit worker who then mentors them throughout the life of the loan.

StepUP Loans sit between NILS and mainstream credit, helping low income consumers transition into mainstream products and experiences. It enables individuals to develop a credit history and improve their financial literacy and confidence, thus providing them with an informed entry into mainstream banking.

The StepUP Loan Program has won the award for Best Socially Responsible Product in **Money** magazine's Best of the Best Awards in 2007, 2008 and 2009.

AddsUP Savings Plan

NAB in collaboration with Good Shepherd Youth & Family Services is offering people who have successfully completed paying at least one NILS or StepUP loan the AddsUP Savings Plan.

Following a discussion with a community worker about saving and setting realistic goals, the customer can ask NAB to open a NAB Concession Card account specifically for the purposes of saving. The AddsUP Savings Plan, which is available with that account, does not specify what people need to save for.

Once an individual has saved $300, they have the opportunity to have these funds matched by NAB, once in the lifetime of the account. NAB will match amounts up to $500. AddsUP aims to help low income Australians achieve their goals and further build on the discipline developed through repaying a loan.

NAB Microenterprise Loans

These unsecured business loans between $500 and $20,000 are for people who have few or no avenues to access affordable business credit.

The loans are provided on a not-for-profit basis and are available to help start up or support an existing business. NAB also ensures loan recipients get access to business skills training and advice during the first year of their business.

The community partners who help deliver Microenterprise Loans are the New Enterprise Incentive Scheme (NEIS), Enterprise Network of Young Australians (ENYA), Business Enterprise Centres (BEC), Indigenous Business Australia (IBA) and Small Business Incubators.

In **Money** magazine's Best of the Best Awards in 2009, NAB Microenterprise Loans was named for the second year running, the best product in the 'low income: enterprise' category.

To find out more about NAB's microfinance programs visit: **nab.com.au/microfinance**

About NAB's Small Loans Pilot

Launched in May 2008, the NAB Small Loans Pilot explored the feasibility of providing fair and affordable small loans in an alternative credit market to those who are not able to access mainstream loan products.

The pilot focused on one segment of the fringe credit market – loans between $1,000 and $5,000 for a 12 month term.

The pilot was not a commercial venture for NAB but an extension of its $130 million microfinance investment in programs that help financially excluded Australians access fair and affordable lending and matched savings products.

Under the pilot, NAB provided up to $1 million in loan capital to non-mainstream lender Mobile Finance (trading as Money Fast, see appendix A, or www.moneyfast.com.au for more information) to fund small personal loans of between $1,000 and $5,000, on a break-even basis for a term of one year. Loans were available via telephone and the internet Australia-wide.

We acknowledge that a high proportion of lending in this market is for payday loans of less than $350 for short periods of two to four weeks and that our pilot did not model this credit product.

The break-even interest rate on offer by Money Fast was significantly less than the interest rate caps in place in some Australian states and was set so that the costs of providing the loans were effectively covered by interest income.

As the credit provider, Money Fast managed all day-to-day operations including promotions and advertising, application processing, loan approval, and loan and customer management.

For the duration of the pilot, NAB publically reported a breakdown of all forecast break-even costs, revenues and loan information and monitored and published these.

To monitor this process, NAB formed an independent Advisory Group that brought an extensive level of expertise to the pilot and related research.

The Advisory Group supported the NAB Small Loans Pilot and its intentions to expose the costs of fringe lending; to draw attention to the high interest rates and charges prevalent with fringe credit; and to increase product diversity in this market.

The Advisory Group was made up of:

- Australian Financial Counselling and Credit Reform Association
- Brotherhood of St Laurence
- CHOICE
- Consumer Action Law Centre
- Consumer Affairs Victoria
- Foresters Community Finance
- Good Shepherd Youth & Family Service
- Griffith University
- NSW Office of Fair Trading
- Queensland Department of Justice and Attorney-General
- RMIT University

The pilot aimed to mirror the everyday operating conditions of the fringe lending market. No overarching rules were placed on who Money Fast lent to; how they marketed the program; or how additional fees were to be levied.

In addition, a third party auditor reviewed samples of Money Fast loans to verify that loans were approved in accordance with lending criteria; loan documentation was delivered to the customer; customer verification occurred; were collections processes followed according to policy; and loan arrears were appropriately identified and reported to NAB.

All published Small Loans Pilot information can be sourced at **www.nab.com.au/smallloanspilot**

About NAB's Small Loans Pilot cont

Money Fast loan product details

Loan size	Loan amounts of $1,000, $1,500, $2,000, $3,000, $4,000 and $5,000
Loan term	1 year
Comparison interest rate	28.25% pa (comparison rate) When quoting interest rates, comparison rates are required to be quoted based on certain loan values and terms. 28.25% pa is the comparison rate based on a loan of $2,500 over a term of 2 years with monthly repayments. Comparison rates take into account all interest and other fees and charges (other than government fees, charges or duties) payable during the life of the loan. This rate means that on a $1,000 loan, total payments over a year will be $1,159.50, including interest payments of $159.50. WARNING: this comparison rate is true only for the example given and may not include all fees and charges. Different terms, fees or other loan amounts might result in a different comparison rate.
Repayments	Weekly, fortnightly or monthly Automatically deducted from client's bank account via the Ezidebit system.
Fees	**Default and arrears fees:** Dishonour fee - $30.00 Phone call for payment - $5.00 Email for payment - $5.00 Overdue letter - $10.00 Legal & recovery cost letter - $10.00 Default notice - $30.00 NOTE: default fees are considered as revenue and so reduce the breakeven interest rate for the loan. **Ezidebit Electronic collection (not Money Fast) fees:** Establishment Fee - $2.20 Transaction Fee - $1.10
Loan purpose	Personal loans for any purpose.
Application process	Online application form.
Security	Loans are unsecured.

About this report

This report documents the research findings of the NAB Small Loans Pilot.

It details the operations and economics of a Money Fast small loan, and also provides behavioural and demographic insights from loan applicants who sought credit under the pilot.

It also provides customer opinion and insight on the pilot, its findings and the customer experience.

The report draws on:

- NAB's analysis of economic data from the NAB Small Loans Pilot. This included quantitative analysis of loan performance data - such as loan values and volumes, customer profiles (financial and demographic) and arrears and default rates from June 2008 to September 2009).
- An external evaluation of pilot customers and applicants (Roslyn Russell & Moulik Zaveri, **Who are the clients and applicants of NAB's Small Loans Pilot Program?**" RMIT University), unpublished paper prepared for NAB in December 2009.
- A literature review of non-mainstream lending (Therese Wilson, Senior Lecturer, Griffith Law School, **Alternative credit provision and its regulation in Australia)**, unpublished paper prepared for NAB in December 2009.
- Qualitative data sourced by Griffith University and RMIT University including surveys and interviews with pilot clients and consumer advocates, NAB executives and the alternate credit providers involved with the pilot (Mobile Finance trading as Money Fast).
- Commercial operational data from Money Fast.

The report outlines pilot findings across five areas:

Section 1	Outlines the current alternate lending landscape in Australia (definitions, scale, regulation, issues)
Section 2	Details what we have learnt about the economics of lending small amounts of money in the alternative credit market
Section 3	Outlines customer and stakeholder insights including demographics, financials, behaviours and views
Section 4	Conclusion and key learnings
Section 5	NAB Recommendations regarding alternate lending

This report was written by NAB. It includes research commissioned by NAB and input from members of the NAB Small Loans Pilot Advisory Group and the Money Fast team.

Quotes appearing in the report have been sourced from the research reports commissioned as part of the pilot.

Section one:
the fringe lending landscape

What do we mean by non-mainstream/payday/fringe lending?

Non-mainstream lenders are alternate credit providers in the business of providing personal credit, including to those people excluded from access to credit from mainstream financial institutions such as banks, but at high cost. Credit may take the form of 'payday loans', defined as short-term loans designed to 'tide the borrower over' until payday (Working Party, 2000, p.14), or may involve slightly longer term 'micro loans' or 'non-payday loans' (Howell et al., 2008, pp34-45).

The National Financial Services Federation ("NFSF") which describes itself as the 'peak industry body representing micro-lenders and payday lenders in Australia' (National Financial Services Federation, 2008, p.1), divides the lending undertaken by its members into 'payday loans' and 'micro loans'. It defines a payday loan as:

"A small, short-term loan, they usually have a 2 to 4 week duration and are designed to meet unexpected expenses. They are not suited for long-term borrowing or continuing financial needs, and are best reserved for temporary cash flow problems (National Financial Services Federation, 2008, p. 2)."

It defines a micro loan as:

"A loan with a duration of two months to two years. They are generally for amounts of $500 or more, with an industry average principal of $1,000. These loans are generally used to meet larger expenses such as replacing whitegoods, car registration, rental bonds, dental expenses and unexpected travel (National Financial Services Federation, 2008, p. 2)."

Consistent with this, a study by the Centre for Credit and Consumer Law into interest rate capping (a form of regulation to be discussed on page 7) divided alternative loans into payday and non-payday loans (Howell et al., 2008, pp. 34-45). It also divided loans into small loans (in the vicinity of $300) and large loans (in the vicinity of $1,000), and found that while few micro-lenders were prepared to offer the large loan on a payday basis (defined in the study as 'short-term lending for personal, domestic or household purposes of up to 2 months' duration), there were some who would lend the larger amount on a short-term basis (Howell et al., 2008, pp. 34, 35, 37).

The data collected indicated an all-inclusive (that is, inclusive of fees and charges) annual percentage rate of interest of between 300 and 3380 per cent for the payday loans products. The non-payday loans, having durations of more than eight weeks, had an all inclusive annual percentage interest rate of between 114 and 580 per cent (Howell et al., 2008, pp 38,39).

How does this differ from microfinance?

An important distinction between non-mainstream/payday/fringe lending and microfinance, is that microfinance seeks to provide fair, safe and ethical financial services for people who, because of their circumstances, are not able to access mainstream financial services. Microfinance's purpose is to alleviate and eliminate poverty (Burkett and Sheehan, 2009).

Non-mainstream/payday/fringe lending has normally been considered exploitative, predatory or unfair, and therefore not included in the definition of microfinance.

How big is this market?

A report to the Minister for Fair Trading in Queensland in 2000 ('the Queensland report") referred to a payday lending industry in its infancy in Australia (Working Party, 2000, p.1). There is evidence that alternative credit providers now operate on a large scale in Australia.

In terms of the current size of the industry in Australia, the Market Intelligence Strategy Centre ("MISC") prepared a report in 2006 which noted the discrepancies in, and lack of reliable sources for, estimates as to the size of the industry (Market Intelligence Strategy Centre, 2006, pp. 50-56).

According to the NFSF, payday loans products and micro loans products jointly 'represent $500 million in loans throughout Australia per annum' (National Financial Services Federation, 2008, p.2).

In its report, MISC takes the approach of projecting US data onto the Australian market and population, and estimating a 'potential domestic market flow of $10 billion' in micro-credit transactions annually. This estimate takes into account 'micro lending market segments of pawnbroker, car title lender, payday and online as well as cheque cashing' (Market Intelligence Strategy Centre, 2006, p. 57).

What are the perceived harms?

There are a number of potential harms associated with alternative credit products, particularly for vulnerable, low-income consumers.

Consistent with the 'mischiefs' associated with payday lending cited in the Queensland Report in 2000, a published report on payday lending in Victoria (Wilson, 2002) summarised the major criticisms as:

- unconscionably high interest rates with effective charges as high as 1300 per cent per annum;
- vulnerable consumers are targeted;
- vulnerable consumers are lead into debt spirals through roll-over and 'back to back' loans; and
- direct debit is used as a form of payment guarantee, thus giving alternate lenders 'first take' at the income of those who may be in financial difficulty, exposing customers to high dishonour fees from banks (Wilson, 2002, p. 33).

Given the high costs associated with alternative credit products, default is more likely than if the credit products were priced more affordably, perpetuating the perception that low income borrowers are more risky than more affluent borrowers. Borrowers from alternative credit providers are said to become ensnared in a 'negative feedback loop' where higher prices lead to higher failure rates (Drysdale and Keest, 1999-2000, p. 663). This is particularly likely to be the case with payday loans because of their very short-term nature, almost dooming borrowers to fail.

Those who borrow at high cost from alternative credit providers can find themselves entrenched in a cycle of over-indebtedness, unable to save or 'get ahead', and unable to improve their positions so that they might access more affordable, mainstream credit products. High cost credit has the potential to oppress those on low incomes in the sense of preventing them from improving their financial positions. Related to this are problems of over-indebtedness that arise due to 'repeat borrowings' which clearly have an impact on a consumer's purchasing power and ability to acquire assets (Howell, 2005, pp. 23-24).

How is it regulated?

The first action taken in Australia to regulate alternative credit, was to ensure that alternative credit providers came within the scope of the Uniform Consumer Credit Code ("UCCC"), ensuring they were subject to disclosure requirements as well as to the possibility of consumers litigating to set aside or vary the terms of unjust credit contracts.

The other key way in which Australian state governments have sought to regulate alternative credit providers under the UCCC, is by the imposition of interest rate caps in some States. A 48% per annum interest rate cap, inclusive of fees and charges, currently operates in New South Wales, Queensland and the Australian Capital Territory. In Victoria there is a cap of 48% per annum on unsecured loans, and 30% per annum on secured loans, however fees and charges are not included in either cap (Howell et al., 2008, pp. 8-10).

The appropriateness and effectiveness of interest rate caps has been hotly debated, with arguments that such caps will effectively put alternative credit providers out of business and exacerbate financial exclusion (Department for Business Enterprise and Regulatory Reform, 2006, p. 8, Stegman, 2007, pp. 186-187). Another criticism is that for interest rate caps to be effective, they must be effectively monitored and enforced, which will be costly (Mann and Hawkins, 2006, pp. 860, 877-880). Conversely, it is argued that interest rate caps are a means of protecting people from usury and exploitation.

In 2009 the Australian federal government began its takeover of the regulation of consumer credit under a two phase process, with the passage of the National Consumer Credit Act (Australian Government Treasury, 2008). Under the new regime, credit licensing requirements apply. This will mean that all credit providers, including alternative credit providers, will need to be licensed. There will be an obligation on licensees to lend responsibly by making an assessment as to whether the credit contract is unsuitable for the consumer, before lending. A civil penalty will apply where a licensee fails to make this assessment before lending.

At the time of drafting this report the prospects of interest rate caps being introduced under the federal legislation are unclear.

Interest rates – it's complicated

In addition to the general data gathered about loan demographics and loan costs and revenues outlined in this report, insights were gained into difficulties in understanding and clearly communicating the structure and comparability of interest rates.

NAB, Money Fast and the Small Loan Pilot Advisory Group discussed at length how to express the "break-even" pilot interest rate.

It's a sensitive issue made more complex by the facts that:

- interest rates in the fringe credit environment are typically higher than those offered by mainstream credit providers; and
- there are Australian legal requirements to express interest rates as comparative or Average Annual Percentage Rates.

When we launched the pilot, we used the following example to illustrate the pilot's Money Fast interest rate:

Total repayments on a 12 month $1,000 loan = $1,159.50, ie $159.50 is the interest component. This means, in this example, if a borrower is lent $1,000 to be repaid in 12 months they will pay an interest component of 15.95% if expressed as a percentage of the original $1,000 loan amount. This however, is not how interest rates are expected to be expressed by Australian regulations.

Australian regulation requires that loan interest rates must be expressed as an Annual Percentage Rate or APR. The Consumer Credit Code defines annual percentage rate in s25(1) as a "rate specified in the contract as an annual percentage rate", stipulating in S26 (1) that a credit provider can't charge interest in excess of the amount determined by applying the daily percentage rate to the unpaid daily balances.

As a result of this definition, the major difference between a flat rate and the APR, is that the APR allows for the reduction in the principle of the loan (ie the daily balance should be lower if the client has started making regular repayments) over the course of the loan. The flat rate is an upfront calculation of the total amount lent. In the above example, with a flat rate of 15.95%, the APR is equivalent to 28.25%.

Early discussions around the interest rate show that there is a challenge in clearly and simply articulating the interest rate in order to communicate the real cost of a loan. In effect, the **APR** does not appear to be a transparent way to inform the customer of what they will be paying back. Money Fast has confirmed that their process ensures that all customers are aware of the cost of the money they are borrowing and the repayments that they are required to make – for example, "for every dollar you borrow you will pay back this much".

Section two:
economics

A primary objective of the Small Loans Pilot was to determine the break-even interest rate for $1,000 to $5,000 loans offered to the typical customer in this market. This section of the report outlines these findings.

Readers are also encouraged to look at the four interim reports on the economics of the pilot. These can be found at **www.nab.com.au/smallloanspilot**

How the economics were determined

To determine the breakeven interest rate to apply to the pilot, an 18 month forecast of Money Fast's cash flows was completed in early 2008. This required a number of assumptions:

- Money Fast's operating costs for the period the pilot was to run;
- The level of additional revenue expected from fees charged to the loans (for example overcharging fees), and
- The anticipated default rate on loans written during the pilot.

The annual operating costs for Money Fast were estimated at $730,000. At the time Money Fast estimated that this would be amortised over 3000 loans, which lead to an administration cost per loan of about $243.

As a part of the Small Loans Pilot it was expected that approximately 370 loans would be written with the $1 million in capital provided, however, Money Fast forecast annual operating costs were spread over other anticipated Money Fast business (to take it to 3000 loans).

Additional fee revenue was estimated at $64.75 per loan. Loan defaults (defined as 180 days past due) were estimated at 5%.

To ensure the pilot approximated what happens in the fringe lending market, cost of funds, or the cost to NAB of lending money to Money Fast, was set at 7.30% for the period of the pilot. This revenue – which approximated $53,000 by the end of the pilot – was used to fund research into the pilot and to cover any additional costs associated with tracking and operating the pilot (for example audit fees). The money did not return to NAB.

No upfront fees are charged to Money Fast customers so these did not form part of the forecast.

A key determinant of the breakeven interest rate is the make-up of the loan portfolio, in particular the number of smaller loans, which would then affect the average loan size of the portfolio. The smaller the (average) loan the greater the proportion of fixed administration costs that need to be recouped through the interest rate, and so the higher the interest rate that needs to apply to the portfolio.

The forecast average sized loan in the Money Fast portfolio was $2,900.

After forecasting the cash flows a breakeven APR of 28.25% was calculated for the pilot. This is equivalent to a flat rate of 15.95%, or $15.95 of every $100 lent.

In order to get the interest rate forecasts as close as possible to breakeven, calculations resulted in a small positive cash balance, recorded as a small profit margin for Money Fast of 1.55%.

Full details of the forecast costs and revenues against actual costs and revenues can be found in Table (i) on page 16.

Actual costs and revenues

Over the period of the NAB Small Loans Pilot (from June 2008 to September 2009) the total amount lent over the pilot period was $1.73m and a total of 510 loans were written.

Results of the pilot were as follows:

- The average size of loans written was $3,397, larger than the forecast size of $2,900.
- Fee revenue per loan was $110.25 against a forecast of $64.75.
- Loan defaults were 4.16% against a forecast of 5%.
- An administration cost of $321 per loan was larger than the forecast cost of $243.

The first three actual outcomes listed above have the individual effect of lowering the breakeven interest rate, while the last outcome has the effect of increasing the breakeven interest rate.

Table (i) on page 16 illustrates a breakdown of these loans and cash flows associated.

With 15 months of actual cash flows in place the pilot data confirmed a break-even APR of 26.5% (a flat interest rate of 14.9%) applied to the portfolio of loans written by Money Fast compared to a forecast APR of 28.25% (flat rate 15.95%).

It should be noted that this outcome still relies on 12 months of forecast data as some loans in the portfolio will continue to be paid off over the following 12 months. Where forecast figures are relied upon, the actual outcomes for the pilot are used, for example loan defaults of 4.16%.

Using the pilot outcomes to examine the economics of small loans

The value of actual cost and revenue data obtained during the small loans pilot lies not so much in looking back at the Money Fast portfolio but in using the information to look more closely at the economics of lending in the fringe sector.

Scenario 1 – reducing the average loan size

Loan size is a key economic driver of lending small amounts of credit in this market – if loan size decreases, each loan in the portfolio will attract a higher proportion of fixed costs.

If we apply the cost and revenue information from the pilot to the forecast portfolio of loans at the commencement of the pilot (where the average loan size was $2,900), we are able to explore what happens to the APR when the loan size changes.

The assumptions behind this scenario are that 3000 loans are written in a year and are paid back over 12 months. All other cost and revenue data is from the actual outcomes from the pilot.

In a portfolio of 3000 loans with an average loan size of around $2,900 and repayments over 12 months, the data shows an APR of 32.84% (flat interest rate of 18.7%) is required to breakeven.

If a modest profit margin of 20 cents in the dollar is added an APR of 39% (flat rate of 22.1%) would need to be charged to customers. This is on the basis that all loans have no up-front fees.

This modelling allows a direct comparison with the forecast made at the beginning of the pilot. The forecast breakeven interest rate was an APR of 28.25% (flat rate of 15.95%) compared with an actual APR of 32.84% (flat rate of 18.7%) using data arising out of the pilot.

The impact of the makeup of any lending portfolio in the fringe lending market is highlighted here – the higher the average loan size the lower the breakeven interest rate. For example a reduction of the average loan size from about $3,400 to $2,900 increases the breakeven APR from 26.5% to 32.8%.

Using the data we can also estimate the lowest average loan size for a portfolio of 3000 loans that has an APR below the 48% per annum cap that operates in some States. The data shows that to be at a (breakeven) rate of 48% per annum, the average loan size can only decrease to $1,700.

This is an important finding of the pilot as it has implications of lending that occurs below an average size of $1,700 over a period of a year.

The pilot data shows that it is not possible to make a profit and legally operate within the 48% per annum cap for loans of $1,700 or smaller for a portfolio of 3000 loans or less for loan terms of one year or less.

It should also be noted that if a loan period is less than 12 months, the APR will also increase. All of the above scenarios will see increased APRs if loans are made for less than 12 months.

Scenario 2 – increasing the loan portfolio

The pilot was limited to a $1 million recurrent capital pool (equating to a total of $1.73 million), which equated to 510 loans being written over 15 months. As noted, the pilot assumed that the fixed cost from loan administration would be averaged over a portfolio of 3000 loans.

Another way of looking at the pilot results is to calculate the minimum capital required to meet these fixed costs and sustainably run a lending program.

Like loan size, loan volume also influences the break-even interest rate. The greater the volume of loans, the more the fixed costs can be spread across the loan portfolio - effectively decreasing the breakeven APR.

Using our model, we asked what would be the minimum amount of capital required to operate a lending program under the APR cap of 48% per annum.

The results show that the minimum capital required to run a loan portfolio where the average loan size is $2,900 and is paid back over 12 months is $5.2 million.

This allows about 1780 loans per year and would see customers charged an APR of 48% (assuming a modest profit to the lender of 20 cents in the dollar).

Data from the pilot can also be used to look at the impact a much larger portfolio has on the required APR.

Assuming an average loan size of $2,900 with a 20 cent in the dollar profit margin, the following outcomes are possible:

- At a $100 portfolio – where $100 million of loans are written per year, an APR of 12.15% is possible.
- At a $50 million portfolio, an APR of 14.10% is possible.
- At a $20 million portfolio, an APR of 20.24% is possible.
- At a $8.8 million portfolio (ie 3000 loans per annum) an APR of 39% is possible.
- At a $5.2 million portfolio, as discussed above, an APR of 48% is possible.

Scenario 3 - What is the lowest possible APR?

The modelling also allows us to look at the case highlighted in "loan size scenario section" with a portfolio with an average loan size of $1,700 and with a 20 cent in the dollar profit margin. What is the lowest possible APR?

- At a $100 million portfolio – where $100 million of $1,700 loans are written per year, an APR of 17.27% is possible.
- At a $50 million portfolio, an APR of 21.11% is possible.

- At a $20 million portfolio, an APR of 27.14% is possible.
- At a $8.8 million portfolio (ie 3000 loans per annum) an APR of 48% is possible.
- At a $5.2 million portfolio, as discussed above, an APR of 54.16% is required.

Scenario 4 - What is the lowest possible loan size?

Finally the modelling allows us to look at the smallest average loan that is possible to be written and stay under the 48% cap, and paid back over a year, with a profit margin of 20 cents in the dollar:

- At a $100 million portfolio – where $100 million of loans are written per year, the smallest average size loan possible is $605 at an APR of 48% (note that this lender would need to lend over 165,000 loans in a year).
- At a $50 million portfolio, the smallest average size loan possible is $635.
- At a $20 million portfolio, the smallest average size loan possible is $735.
- At a $8.8 million or 3000 loan portfolio the smallest average size loan possible is $1,700 as discussed earlier.

This analysis shows how mainstream lenders are able to keep their interest rates low by lending at a considerable volume. Volume lending is, however, often at the expense of higher risk customers who don't fit the simplified criteria needed to run such programs.

The analysis also shows that large fringe lenders, say with portfolios between $20 million and $100 million, are capable of delivering interest rates well below the 48% cap where the average loan size is around $1,000.

It also confirms that even large fringe lenders with portfolios of between $20 million and $100 million cannot lend small amounts of money, say less than $700 over a year and remain under the cap.

Conclusions from modelling

The APR that applies to a loan is a balance between average loan size, the size of a lending portfolio and loan term. This much was known before the small loans pilot.

The pilot can, however, speak to some specific outcomes. For example, the modelling suggests that you cannot lend below an APR of 48% for a loan portfolio of less than $5 million and an average loan size of $2,900 or less for a loan term of one year.

The modelling also suggests that for a reasonable sized loan portfolio of approximately 3000 loans at an average loan size of $2,900 - an APR within the range of around 30% to 35% is required to generate a modest profit of 20 cents in the dollar. This requires a capital pool of around $8.8 million and may be considered an average lender in this space.

Although considerably higher than mainstream bank lending, this would be considered a low cost lending model in the fringe lending sector and is below government regulated interest rate caps of 48% that operates in some States.

The modelling shows the need to investigate further the provision of loans with less than an average size of $700. Even large lenders (with portfolios greater than $20 million) would struggle to deliver such loans under the 48% per annum cap. This would be further exacerbated if the lending period was shorter than a year.

This is a particularly important finding as it brings into sharp focus first the ability of lenders to meet legislative requirements when lending small amounts of money, and second, the ability of customers to be protected under such loans where they will be paying interest in excess of regulated levels.

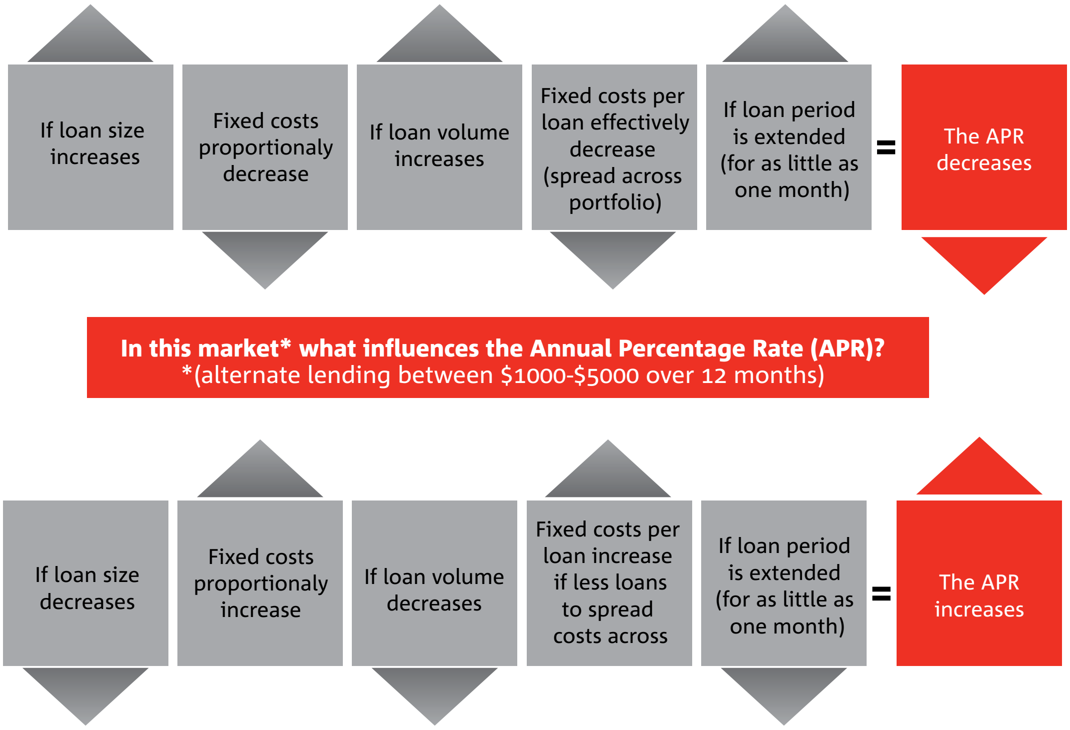

If loan size increases
Fixed costs proportionaly decrease
If loan volume increases
Fixed costs per loan effectively decrease (spread across portfolio)
If loan period is extended (for as little as one month)
=
The APR decreases
In this market* what influences the Annual Percentage Rate (APR)?
*(alternate lending between $1000-$5000 over 12 months)
If loan size decreases
Fixed costs proportionaly increase
If loan volume decreases
Fixed costs per loan increase if less loans to spread costs across
If loan period is extended (for as little as one month)
=
The APR increases

Table (i)

Break even small loans lending pilot: breakdown of costs and revenue - Final (June 2008 to September 2009)

Loan features		Loan size	Expected loans across pilot	Actual loans across pilot
Average loan size	$3,397	$1,000	18%	3%
Loan term	1 Year	$1,500	13%	2%
Application / monthly fees	$0	$2,000	21%	9%
APR	28.25%	$3,000	5%	17%
Comparison rate	28.25%*	$4,000	18%	15%
		$5,000	25%	53%

	Forecast breakeven rate	Actual breakeven rate
Comparison	28.25%	**26.45%**
Flat	15.95%	14.90%

Costs	Actual for pilot to date				Forecast at beginning of pilot			
	Rate	Total for average loan	Total across pilot	Portion of costs (%)	Rate	Total for average loan of $3,000	Total across pilot	Portion of costs (%)
Administration costs ($/loan)	$321	$321.11	$163,766	52%	$243	$243.07	$89,449	46%
Costs of funds (%)	7.30%	$103.78	$52,944	17%	7.30%	$103.78	$35,976	18%
Default costs (%)	4.16%	$141.29	$72,056	23%	5.00%	$150.00	$53,775	28%
Profit margin (%)	2.53%	$85.91	$25,582	8%	1.55%	$46.40	$16,171	8%
Total costs ($)	n/a	$652.09	$314,347		n/a	$543.25	$195,370	

Revenue	Rate	Total for average loan	Total across pilot	Portion of revenue (%)	Rate	Total for average loan of $3,000	Total across pilot	Portion of revenue (%)
Interest income (% pa)	28.25%*	$541.83	$258,117	82%	28.25%*	$478.50	$171,542	88%
Upfront or compulsory fees ($)	$0	$0.00	$0	0%	$0	$0.00	$0	0%
Additional fees ($)	$110.25	$110.25	$56,230	18%	$64.75	$64.75	$23,828	12%
Total revenue ($)	n/a	$652.09	$314,347		n/a	$543.25	$195,370	

***About the interest rate**

The NAB Small Loans Pilot plans to operate under a "breakeven" interest rate where revenues fully cover costs. This rate can only be determined by forecasting the cash inflows and outflows for a portfolio of loans. The rate is sensitive to the number of smaller loans in a portfolio.

When quoting interest rates, comparison rates are required to be quoted based on certain loan values and terms. 28.25% pa is the comparison rate based on a loan of $2,500 over a term of 2 years with monthly repayments. Comparison rates take into account all interest and other fees and charges (other than government fees, charges or duties) payable during the life of the loan which are known at the date the comparison rate is calculated. WARNING: this comparison rate is true only for the example given and may not include all fees and charges. Different terms, fees or other loan amounts might result in a different comparison rate.

Section three:
customer and stakeholder insights

While the pilot's initial aim was to establish some of the economics of fringe lending, a key goal was also to learn more about Money Fast clients and the impact of the service and product provided. This section of the report draws on two sets of data:

1. **Money Fast customer and applicant data.**
2. **Empirical research conducted by RMIT University and Griffith University.**

Money Fast customer and applicant data

During the pilot, Money Fast was able to capture generic demographic data about their clients and people that applied for the loans throughout the pilot.

Table (ii) shows a summary of that data captured from June 2008 to September 2009. It provides insight into the demographics of more than 6000 Small Loans Pilot applicants and the customers who received a loan.

	Money Fast applicants	Money Fast customers
Male	3,240	235
Female	2,920	304
Male/female: not specified	14	
Average age	32	35
People with children	2,205	150
People on govt benefit	1,541	99
Individual applications	5,964	471
Joint applications	350	35
Had defaults/bankruptcies	2,138	192
Single	3,677	260
Married	1156	131
Marital status: other	433	28
Divorced	307	33
Separated	371	22
Common Law Partners	329	29
Widowed	27	3
No dependents	4,048	350
1 dependents	1,117	78
2 dependents	650	44
3 dependents	273	18
4 or more dependents	214	12
Full-time employment	4,668	446
Employment status: other	180	2
Part-time employment	887	79
Unemployed	579	15
Paying rent	3,387	342
Paying board	2,006	84
Home owner	906	77
Residential status: other	15	2
Average Income	$823 per fortnight	$859 per fortnight
Highest income	$5,960 per fortnight	$4,810 per fortnight
Lowest income	$100 per fortnight	$304 per fortnight
Loan purpose: pay bills	1,817	103
Loan purpose: other	1,460	102
Loan purpose: pay other credit	565	43
Loan purpose: buy item	860	62
Loan purpose: car registration/repairs	736	48
Loan purpose: holiday/ spending money	596	52
Loan purpose: dental expenses	189	11

	Money Fast applicants	Money Fast customers
Loan purpose: buy food or groceries	41	1
Loan purpose: pay vet bills	26	4
Reason for choice: lower rates	1,819	163
Reason for choice: advertising	1,395	94
Reason for choice: other lender declined	883	92
Reason for choice: other	877	75
Reason for choice: family/friend	680	48
Reason for choice: good service	521	22
Reason for choice: not specified	189	13
ACT based	850	66
NSW based	1,795	155
NT based	649	49
QLD based	1,138	104
SA based	307	22
TAS based	149	4
VIC based	1,055	80
WA based	353	24

Applicant and customer existing credit:

Has credit card	Has personal loan	Has car loan	No of applicants	No of customers
Yes	Yes	Yes	274	47
Yes	Yes	No	654	74
Yes	No	Yes	375	43
Yes	No	No	816	115
No	Yes	Yes	243	43
No	Yes	No	721	92
No	No	Yes	596	75
No	No	No	2,635	263

Conclusions and summary

- Applicants and clients were evenly spread between men and women and had an average age of 32 for men and 35 for women.
- The majority of applicants and clients had no dependents.
- More than a third of applicants and clients had prior credit defaults or bankruptcies.
- The clients of Money Fast are not necessarily low-income, and do not fit the stereotypical profile of a payday lender client.
- The majority of applicants and clients wanted to use the loan to pay bills.
- Most clients and applicants had existing credit with other financial services providers.

Research conducted by RMIT University and Griffith University

The pilot also included an empirical research component to collect data from a sample of clients and declined clients of Money Fast to investigate the impact of the service and product provided.

It also included interviews with Money Fast staff and members of the Advisory Group.

This research aimed to:

1. Determine the profiles of Money Fast clients (demographic and financial).

2. Evaluate the impact of the Money Fast service on clients:

- What would the applicants do without access to the Money Fast product?
- What are the characteristics of the product that are most valuable to the client?
- What are the effects on the stress levels of applicants by obtaining the loan or alternatively not obtaining the loan?

3. Create a platform for debate about the alternative finance providers by harnessing the views of stakeholders and experts in the area of microfinance.

Method

A mix of quantitative and qualitative techniques was used in the research. A survey was sent to Money Fast clients and non-clients. Clients are those who have had or currently have a loan with Money Fast. Non-clients are those who have applied for a loan and were either declined by Money Fast or chose not to continue with the application.

The members of the Pilot Advisory Group were also interviewed in their capacities as subject matter experts. The collective extent of experience and knowledge provides a rich context to the project.

Interviews were also conducted with directors and one administrative employee of Money Fast to inform the evaluation of the operational issues and to gain information on their knowledge and assessments of the type of clients receiving the loans, reasons for declining applications and information on defaults.

In terms of clients surveyed, out of a possible 328 approved applications at the time of the survey, 64 responses were received giving a response rate of 19.5%.

The non-clients were much harder to contact and engage in the research. Only 40 responses were received from the non-clients out of a possible total of 4,664 applicants (at time of the survey). However, from these only 67 had agreed to be sent a questionnaire, 40 sent back valid questionnaires, and 10 agreed to participate in the interviews. The results from the non-client survey analysis should be treated with caution due to the small sample size.

In order to obtain a more detailed understanding of the views of the pilot participants, telephone interviews were also conducted with eight approved customers, six declined customers, eight members of the advisory group, and the two Money Fast representatives.

While not statistically significant, the qualitative telephone interviews assist in gaining an 'authentic understanding of people's experiences' and view points. (Silverman 2001, p.13) The interviews were audio-recorded and transcribed, and relevant parts of the interviews have been quoted verbatim in this report (refer Appendix B for copy of interview questions). The interviews were audio-recorded with explicit consent from the interviewees.

Conclusions and summary:

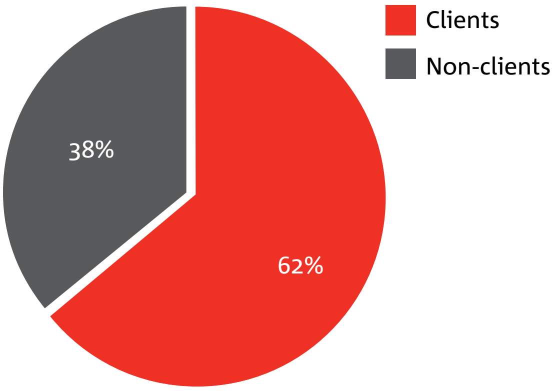
- The qualitative and quantitative research shows that Money Fast has met an important need in the community. It also reveals that there is a latent demand for non-mainstream, short-term, small loans.
- The clients of Money Fast are not necessarily low-income, and do not fit the stereotypical profile of a payday lender client.
- The reasons for seeking a loan through a non-mainstream provider are varied. Research shows the applicants may be over-committed in other financial areas and therefore not able to access further credit from their banks; or the applicant could be seeking the privacy provided by the Money Fast process; or the on-line service provided by Money Fast was more convenient and accessible than other mainstream products.
- Being financially excluded from access to mainstream loans due to having a default on their credit record, was a significant reason for some applicants to apply for a Money Fast loan.
- The need for short-term loans is most likely to have heightened over the last 12 months with many Australians experiencing difficult financial conditions – and not just those in the lowest quintiles of income and wealth. This is supported by the majority of clients seeking a loan to pay bills.
- Stakeholder insights from the Independent Advisory Group indicated that the pilot has been a worthwhile exercise.
- Some stakeholders felt that the major shortcoming of the pilot was its focus on the Money Fast model which did not attract those financially excluded on grounds of income, possibly due to the internet form of delivery, and did not really test the cost of smaller, shorter term loans (ie payday loans).

Customer research results

Survey respondents approved and declined applicants

The overall number of applicants who responded to the survey is 104 including 64 (62%) clients and 40 (38%) declined clients.

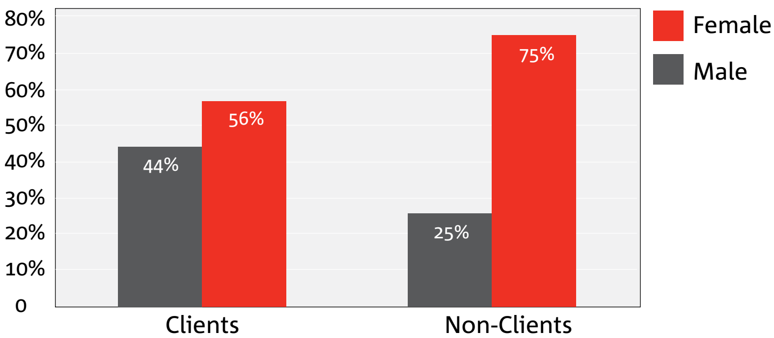
Figure 1: Number of Respondents



Demographic information of overall respondents

Figure 2 shows there was a higher proportion of female respondents than males from both the client and non-client groups. However, Money Fast records show that in reality there are more equal proportions of male and female applicants.

Figure 2: Gender

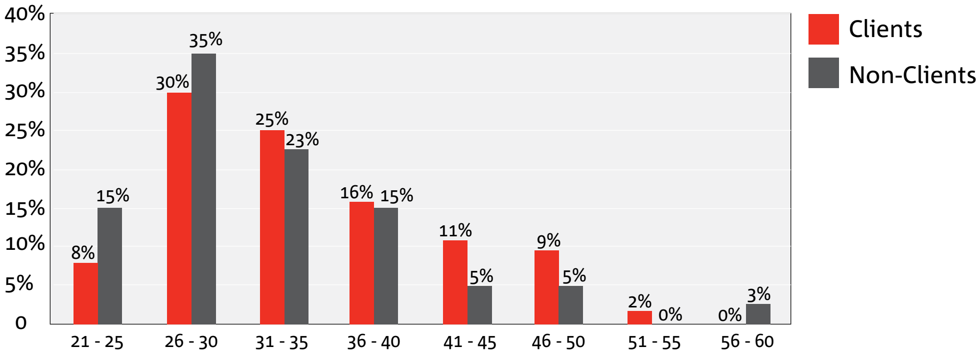


Age groups of respondents

Most of the respondents (clients and non-clients) were aged between 26 and 30 years. The second highest number of respondents from both categories is in the age range of 31 to 35. As Figure 3 shows the remaining age groups have

proportionate numbers of client and non-client respondents, except in the age range of 21 to 25 years in which there was a much higher proportion of non-client respondents to clients.

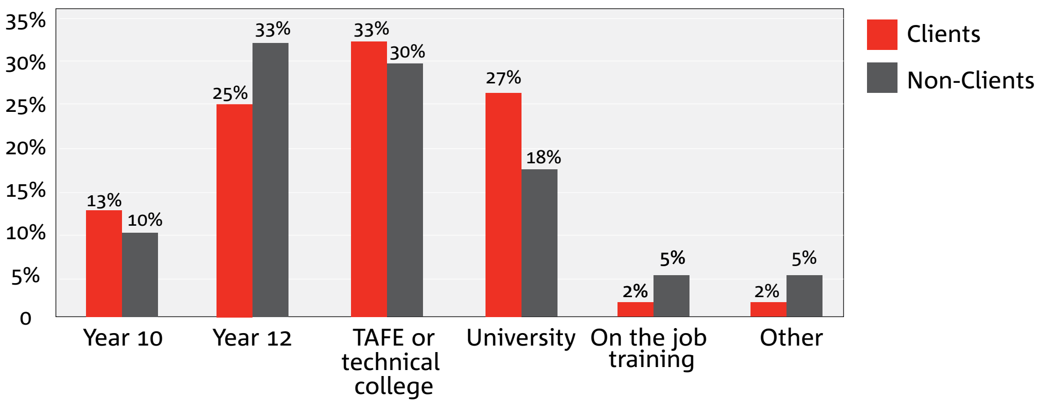
Figure 3: Age range of respondents



Education level of the respondents

Most of the respondents have a TAFE or technical college qualification or Year 12 certificate. However there is a higher proportion of clients (27%) than non-clients (18%) who have a university qualification.

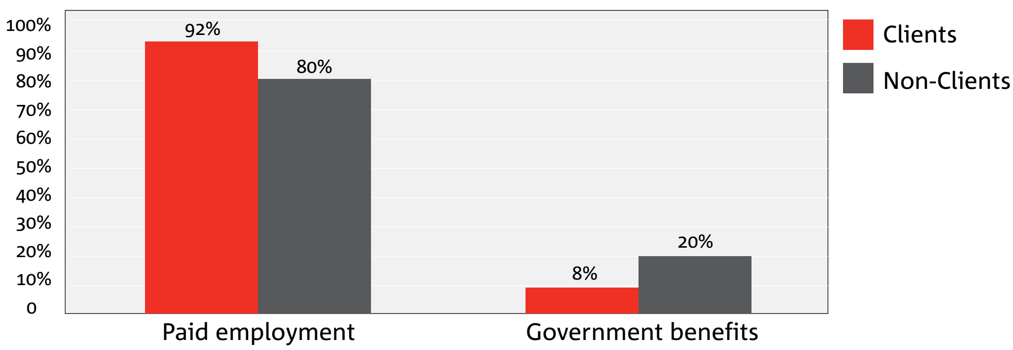
Figure 4: Education levels



Source of household income

Nearly all clients (92%) receive most of their income from paid employment whereas 80% of non-client respondents said that the majority of their income was from paid employment. Conversely, 20% of non-clients said most of their income was derived from government benefits.

Figure 5: Source of household income

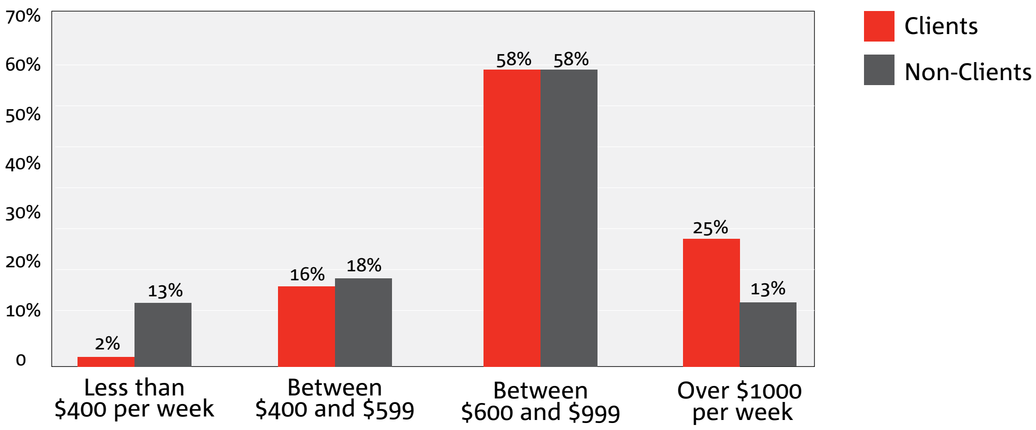


Income levels

The majority of both client and non-client respondents reported earning between $600 and $999 per week. As one would expect, the proportion of clients who earn over $1,000 per week are higher in the client sample compared to the non-client sample. There was a significantly higher proportion of non-clients than clients who earned less than $400 per week.

This is in line with research that shows there is a growing proportion of households on higher incomes that suffer cash-flow problems and financial stress. A recent study of financial stress and hardship in Australia reported 36% of Australian households with income in the top two quintiles suffer cashflow problems (Bruenig & Cobb-Clark, 2005).

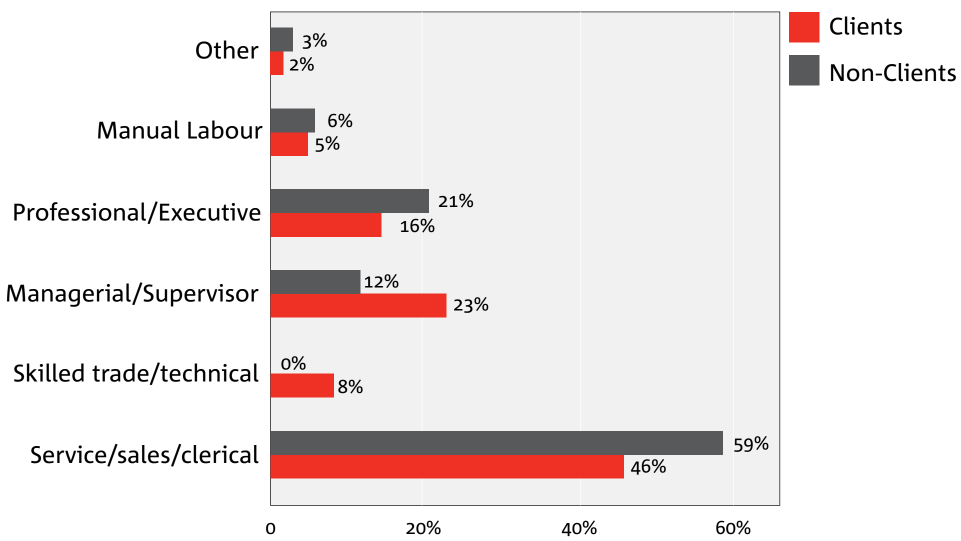
Figure 6: Income levels of respondents



Employment – type of work

As described in Figure 7, the most frequently occurring type of work in both the samples is service/sales/clerical (clients 46% and non-clients 59%). There are however, a higher proportion of managerial/supervisory roles held by clients (23%) than non-clients (12%).

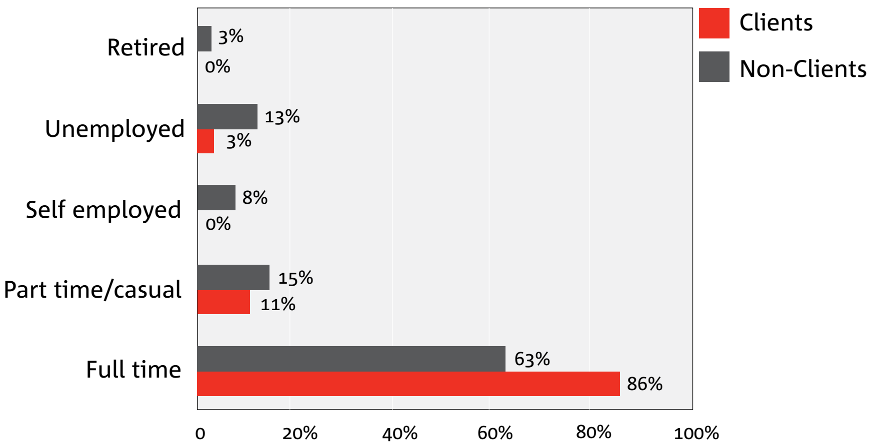
Figure 7: Type of work



Employment status

While the majority of clients and non-clients were employed full-time, there is a higher proportion (86%) of client respondents employed full-time than non-clients (63%). There were 13% of non-clients who reported to be unemployed compared to only 3% of clients.

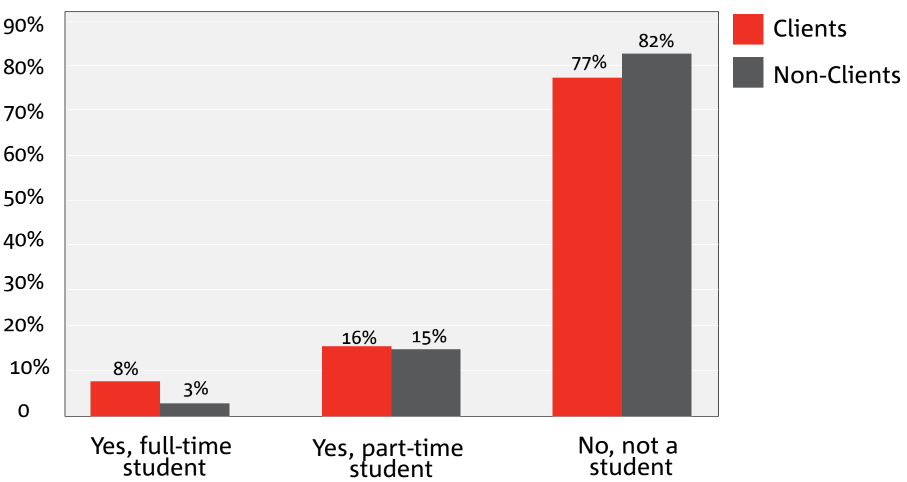
Figure 8: Employment status



Enrolled as a student

The majority of the respondents were not enrolled as students although there were slightly more clients enrolled as students than there were non-clients.

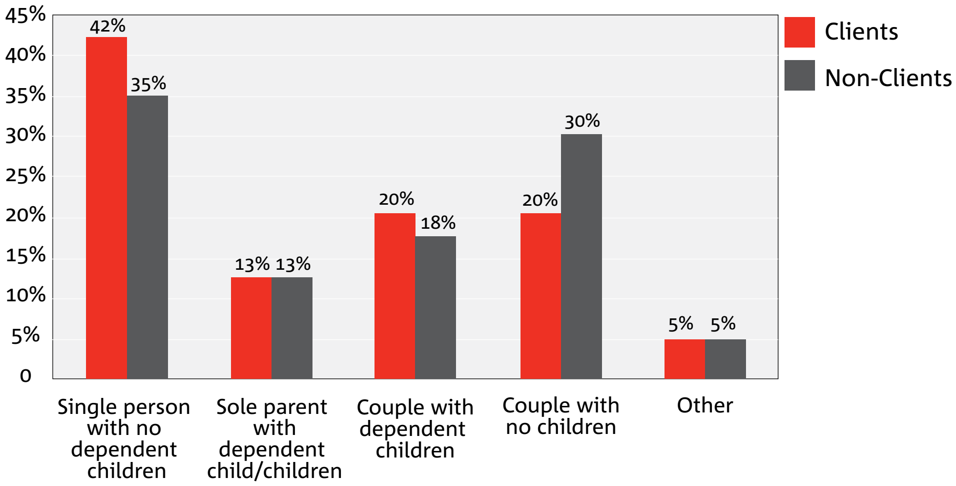
Figure 9: Enrolled as a student



Household structure

Figure 10 shows the respondents – clients (42%) and non-clients (35%) were more likely to be single with non-dependent or no children. There were an equal proportion of clients that were couples with children (20%) and no children (20%). Sole parents with dependent children accounted for 13% of clients and non-client respondents.

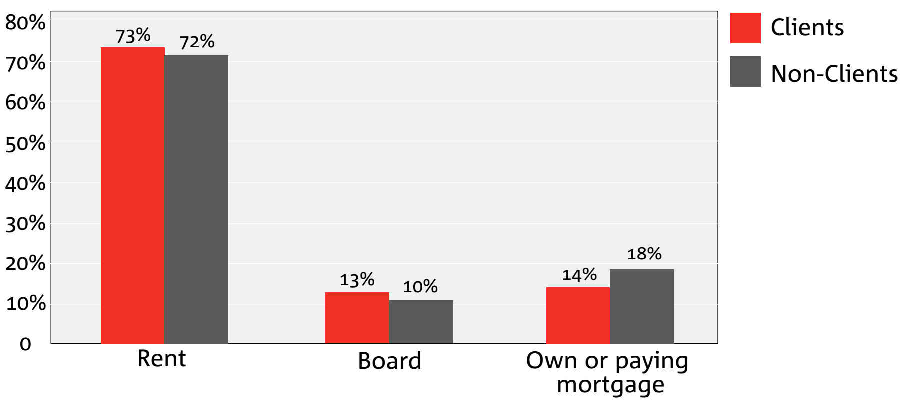
Figure 10: Household structure



Residence status

All respondents were more likely to be paying rent than own their place of residence. There were 73% of clients and 72% of non-client respondents who rent and 14% of clients and 18% of non-clients that own or are paying a mortgage on their residence.

Figure 11: Residence Status



Clients of Money Fast

This section gives a more detailed description of the survey respondents that were clients of Money Fast.

Gender and amounts borrowed

Out of all the client respondents, 95% said they applied for a loan as an individual. The remainder were joint applications.

Table 1 shows the most common amount borrowed was $5,000 and there were more males than females who borrowed this amount (see also Figure 12).

The least common amount borrowed was $1,500. Females were more likely to borrow the lower amounts of $1,000, $1,500, $2,000 and $4,000 than were males.

Table 2 shows that overall females borrowed less than the male respondents. On average, females borrowed $3,750 while males borrowed an average amount of $4,610.

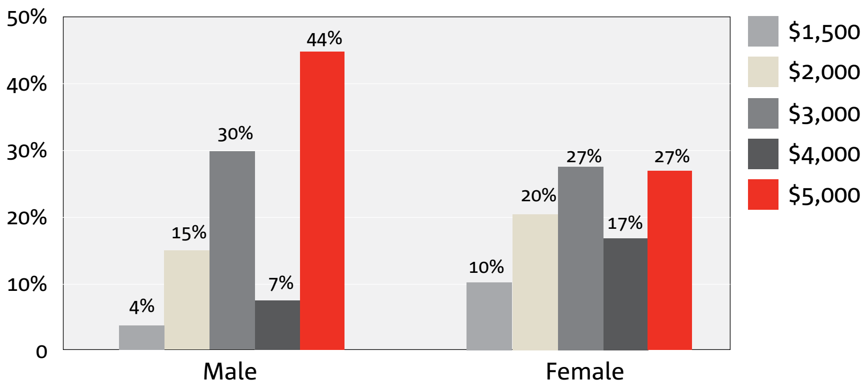
Table 1: Gender and amount borrowed

		Amount borrowed						Total
		$1,000	$1,500	$2,000	$3,000	$4,000	$5,000	
Gender	Male	1	1	4	8	2	12	28
	Female	6	3	6	8	5	8	36
Total		7	4	10	16	7	20	64

Table 2: Average amount borrowed by male and female applicants

Gender	Average
Male	$4,610
Female	$3,750

Figure 12: Gender and amount borrowed



Purpose of loan

The clients were asked to indicate the purpose for the loan and while it is not possible to know for sure how the loan was used, Table 3 presents the range of responses. The most common purpose reported by respondents was to 'pay bills' (35.9%). The inability to pay bills, especially utility bills, is the most common cause of financial stress in all households (Bruenig & Cobb-Clark, 2006).

Buying household items were the second most common purpose for applying for a loan. Where the respondents indicated 'other', many cited needing the loan for rent and bond or expenses related to moving house. Nearly 11% indicated they borrowed the money for holiday spending while an equal proportion of respondents reported using the loan to pay off other credit or to pay for car expenses.

Table 3: Purpose of loan

Purpose	%
Pay bills	35.9
Buy household item	14.1
Holiday spending	10.9
Car rego/ repairs	7.8
Pay off other credit	7.8
Celebration	3.1
Education expenses	1.6
House repairs	1.6
Medical costs	1.6
Reduction in income	1.6
Other	14.1

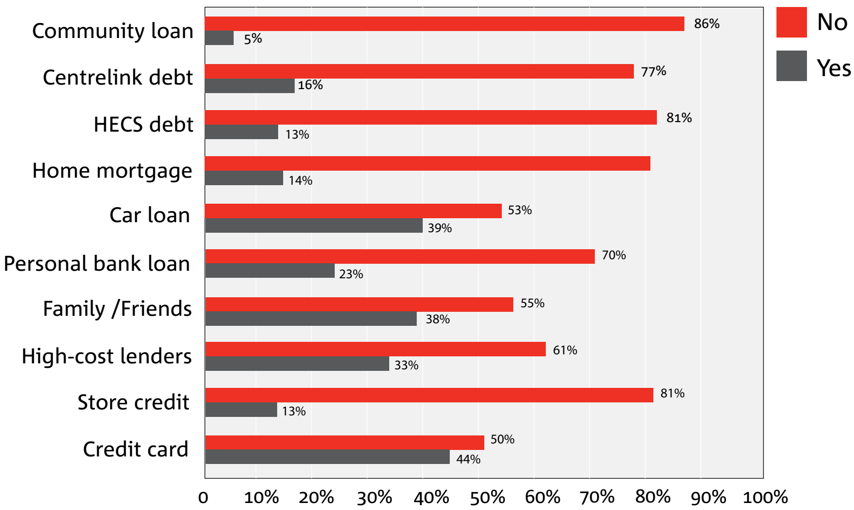
Types of debt held by clients

When asked what types of debt the applicants have had in the previous 12 months, 44% said they had credit card debt; 39% had a car loan; and 33% had debt to high-cost lenders.

Table 5: Account of debts in the past 12 months

	Yes %	No %
Credit Card	44	50
Store Credit	13	81
High-cost lenders	33	61
Family/Friends	38	55
Personal bank loan	23	70
Car loan	39	53
Home mortgage	14	80
HECS debt	13	81
Centrelink debt	16	77
Community loan	5	86

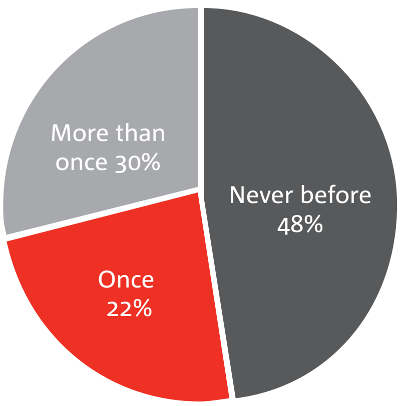
Figure 13: Range of debt type held by clients



Borrowing history of respondents

For 52% of the clients, the Money Fast loan was not the first loan they had applied for from a non-mainstream lender. There were 30% of clients who had applied for a non-mainstream loan more than once (see Figure 14).

Figure 14: Previous borrowing activity from non-mainstream lenders



The respondents were asked if they had tried to obtain a loan from somewhere else before they approached Money Fast. Table 6 shows that just over half of the respondents (52%) said they had applied for a loan at a bank/credit union first and were declined.

There were 35% of respondents who reported that Money Fast was their first choice. Surprisingly, 9.5% said they had been declined by a payday lender before they applied for a loan from Money Fast.

Table 6: Previous borrowing attempts before approaching Money Fast

Purpose	%
Declined by a bank/credit union	52.4
Declined by a payday lender	9.5
Money Fast was my first choice	34.9
Other	3.2

When asked where the applicants would get a loan from if Money Fast closed, 39% of the respondents said they would approach a bank as their first choice and 22% said they would need to approach a payday lender for a loan. The remaining population indicated family/friends, credit union and pawn broker.

Table 7: Other options for a loan

Purpose	%
Bank	39.1
Credit Union	6.3
Pawn Broker	3.1
Payday Lender	21.9
Family/Friend	14.1
Community group (microfinance)	4.7
Other	10.9

General Money Management Behaviour of Clients

Saving and budgeting behaviour

As expected, only a small proportion (14%) of clients indicated they save on a regular basis. Nearly half the respondents said they saved the odd amount when they could and 20% said they saved what is left over after expenses are paid.

Table 8: Saving pattern of clients

	%
Regular basis	14.1
What is left over after expenses	20.3
Save odd amount	48.4
Unable to save	17.2

The practice of drawing up and maintaining a household budget is an indicator of financial capability. There were 39% of clients who said they 'sometimes' used a budget; 28% of clients reported they always keep track of their budget; and 23% said they regularly budgeted. Only 9% of clients said they never used a household budget.

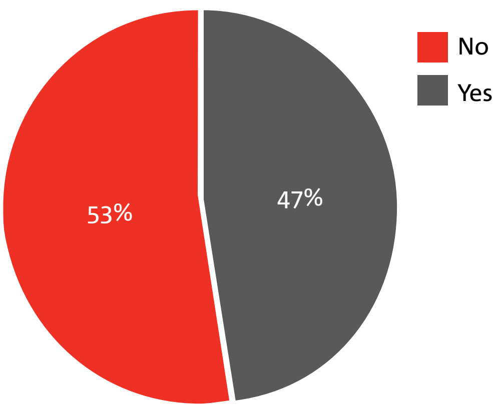
"I really sort of had factored it in- the fact that I had to pay that loan...it was just something that I had budgeted for."

"Yeah, it's easy. I'm not a lover of the whole direct debit thing and the first couple of months I would forget about the payments and think 'Oh, I'm fifty bucks short. I should have more money.' But it's really not been that much of an impact on my budget. Yeah, it's been good."

Although obtaining a loan from non-mainstream lenders usually indicates an individual is having difficulties in managing their financial commitments, the majority of clients (73%) have never sought advice from a financial counsellor.

The clients were asked whether they would save the loan repayment amount after they finished paying off the loan. Just over half the respondents said they would.

Figure 15: Save the loan repayment amount after they finished paying off the loan



Manageability of loan repayments

The majority of clients (90.6%) said they had no difficulty in making the loan repayments. The most common reasons for those who had found it difficult were a change in their financial circumstances or an increase in other debts. All the clients (100%) reported they thought the Money Fast loan was reasonably priced.

These results suggest that the Money Fast product is well-priced and the repayment structure is reasonable and manageable.

"Yeah, they [the repayments] are very high so it has been a challenge. Having said that, there was a period where I was unemployed for nearly 6 months and they have been very understanding and accommodating with that period of time that I wasn't able to make any repayments. They just extended the term of the loan out by 6 months."

"Extremely easy. The repayments were very manageable and I just set up a direct debit. Yeah, it was really good."

"It's been pretty easy. You know being a student I didn't have the money I needed on hand, whereas just having the repayments isn't a big deal when it's spread out over a year."

Impact on financial stress levels

The provision of the Money Fast product has had a positive impact on the financial stress levels of the clients. Around 87% of clients said their financial stress levels were reduced a little or a lot due to obtaining the loan.

Table 9: Impact on financial stress levels

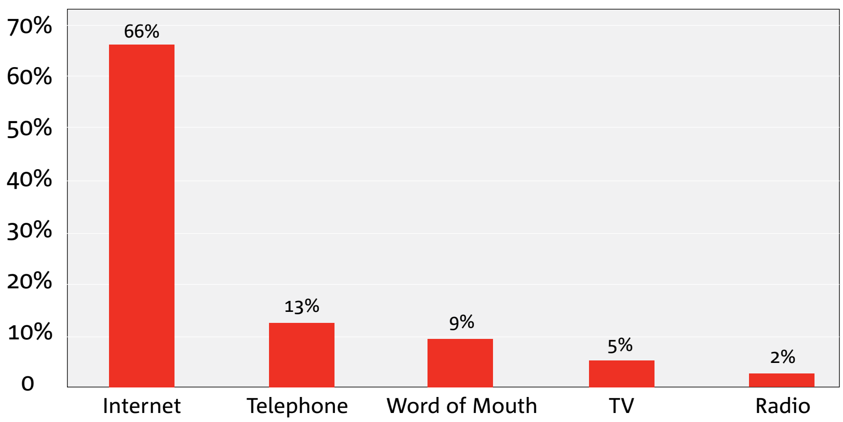
	%
Reduced financial stress levels a little	45.2
Reduced financial stress levels a lot	41.9
Increased financial stress levels a lot	1.6
Stress levels stayed the same	11.3

Choosing Money Fast

There were 70.3% of the clients in the sample who reported they shopped around for the best deal before applying for the Money Fast loan. Shopping around before purchasing goods or a service is one indicator of financial capability (Atkinson, et.al., 2006).

The respondents were asked to indicate all the sources they used to gather information about loan products. The most common source used by the respondents was the Internet 66%, followed by telephone 13%, word-of-mouth 9%, television 5%, and radio 2%.

Figure 16: Sources of information about loan products



"Well I went to a couple of banks and they wanted a minimum [loan] of $5,000, or a high interest rate, and I just Googled online and that was one of the options that came up and looked quite competitive."

Choosing Money Fast – factor analysis

In order to determine what influenced customers' decision to apply for a loan from Money Fast over other lenders, the respondents were given a range of features to choose from. A factor analysis was conducted to discover core themes that were important in the decision making process.

Three distinct factors became clear. Each of these factors relates to a specific aspect of the customers' decisions to choose Money Fast.

1) Customer Orientation:

The first factor can be identified as 'customer orientation' and this was formed by the combination of the following four variables:

- Hours of operation,
- No other alternative source for borrowing,
- Greater level of privacy, and
- Good customer service.

2) Competitive Pricing:

It seems that Money Fast has chosen an appropriate pricing and repayment strategy. As mentioned above, 100% of applicants indicated that Money Fast products were reasonably priced.

Furthermore, from a price perspective, the following variables were considered important by applicants for choosing Money Fast. Further analysis revealed the following variables were important for clients in choosing the Money Fast product:

- Better interest rate: 84% of respondents said that the interest rate was very or moderately important in their decision to choose Money Fast.
- Better repayment amounts: 88% of respondents said that the repayment amount was very or moderately important to them as a reason to choose Money Fast.
- Less expensive than borrowing cash elsewhere: 91.5% of responding clients indicated that Money Fast was less expensive than borrowing cash elsewhere and this was very or moderately important to them.
- Better repayment schedules: 83% of responding clients preferred the repayment schedule to other loan providers and this was very or moderately important in their decision to choose Money Fast.

3) Efficient management

Three variables highly correlated to comprise a construct we can call 'efficient management'.

This factor includes the following variables:

- Simple application process: rated by 74% of applicants as being important.
- Quick decision turnaround time: 73% of applicants said this was very important.
- Online application facility: 66% of clients rated this as important.

Respondents were also given the opportunity to write other reasons for choosing Money Fast over other lenders.

'I read on the Money Fast website that they like to treat every person fairly and understand that people may have had problems with handling their money in the past. This was a major influence on my decision to apply. I have made many bad decisions with my money when I was in my early 20s- and unfortunately I am still paying the price for this. I am now 30 years old, have an excellent job and make great money however can't even get a mobile phone in my own name! I was over the moon when Money Fast approved my loan.'

'The influence for me to apply for a Money Fast loan over other lenders was that I was finally willing to take into account all my financial details and spending habits rather than just go by credit file which is completely outdated to my current circumstance and income.'

"I'd probably go to Money Fast again for credit. I got a loan from Cash Converters once. I remember it was a high interest rate and I thought nope- that's probably why I never did it again because it was a memorable experience."

"I'd normally go to my usual bank. I've applied through my usual bank before and I actually have a car loan, and I just remember the process being a bit more sort of rigorous and I didn't really want to have to go to all that trouble and because it was a small amount I think it was actually under the minimum that my bank lends as a personal loan."

Declined Clients of Money Fast

The following section gives a more detailed analysis of the declined client sample. These were individuals who initially applied for a loan with Money Fast but either did not proceed with the application or their application was declined by Money Fast.

Purpose of loan

Similar to the client sample, the majority of non-clients (45%) applied for a loan to pay bills. However there was double the proportion of non-clients (15%) than clients (7.8%) who needed the loan to pay off other credit. This perhaps signals a greater degree of financial problems and hardship than that experienced by clients.

Table 10: Purpose of loan for non-clients

	%
Pay bills	45.0
Pay off other credit	15.0
Car expenses	7.5
Dental costs	7.5
Holiday spending	7.5
Other	7.5
Buy household item	2.5
Education expenses	2.5
Medical costs	2.5
Reduction in income	2.5

"It was basically a situation where we needed the money, so we had to find whatever means we could at the time….I think we were moving house and needed money for bond and stuff so it was basically just whatever we could get at the time to fix the situation we were in."

Reason for not proceeding with loan application

There were 28% of non-clients who were not able to proceed with their loan application because their application was declined by Money Fast. The same proportion of non-clients did not proceed because they managed to get the money they needed from elsewhere. Only small proportions of non-clients said they did not proceed because of the process involved. Approximately 9% of non-clients said their financial circumstances improved sufficiently to not need the loan after all.

Table 11: Reasons for not proceeding with loan application

	%
Managed to receive money from elsewhere	28.1
Application declined by Money Fast	28.1
Money Fast rates were too high	9.4
Financial circumstances improved	9.4
Complicated process	9.4
Paperwork too hard to collect	6.3
Don't like computers	3.1
Other	6.3

Impact on financial stress levels of not receiving a loan from Money Fast

Over half the non-clients (54%) reported that by not obtaining a loan, their financial stress levels increased a little or a lot. Although 38% of applicants stated that their financial stress levels remained the same despite not receiving a loan from Money Fast, it could be that their stress levels were already at high levels.

Table 12: Impact on financial stress levels from not receiving a loan

	%
Financial stress stayed the same	37.8
Increased financial stress a little	29.7
Increased financial stress a lot	24.3
Reduced financial stress	8.1

The non-clients were given the opportunity to provide qualitative information about the impact on them personally from not obtaining a Money Fast loan. While some non-clients said it worked out better for them because they either asked for financial help from family and therefore did not have to pay interest; or they managed to get a job and no longer needed the loan, there were over half of the non-recipients who suffered financial hardship as a result of not obtaining the loan. Following are some examples of their comments:

'The impact of not receiving the loan caused increased financial stress because I then had to seek alternative avenues of finance. This also had a negative impact on my personal being as I felt rejected by the finance company.'

'Because I did not receive the Money Fast loan I was forced to go to a small lender with much higher interest rates and fees. I paid back a lot more money in the end.'

'Not receiving the Money Fast loan meant that I had to request an extension of time to pay my expenses which was difficult to obtain but they agreed to it in the end.'

'Without the Money Fast loan I struggled to pay bills.'

'Because I did not get the Money Fast loan my teeth still need fixing and I'm finding it impossible to establish a credit rating as no one will give me a chance.'

'The impact of not receiving the loan was that I wasn't able to improve my credit rating.'

'I have had to try and find money elsewhere, without much luck may I add.'

'The fact that I did not receive the Money Fast loan meant a lot. It would've allowed me to get back on track….To arrange payment plans with companies.'

'The impact of not receiving the loan meant that in the long-term I was better off. I borrowed the money from a family member instead and didn't have to pay back interest. Personally I had to swallow a bit of pride to ask my family member for the money.'

'The consequence of me not receiving the loan was that I was better off in the long run because I didn't have to pay interest back.'

'The major impact from not receiving the loan was that I ended up getting a debt- consolidation with Fox Symes.'

The non-clients were asked if they managed to secure a loan from elsewhere. The majority of applicants (37%) indicated that they managed to borrow from family/friends and 30% had to borrow from payday lenders. A further 11% managed to secure a loan from a bank and 7% obtained funds from pawnbrokers.

Table 13: Alternative sources of loans for non-clients

	%
Family/Friend	37.0
Payday Lender	29.6
Other	14.8
Bank	11.1
Pawn Broker	7.4

Money Fast officers – telephone interview survey

In relation to the **sustainability** of the Money Fast product, both representatives expressed the strong view that a significantly higher volume of loans or higher interest rate would be required. There were approximately 500 clients who had received loans during the pilot, however more than 3000 loan recipients would be required per annum for sustainability.

One representative indicated more than that: "Over a five year time frame we're looking at targeting up to 30,000 loans." Even at that level, the Money Fast representatives stated that they would need to charge "close to 28.5%" to be sustainable, which is "a bit of a guess... it'd be between 28 and 35%."

Both agreed that the pilot had **met their expectations.**

- "We think there's certainly that massive demand for the product...what the pilot has done is help to see that there is a demand for this product out there and it has also helped us to validate the model that we've got."
- "We've proved the business model. We proved that you do not need to charge 100% pa. We're very satisfied with what we've achieved and we know our business model is sound."

Commenting on the **types of people who applied for loans:**

- "We've probably been surprised at the type of client that has actually been applying. We really thought it would be a more lower socio economic sort of client that would be applying- we've been quite surprised at the range of people who have been applying...we're getting a lot of people who are seeing our business as a real alternative to mainstream lending."
- "Our customers' average take home pay is $900, so you know we're just hitting 'average Joe'. Why didn't we get lower income people? They probably believe that they can't get credit anywhere."

In response to the question as to whether Money Fast was **excluding people on the basis of income:**

- "They won't be declined if they're on a low income. They'll be declined if they can't afford it based on the Henderson Poverty Index which most people use to judge whether or not you can afford to re-pay credit."

The views of the Money Fast representatives on the **impact of being internet based** on the types of borrowers applying:

- In response to the question: Do you think use of internet delivery has any impact of the types of people you've attracted?: "Possibly. The question is, is the sort of person you may see at a local cash shop or payday lender the sort of person who has got access to the internet? I don't know. We just don't know whether people who haven't come to us haven't come because of the internet."
- But the idea of lending through a shop front was ruled out: "There's no business that's going to be able to afford to lease the real estate and then offer a financial product. As simple as that- it just doesn't add up."

The perceived **benefits of internet delivery** went beyond efficiency:

- "What the internet platform does is provide people with ease of access and a level of discretion. You know, the existing sort of payday lenders and so on have got a stigma attached to them and especially with the retail front some people must be scared about going in there or being seen to be going in there. This gives them the opportunity of privacy in their own home."

Loan defaults were not an issue during the pilot.

- "They were under what was catered for in the pilot. They ended up being just over 4%. You know, most people do want to repay their loans."
- "We've managed to keep them at about 4% over the course of the pilot. We don't lend to anyone but also we just try and manage people when they do get into arrears and try and get them staying on track."

In terms of **procedure for managing default:**

- "If they do contact us beforehand and they want to suspend a payment we'll usually do that without any issue. If they contact us after the dishonour has occurred, in the majority of cases it's something like 'my pay didn't go in' or 'I got bills taken out of my account that day that I wasn't expecting'. In probably 60% of cases then they will be willing to either make up the repayment immediately if the money is in their account, or they will look at doing an additional payment when their repayment's due. In the other cases we'll suspend the payment if they're having difficulties. We'll actually suspend the payments to the end of the loan so we won't actually ask them to make it up immediately. Effectively we'll extend the term of the loan."
- "We're not actually charging them on the spot. We're just putting them [payments] to the back end of the loan which makes it manageable. We're flexible if customers have hardship issues....If they dishonour, the process is we make contact with them. We try and find out what the reasons behind the dishonour are and if they can make up the repayment or part of the repayment we will ask them to. If they can't then we are very accepting. It's got to be a legitimate reason obviously."

How **effective** is this method **in managing defaults?**

- “It’s effective because if someone can’t pay and you try and pull the money out straight away and they haven’t got the money there, well it just makes sense that we don’t really want to be hard on them as well. The last thing we want to do is default someone. People do try and pay their bills and they do try and meet their obligations, so we just try to assist them. There are some people who just don’t want to pay or can’t or do a runner but they’ve been few and far between.”

The Money Fast representatives expected that **the most attractive aspects of the product** for customers were internet delivery, the interest rate, and the fact that people with credit defaults who couldn’t obtain mainstream loans could qualify for Money Fast loans. This is significant because although the Money Fast loans may not have serviced people suffering financial exclusion on the ground of low incomes, they were servicing those suffering financial exclusion on the ground of having credit defaults.

- “I think the rate is attractive to them. I think 50-60% of our clients say that they have some sort of credit default so they can’t get credit through a mainstream lender. Google is such a powerful marketing tool. If people are looking for anything they tend to jump on the internet. That’s been where they’ve seen us.”

In terms of **improving the product**, it was felt that the process could be made more efficient by being more automated, and also that a quicker application process involving less documentation would improve ‘follow through’ rates by those initially applying.

- “[We are] trying to automate a lot more so that we can contact clients automatically rather than actually having to manually do stuff.”
- “One of the issues we’ve had is ‘follow through’...it [online application] takes a person too long to fill in...we’re probably getting maybe 25-30% who do fill in an application to follow through with documentation. We tried to reduce the initial documentation requirement than we had previously- we just asked for 3 months’ bank statements to try to get them to follow through and we feel that has worked.”

Members of the Advisory Group (8) telephone interview survey

Backgrounds of interviewees and the **expertise** that they felt they brought to the advisory group:

Four community service organisation representatives brought the following expertise:

- "Knowledge of consumer issues broadly, specifically experience of working with vulnerable consumers and an understanding of credit and debt issues in the community."
- "Experience dealing with credit contracts and credit laws, the experience of people accessing unfair fringe contracts and providing more affordable and fair small amount personal loans."
- "Supporting consumers living on low incomes. The challenges some people on low incomes face with regards to access."
- "Financial counselling, microcredit, advocacy in the financial inclusion space."

One consumer advocate:

- "Consumer legal case work including credit issues and consumer advocacy."

Two government department representatives:

- "A long expertise with credit legislation, implementation of the consumer credit code, a focus on small amount lending and high interest loans."
- "Credit regulation and credit policy development."

One academic:

- "Evaluating microfinance programs. While payday lending and short-term loans have not been a major focus, I have dealt with the usual markets that access those products. I have interest and expertise in the markets that usually access these products."

All interviewed advisory group members felt that the **pilot** had been **a worthwhile exercise**, their reasons being:

- "It's shone a light on how you can provide small loans on an ethical basis and proven the financials of it. In that sense, yes, I think it has been a success."
- "Yes, probably the most worthwhile aspect of it was for stakeholders to get a better understanding of the costs of credit lent in these circumstances."
- "Yes, it's tested an area that to my knowledge probably hasn't been tested to a great extent. Anything that further examines and explores people's access and experience of fringe credit is really helpful to inform policy development, program design, and just as part of the future debate."
- "Yes, I think it's demonstrated that the loans provided in this space can be provided on a more equitable basis than they have previously been. I think it's been a good test of the cost. However the interest rate is calculated, it is still significantly less expensive than some of the options commercially available. The other thing it has done I think is to bring people together with an interest in the area to contribute to the project and I think that fostered mutual understanding of the various concerns. Thirdly, I think it's revealed more about the profile of potential users."
- Yes, I think firstly it's good just to see a mainstream financial institution taking an interest in this area of the market. It will provide some useful information about the particular segment of the market. We're always looking for evidence to get better at making policy and regulatory decisions. Anything that adds to the evidence base is worthwhile I think."
- "I think it provides really excellent groundwork in comparing the economic viability of the micro or fringe credit providers. There has been a need for some sort of objective data."
- "Definitely. It's certainly given us insights into the lenders' experience and given us much more detail on the issues that lenders see in small amount lending. We didn't have that before because you really couldn't rely on the information given by fringe lenders because it was obviously self-serving as they didn't want to be regulated."
- "It reinforces the need for this type of product and it hasn't been met by mainstream banks. It's been trialled for a year in real conditions."

In terms of **shortcomings of the pilot**, the following comments were made, which focused mainly on the fact that the Money Fast loan did not attract those financially excluded on grounds of income, possibly due to the internet form of delivery, and did not really test the cost of smaller, shorter term loans (i.e. payday loans):

- Most of the people who were accessing the loan were doing that because they were credit impaired and not necessarily because they are low income or disadvantaged. I guess the shortcoming was that this service isn't really servicing those people that are excluded in that way [on grounds of low income]."
- "It might have focused more on people who are financially excluded. It's sort of an access equity issue I guess. I think the technology restricts the opportunity that might have been present to work in this area."
- "The issue of online access left another significant part of the profile to be tested. There is still the shop-front market with its range of costs to be tested."

- “I think probably the major shortcoming of the pilot was that they kind of kept returning to that fact that it was about payday lending, when it clearly wasn’t about payday lending. They probably need to be clearer about what type of product they were actually investigating and what the purposes of the pilot were.”
- “My main concern is with the slant it introduced in using the internet as its main form of acquiring applicants for credit. It might have limited the applicability or transferability of the information to applying it to other more traditional means of providing credit. It skews the customer base.”
- “A lot of people do want smaller amounts of money and that small amount lending wasn’t part of this pilot. We know that amounts under $1,000 are not profitable at this sort of interest rate.”

The **potential benefits** of the research were identified as including:

- “There’ll be some surprising learnings with regards to who does access fringe lending. The levels of employment and skills of people accessing this option is quite surprising.”
- “It won’t tell us much about payday lending. It’s a breakeven cost for that type of loan – for the slightly longer and slightly larger amounts, but still high cost loans. We’ll learn something but we have to be really careful about narrowing it down and saying that we’re only learning in this context.”
- “I think the real benefit of this project is going to come from the transparency that accompanies the report. A clear picture in the broader community about the costing of these sorts of activities and the viability of this sort of activity. The point of doing the pilot was to prove the viability of the numbers.”
- “It gives you an insight into the commercial operations...there wasn’t much information on that in the marketplace.”
- “We have a greater knowledge of the industry – the industry viewpoints and costs. The results of this pilot will be available for use by the Commonwealth in determining whether they need to do anything else in relation to fringe lending.”
- “It illuminates a different market but it certainly demonstrates there is a need for it and it can be successful. It extends the awareness of banks to what some of the issues are and the needs of people out there who can’t always get mainstream products”

Four of the interviewed advisory group members saw some **future in the bank/ fringe credit partnership model**, while four were unsure. Comments from those who did see a future in the model included:

- “One of the really great benefits of partnering in this way is that it [a mainstream bank] does become more accessible to the target audience, providing the sort of financial backing that’s needed to provide the product at a reasonable price.”
- “Given that administration costs are going to be a huge hurdle in all of this, I think it would be desirable if it did happen. There would be benefits from a commercial perspective.”
- Yes, I think it can be a great way to do it because it gives some credibility- makes sure they operate legally and ethically.”
- “Having the involvement of the bank led to lending in a more responsible fashion than some of the other providers out there in the market.”

Comments from those who were unsure included concerns that rather than the banks making fringe lenders behave more ethically, fringe lenders could have the opposite effect on banks:

- “Within the bank there would be a certain group of people who would be dealing with the fringe business. You know we’ve seen problems with things like the debt collections arm of banks having cultural problems because they’re dealing with the debt collectors that they outsource to and they’ve kind of got more in common with the debt collectors who are engaging in poor practices than with the rest of the bank which is engaging in better practices. So there is a real risk that that would occur.”

Section four:
Conclusion and key learnings – a line in the ground

Financial exclusion in Australia is concerned with a lack of access to mainstream financial services, particularly credit services. A report commissioned in 2004 indicated that approximately 6% of Australians might face financial exclusion in the sense of lack of access to credit, on the basis that these were Australians with 'transaction only' banking products, that is, no credit products (Chant Link and Associates, 2004, p.9.).

We acknowledge there is a 'gap' in the market in terms of the provision of small amount personal credit that is not being met by mainstream financial institutions such as banks and most credit unions.

But how that 'gap' is best met is still the subject of debate.

The first challenge for microfinance development in Australia is sustainability of the programs - ensuring the continuity of services and programs that make a positive and ongoing contribution to addressing financial exclusion – both financially and socially (Burkett and Sheehan, 2009).

Alternative credit providers regard themselves as providing an essential service for financially excluded consumers (Howell et al., 2008, pp. 72-73).

Most alternative credit providers maintain that they need to charge high costs in order to operate profitably (Howell et al., 2008, pp. 74-76). In this regard Cash Doctors assert that:

> Cash Doctors' average cost for providing a loan to date is $100. If Cash Doctors charged a mainstream unsecured loan interest rate of 12% on a $200 loan over **our** average loan period of 24 days, $1.58 of gross revenue would be generated, resulting in a $98.42 loss on the loan. If Cash Doctors charged the proposed capped interest rate of 48% per annum, $6.31 gross revenue would be generated yielding a $93.69 loss on the loan (Cash Doctors, 2007).

While most commentators accept this is the case, we now have empirical evidence demonstrating one alternative lending model that can continue on a sustainable basis under the current government interest rate caps, given sufficient loan volumes and greater efficiencies in product delivery. It is safe, affordable and responsible.

It has demonstrated there are possible benefits to having alternative credit products available on the market for those excluded from access to mainstream credit, provided the harms associated largely with high cost can be overcome.

The pilot also tested an efficient internet based application process in a real market showing that it is possible to take to market a viable model that offers small, affordable loans responsibly in a non-mainstream market.

What the pilot didn't do is mimic the small loans associated with payday lending eg smaller loans under $1,000 for weekly or monthly terms. There remains strong demand for these types of loans evidenced by the growing scale and visibility of payday lenders across Australia.

In addition, the pilot tested an efficient online application process as opposed to the more costly "bricks and mortar" model adopted by many fringe lenders.

These factors need to be considered if drawing direct comparisons between the economics of the pilot model and that of other fringe lenders – particularly payday lenders, operating their services via "shop-fronts".

In addition, the pilot did not always track to forecasts. For example, we expected more smaller loans in the pilot portfolio (refer Table (i) on page 9). However, we experienced more than double the amount of $5,000 loans than forecast and 15% less $1,000 loans. The pilot's break-even interest rate was sensitive to the number of small loans in the portfolio.

During the pilot a decision was also made to extend the pilot beyond its original 12 month time scale. This enabled us to capture additional loan data to further test our model.

Some critics of this pilot cite that alternative credit lenders are providing credit to financially excluded people – segments of the community not catered for by banks. While this is true, NAB argues that ultimately, the end-game for all credit consumers should be that no matter where they access their credit, the process should be safe, affordable and responsible.

This need, and the demand for non-mainstream credit, remains constant.

Hopefully these learnings can contribute to better outcomes for all people borrowing within the fringe sector by informing the debate and influencing policy on the provision of credit by non-mainstream lenders.

Key learnings

- The pilot shows it is possible to lend small amounts of money (average loan size of $3,000) in this market, make a modest profit (20 cents in the dollar) and be below government regulated rates of 48%. Rates of between 30% to 35% would need to be charged to remain sustainable.
- The upfront administrative costs associated with providing a loan mean that you can not lend below an APR of 48% for a loan portfolio of less than $5 million and an average loan size of $2,900 or less.
- The pilot shows that large fringe lenders with portfolios between $20m and $100m are capable of delivering interest rates well below the 48% cap where the average loan size is around $1,000.
- The pilot also confirms that even large fringe lenders with portfolios of between $20m and $100m cannot lend less than $700 over a year and remain under the cap.
- The pilot customers were not entirely low-income, and do not fit the stereotypical profile of a payday lender client. Typically:
    - They earned an average income of $859 per fortnight (the highest salary recorded was $4,810; the lowest $304).
    - Over a third (38%) have had defaults and bankruptcies.
    - 19% are on a government benefit.
    - Majority are employed in either full-time (87%) or part-time work (16%).
    - Most rent their homes (67%), 17% pay board; 15% own.
    - They have an average age of 32 years.
    - They are evenly split between men and women.
    - 51% are single, 26% married .
    - Majority of applicants have no dependents (67%).
    - Nearly 52% have stated they have no existing loans (car, personal or home) and no credit card.
- Pilot customers chose the Money Fast product for a range of specific reasons, including convenience, competitive price, ease and speed of the online application process with the majority seeking cash to manage bills. Many were financially excluded from mainstream loan options due to defaults on their credit records.

Section five:
Recommendations

With the insights from the Small Loan Pilot, NAB supports four key recommendations in regard to the alternate lending market:

1. Further research and economic modelling is required to improve understanding of personal lending products below $700 available from alternate lenders.

We acknowledge that a high proportion of lending in this market is for payday loans of less than $350 for short periods of two to four weeks and that our pilot did not model this credit product.

There is a need to research the costs and revenues of alternate credit providers that offer personal loan products under $1,000 for terms less than a year. As part of this, there is a need to review if these lenders, in States where interest rate caps of 48% apply, are complying with the regulations and how they are doing this. Based on the economic insights we have gained with the pilot, we do not believe it is possible to do this.

2. Explore alternative ways of regulating fringe lenders.

With fresh focus on consumer credit regulation (following the transitioning of consumer credit regulation from State to Federal Government) it is timely for greater debate about the excessive interest rates, fees and charges many payday lenders are charging.

Based on the economic insights we have gained from the pilot, we do not believe it is possible to place a 48% cap on loans under $2,900 with loan terms a year or less. As such, given the clear demand for fringe credit, NAB believes the imposition of a 48% interest rate cap on all forms of fringe lending may in fact lead to the disappearance of many forms of fringe lending, or make it partially a 'black market' industry.

NAB views proposed credit regulation changes, meaning all credit providers (including fringe lenders) will need to be licensed, as a positive step. There will be an obligation on licensees to lend responsibly by making an assessment as to whether the credit contract is unsuitable for the consumer, before lending. Unsuitability must be found where it would be unlikely that the consumer would be able to comply with their financial obligations under the credit contract, or could comply only with substantial hardship. A civil penalty will apply where a licensee fails to make this assessment before lending.

Provided that this regime is effectively monitored and enforced, with penalties imposed for breach, then this may go some of the way to removing the potential for harmful products and may increase the likelihood that alternative credit products will be safe and affordable.

NAB recommends that the Federal Government continue to explore alternative ways to ensure fringe lenders provide safe, affordable and responsible lending products.

3. Provide greater choice for consumers seeking safe and affordable alternative credit products.

The pilot shows there is clearly a demand for non-mainstream credit in Australia. NAB believes, when it is safe, affordable and responsibly lent, it is a legitimate option for people unable to secure credit in the mainstream banking system.

It is with this aim, to help address financial exclusion and to provide safe, affordable and responsible alternate forms of lending, that NAB is extending the pilot.

NAB is lending Money Fast $1 million in capital at 0% to provide Money Fast Small Loans to Australians who qualify for Family Tax Benefit Part A for the next two years, commencing March 2010.

Money Fast Small Loans, will continue to be available at the same terms.The lowering of the cost of funds to 0%, has provided for Money Fast to make a modest profit of 20%, embedding the sustainability of the model.

The Money Fast Small Loans do not change NAB's commitment to microfinance and our existing programs. We recognise that as a mainstream lender, NAB must also address its role in perpetuating financial exclusion and we will continue to grow our other not-for-profit credit and savings programs (eg No Interest Loans Scheme (NILS)®, StepUP, AddsUP Savings Plan, NAB Microenterprise Loans).

4. A fresh look at interest rate regulations.

It is our view that greater attention needs to be brought to interest rates, in particular the technicalities around the terms "annual percentage rate" and "comparison rate" - customers don't appear to understand them and regulators are challenged by them, which leaves some lenders in this market open to exploiting customers.

We recommend that the Federal Government explore alternative regulations for the ways interest rate calculations are communicated, so that customers can more easily understand how much they have to pay in interest.

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Appendix A:
About Mobile Finance (Money Fast)

Mobile Finance Pty Ltd (ACN 123 592 487), trading as Money Fast offers personal loans and mortgage broking services and has been in operation since January 2007.

The company has a vision to become a leading alternative finance company in Australia and to be recognised as a professional and fair provider of financial services at affordable prices.

Rather than charging high interest rates, the directors of Mobile Finance, have based their business model on offering loans at low industry rates and growing a sustainable commercial operation through volume and high customer demand.

Company directors are Justin Hatfield, Chief Executive Officer and Anthony Novak, Chief Operations Officer. See biographies below.

More information about the company is available at **www.moneyfast.com.au**

Executive Biographies

Justin Hatfield, Chief Executive Officer

Justin has joined Mobile Finance from Industrial Identity Systems (IN ID), where he held the position of Managing Director. IN ID is one of the worlds leading suppliers of real time retail traffic and sales data. IN ID provides real time data to Westfield Pty Ltd, the City of Melbourne and the Commonwealth Games.

Prior to IN ID Justin was the Sales Director at Argus Solutions one of the worlds foremost Biometric Solution providers. A position he held for 4 years prior to and post ASX listing.

Justin joined Argus from Mirapoint Incorporated, a California-based Internet messaging company, where he was the Asia Pacific Sales Manager. Prior to that, Justin was General Manager of Sales for FASTWIRE, the only accredited Cisco Professional Services provider in the Asia Pacific region. Earlier, Justin was employed for ten years at Banque Nationale de Paris where he was responsible for Mainframe Operations, technical mergers and finally the network for over 1,000 trading and support staff.

Anthony Novak, Chief Operations Officer

Anthony has joined Mobile Finance from Industrial Identity Systems where he held the position of Sales Director.

Prior to this role Anthony was Co-Director and General Manager of Renovation Central: a start-up business involved in the manufacture and retail of high-end contemporary furniture.

Earlier, Anthony spent over 10 years in senior roles in the Funds Management and Financial Planning Industries. Firstly with BT Funds Management as National Brokerage Manager gaining high level expertise in the development and administration of client and adviser management systems and databases.

Following that he was a Business Development Manager for Count Financial Group, one of Australia’s largest financial planning institutions. Working with small, medium and large Accountancy practices to improve their efficiency and profitability via a structured business planning process incorporating marketing and organisational initiatives.

Appendix B:
Research questionnaire and interview questions

RMIT UNIVERSITY

Applicant Number:	Office use only

The following questionnaire is designed to assist in understanding more about the importance of small loans offered by Money Fast. RMIT is undertaking the research on behalf of the National Australia Bank's Small Loans Pilot, in collaboration with Money Fast.

All information you provide will be treated in the strictest confidence.

Your privacy will be protected and your individual responses will be grouped together so no individual can be identified. This questionnaire is for research purposes only and is protected by the Information Privacy Act 2000.

We would appreciate it if you could take the time to complete the following questionnaire. Please do not worry about what you think may be the "right" answers and just skip those questions you don't know the answer to. The results of the research will only be useful if you answer honestly. Thank you very much for your help on this survey.

By returning the questionnaire by Wednesday 30 September you will receive a $50 Coles Myer voucher. If you have any questions about the research please email roslyn.russell@rmit.edu.au or phone 03 9925 5187.

1. Describe your application (choose one only)

1 ☐ Individual; *or*
2 ☐ Joint

2. How much did you borrow from Money Fast? (choose one only)

1 ☐ $1000
2 ☐ $1500
3 ☐ $2000
4 ☐ $3000
5 ☐ $4000
6 ☐ $5000

3. What is the *main* purpose of your Money Fast loan? (choose one only)

1 ☐ Pay bills
2 ☐ Pay off other credit
3 ☐ Buy household item (eg furniture or whitegoods)
4 ☐ Car rego / repairs
5 ☐ Holiday spending
6 ☐ House repairs
7 ☐ Dental costs
8 ☐ Medical costs
9 ☐ Food / groceries
10 ☐ Vet
11 ☐ To help get through a temporary reduction in income
12 ☐ Celebration (anniversary and weddings)
13 ☐ Education expenses
14 ☐ Other (please state)__________

4. Did you shop around for the best deal?

1 ☐ Yes
2 ☐ No (go to question 6)

5. How did you source information when comparing quotes? (please answer each item)

		Yes	No
A	Internet	1	2
B	Telephone	1	2
C	Word of mouth	1	2
D	TV	1	2
E	Radio	1	2
F	Other (please state)___________		

6. In the past have you ever borrowed high-cost small amounts from non-mainstream lenders?

1 ☐ Never before
2 ☐ Once
3 ☐ More than once

7. Before you applied for the Money Fast loan did you apply for a loan from somewhere else and were declined? (choose one only)

1 ☐ Yes, by a bank/credit union
2 ☐ Yes, by a payday lender
3 ☐ Yes, by a pawn broker
4 ☐ Yes, by a family member/friend
5 ☐ No, Money Fast was my first choice
6 ☐ Other- (please state)___________

8. If Money Fast closed, where would you go if you needed to borrow money? (choose one only)

1 ☐ Bank
2 ☐ Credit Union
3 ☐ Pawn Broker
4 ☐ Payday Lender
5 ☐ Family/friend
6 ☐ No interest or low interest loan from a community group or not for profit (eg NILS, LILS or Step Up)
7 ☐ Other (please state)___________

9. How would you describe your current saving pattern? (choose one only)

1 ☐ I save a set amount on a regular basis
2 ☐ I save what is left over after other expenses on a regular basis
3 ☐ I save the odd amount when I can
4 ☐ I am unable to save

10. When you finish paying off your Money Fast loan, would you deposit your loan amount into a savings account?

1 ☐ Yes
2 ☐ No

11. Do you currently have or have had in the last 12 months any of the following kinds of debt? (please answer each item)

		Yes	No
A	Credit Card (not including charges still in the interest free period)	1	2
B	Store Credit	1	2
C	High-cost lenders (eg Payday Lenders, Pawn Brokers)	1	2
D	Borrowing from family or friends	1	2
E	Personal bank loan	1	2
F	Car loan	1	2
G	Home mortgage	1	2
H	HECS debt	1	2
I	Centrelink debt	1	2
J	No or low-interest community loan scheme (NILS, LILS, Step Up)	1	2
K	None of the above	1	2
L	Other (please state) ___________		

12. What interest rate is Money Fast charging you on your current loan? (please state)_______________

13. How much are you paying Money Fast *over* the amount you borrowed? (please state)_____________

14. Do you use a personal or household budget to help keep track of your money? (choose one only)

1 ☐ Never
2 ☐ Sometimes
3 ☐ Regularly
4 ☐ Always

15. Have you ever sought advice from a financial counsellor?

1 ☐ Yes
2 ☐ No

16. Has this loan been difficult to repay?

1 ☐ Yes
2 ☐ No (Go to question 18)

17. If yes, what is the *main* reason why? (choose one only)

1 ☐ I underestimated available funds to meet loan repayments
2 ☐ My financial circumstances changed during the course of the loan
3 ☐ Other debts have increased
4 ☐ Unexpected bills
5 ☐ I have trouble budgeting my money
6 ☐ I missed a payment and can't catch up
☐ Other (please state)

18. What would you do if you were having difficulties repaying a loan?

1 ☐ Call the credit provider
2 ☐ Avoid contact with the credit provider
3 ☐ Contact a financial counsellor
4 ☐ Contact a community legal centre
5 ☐ Contact private lawyers
6 ☐ Other (please state)___________

19. What influences you most when you choose a credit provider? (please answer each item)

		no importance	minor importance	moderate importance	major importance
A	Simple application process	0	1	2	3
B	Quick decision turnaround	0	1	2	3
C	Online application	0	1	2	3
D	Preference to talk to someone face to face about my loan request	0	1	2	3
E	Must provide small loan amounts	0	1	2	3
F	Interest rate	0	1	2	3
G	Repayment schedules	0	1	2	3
H	Repayment amounts	0	1	2	3
I	Low fees and charges	0	1	2	3
J	Reputable company	0	1	2	3
K	Advertising (TV, radio)	0	1	2	3
L	Friends recommendation	0	1	2	3
M	Had a loan already with company	0	1	2	3
N	Willingness to overlook my bad credit	0	1	2	3
O	I apply to many and go with whoever approves my loan	0	1	2	3
P	Other (please state)				

20. What influenced you to apply for a Money Fast loan over other lenders? (please answer each item)

		no importance	minor importance	moderate importance	major importance
A	Simple application process	0	1	2	3
B	Quick decision turnaround	0	1	2	3
C	Online application	0	1	2	3
D	Less expensive than borrowing cash elsewhere	0	1	2	3
E	Better interest rate	0	1	2	3
F	Better repayment amounts	0	1	2	3
G	Better repayment schedules	0	1	2	3
H	No other alternative source for borrowing	0	1	2	3
I	Needed the money quickly	0	1	2	3
J	I have bad credit	0	1	2	3
K	Greater privacy	0	1	2	3
L	Hours of operation	0	1	2	3
M	Good customer service	0	1	2	3
N	First lender I came across	0	1	2	3
O	Other (please state)___________				

21. Do you believe that a Money Fast loan is reasonably priced compared to other similar products? (choose one only)

1 ☐ Yes
2 ☐ No

22. Getting the Money Fast loan has: (choose one only)

1 ☐ Reduced my financial stress levels a little
2 ☐ Reduced my financial stress levels a lot
3 ☐ Increased my financial stress levels a little
4 ☐ Increased my financial stress levels a lot
5 ☐ My financial stress levels have stayed the same

23 Are you:

1 ☐ Male
2 ☐ Female

24. How old are you?

1 ☐ 18-20
2 ☐ 21-25
3 ☐ 26-30
4 ☐ 31-35
5 ☐ 36-40
6 ☐ 41-45
7 ☐ 46-50
8 ☐ 51-55
9 ☐ 56-60
10 ☐ 60+

25. What is the highest level of education you have *completed?* (choose one only)

1 ☐ Primary school
2 ☐ Year 10
3 ☐ Year 12 (VCE, HSC or equivalent)
4 ☐ TAFE or technical college (other than apprenticeship)
5 ☐ University
6 ☐ On the job training course eg apprenticeship, hairdressing
7 ☐ Other (please state)___________

26. How would you describe your family? (choose one only)

1 ☐ Single person with no dependent children
2 ☐ Sole parent with dependent child / children
3 ☐ Couple with dependent children
4 ☐ Couple with no children
5 ☐ Other (please state)___________

27. What is your employment status? (choose one only)

1 ☐ Full time
2 ☐ Part time/casual
3 ☐ Self employed
4 ☐ Unemployed
5 ☐ Retired

28. If you are employed, how would you best describe your work?

1 ☐ Service /sales / clerical
2 ☐ Skilled trade / technical
3 ☐ Managerial / Supervisor
4 ☐ Professional / Executive
5 ☐ Manual Labour
6 ☐ Other (please state)___________

29. Are you currently enrolled as a student?

1 ☐ Yes, I am a full-time student
2 ☐ Yes, I am a part-time student
3 ☐ No, I am not a student

30. Which of the following sources does MOST of your household income come from? (choose one only)

1 ☐ Paid employment; or
2 ☐ Government benefits (unemployment payment, AusStudy, parenting payment, newstart allowance, pension etc)

31. What best describes your income level? (choose one only)

1 ☐ Less than $400 per week
2 ☐ Between $400 and $599
3 ☐ Between $600 and $999
4 ☐ Over $1000 per week
5 ☐ Don't know / refused

32. In terms of your residence, do you:

1 ☐ Rent
2 ☐ Board
3 ☐ Own or paying mortgage

33. What is your postcode?___________

Thank you very much for your assistance in this research.

Appendix B:
Research questionnaire and interview questions

RMIT UNIVERSITY

Applicant Number:	Office use only

The following questionnaire is designed to assist in understanding more about the importance of small loans offered by Money Fast. RMIT is undertaking the research on behalf of the National Australia Bank's Small Loans Pilot, in collaboration with Money Fast.

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Your privacy will be protected and your individual responses will be grouped together so no individual can be identified. This questionnaire is for research purposes only and is protected by the Information Privacy Act 2000.

We would appreciate it if you could take the time to complete the following questionnaire. Please do not worry about what you think may be the "right" answers and just skip those questions you don't know the answer to. The results of the research will only be useful if you answer honestly. Thank you very much for your help on this survey.

By returning the questionnaire by Friday 9 October you will receive a $50 Coles Myer voucher. If you have any questions about the research please email roslyn.russell@rmit.edu.au or phone 03 9925 5187.

1. What was the main reason for your Money Fast loan application? (choose one only)

1 ☐ Pay bills
2 ☐ Pay off other credit
3 ☐ Buy household item (eg furniture or whitegoods)
4 ☐ Car rego / repairs
5 ☐ Holiday spending
6 ☐ House repairs
7 ☐ Dental costs
8 ☐ Medical costs
9 ☐ Food / groceries
10 ☐ Vet
11 ☐ To help get through a temporary reduction in income
12 ☐ Celebration (eg anniversary, birthdays or weddings)
13 ☐ Education expenses
14 ☐ Other (please state)__________

2. If you chose NOT to go ahead with your application, what was the main reason?

1 ☐ Paperwork too hard to collect
2 ☐ The process was too complicated, I didn't understand what I had to do next
3 ☐ I don't like computers
4 ☐ The Money Fast rates were too high
5 ☐ My financial circumstances improved and I no longer needed the loan
6 ☐ I managed to receive the money I needed from elsewhere
7 ☐ Other (please state)____

3. What was the impact on you personally and / or financially from *not* receiving the Money Fast loan?

____

____

____

____

4. Not receiving the Money Fast loan has:

1 ☐ Increased my financial stress levels a little
2 ☐ Increased my financial stress levels a lot
3 ☐ My financial stress levels have stayed the same
4 ☐ Reduced my financial stress levels

5. Did you secure a loan from somewhere else – as listed below?

1 ☐ Bank
2 ☐ Credit Union
3 ☐ Pawn Broker
4 ☐ Payday Lender
5 ☐ Family/friend
6 ☐ No interest or low interest loan from a community group or not for profit (eg NILS, LILS or Step Up)
7 ☐ Other (please state)__________

6. Are you:

1 ☐ Male
2 ☐ Female

7. How old are you?

1 ☐ 18-20
2 ☐ 21-25
3 ☐ 26-30
4 ☐ 31-35
5 ☐ 36-40
6 ☐ 41-45
7 ☐ 46-50
8 ☐ 51-55
9 ☐ 56-60
10 ☐ 60+

8. What is the highest level of education you have *completed?* (choose one only)

1 ☐ Primary school
2 ☐ Year 10
3 ☐ Year 12 (VCE, HSC or equivalent)
4 ☐ TAFE or technical college (other than apprenticeship)
5 ☐ University
6 ☐ On the job training course eg apprenticeship, hairdressing
7 ☐ Other (please state)___________

9. How would you describe your family? (choose one only)

1 ☐ Single person with no dependent children
2 ☐ Sole parent with dependent child / children
3 ☐ Couple with dependent children
4 ☐ Couple with no children
5 ☐ Other (please state)___________

10. What is your employment status? (choose one only)

1 ☐ Full time
2 ☐ Part time/casual
3 ☐ Self employed
4 ☐ Unemployed
5 ☐ Retired

11. If you are employed, how would you best describe your work?

1 ☐ Service /sales / clerical
2 ☐ Skilled trade / technical
3 ☐ Managerial / Supervisor
4 ☐ Professional / Executive
5 ☐ Manual Labour
6 ☐ Other (please state)___________

12. Are you currently enrolled as a student?

1 ☐ Yes, I am a full-time student
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13. Which of the following sources does MOST of your household income come from? (choose one only)

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3 ☐ Between $600 and $999
4 ☐ Over $1000 per week
5 ☐ Don't know / refused

15. In terms of your residence, do you:

1 ☐ Rent
2 ☐ Board
3 ☐ Own or paying mortgage

16. What is your postcode?___________

Thank you very much for your assistance in this research.

For further information please contact:

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Mikala.S.Hehir@nab.com.au
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RECYCLED CONTENT