

# Progress Loans Update

July 2007

ANZ and the Brotherhood of St Laurence commenced Progress Loans in May 2006 to provide small loans to people on low incomes.

These people have historically been most at risk of being excluded from affordable, fair and safe credit from mainstream providers. They either go without essential items or are forced to high cost and 'unsafe' alternatives such as payday lenders and loan sharks, often leading to unmanageable debt.

The program to date has assisted over 150 people obtain credit for the purchase of essential household items and services. ANZ and the Brotherhood plan to continue the program over the next 12 months.

This update explains the initial objectives of Progress Loans, our key observations about the pilot program so far, including the experience of our customers, and our future plans.

## The need for small loans

Consumer credit benefits many Australians. It can help people meet life's expenses when they arise, increase their financial flexibility and access money to purchase things such as a house, a car or a holiday.

The right form of credit can also assist people on low incomes. It can reduce their vulnerability to lump sum expenses and unexpected events, improve their living conditions and enable them to invest in measures to increase their income.

In a broader sense, small amount lending can allow people to move away from a reliance on welfare or other assistance, become more self-sufficient, and participate more fully in mainstream society.

However, research has shown that for low income earners, getting access to the credit they need from mainstream providers can be difficult and distressing.

Many are too intimidated to walk into a bank branch and find our application processes and products complex. They often go without essential items and services that most of us take for granted, like a fridge or a washing machine, or medical and dental care.

The credit that is available is usually at high cost, with interest rates of up to 1000% per annum, provided by 'fringe lenders' such as payday lenders and pawnbrokers. This credit is often unregulated, without the consumer protection measures such as disclosure and complaint handling processes.

This creates a classic poverty trap - the availability of expensive credit can lead to unmanageable debt, prolonging the cycle of poverty for low income households.

Mainstream banks have in the past struggled to make affordable small loans programs a commercially viable part of their business. These difficulties stem from perceived high start-up costs, reported low take-up rates, concerns about comparatively high rates of default and risks to the bank's reputation posed by the recovery of debts.

In response to these issues, ANZ established Progress Loans in partnership with the Brotherhood of St Laurence (the Brotherhood), an organisation which has, with care and insight, worked alongside people on low incomes for over 76 years.

## Joanna's story

Joanna Wilson works in the Personal Loans team at ANZ and was responsible for conducting ANZ's credit assessment of Progress Loans applications during the pilot. Her assessments are based on modified ANZ credit assessment criteria and the initial assessment of the applicant conducted by the Brotherhood of St Laurence.

"Being a part of the Progress Loans program has been the most rewarding experience I have had at ANZ.

"It offers customers who have struggled to access mainstream credit in the past a second chance and challenges the traditional notion that past performance predicts future behaviour. A poor credit history may be a reflection of a particularly hard time in someone's life and doesn't necessarily mean they can't pay off a loan in the future.

"By offering credit to people who normally cannot get a loan from a bank, we are saying their future is still unwritten. I think this concept is really empowering."



## Financial exclusion in Australia

'Financial exclusion' is the lack of access by certain consumers to affordable, fair and safe financial products and services from mainstream providers.

ANZ commissioned research into the extent of financial exclusion in Australia which found that six per cent of adult Australians have minimal access, only owning a transaction account. Low incomes and low savings were observed as the most common indicators of financial exclusion. There are specific groups such as unemployed people, sick and disabled people, and Indigenous communities, who find it most difficult to get access to low cost, fair and safe financial products.

There are also around 120,000 people considered to be totally excluded from mainstream financial services.

Research findings are reported in *Community Development Finance in Australia – ANZ Response to Consultation (2004)*

## Building a repayment history

For Kevin, Progress Loans was an opportunity to not only buy a fridge, but also improve his chances to build a repayment history with a major bank.

"You can imagine life without a fridge. I suppose an esky would have been the next thing. The loan was just a godsend. Knowing you've got a fridge, you can stock up on specials.

"It was a really good sense of achievement. When I finished ANZ sent me a letter thanking me. It's usually us against the banks. I found this a pleasant relationship. I guess my credit rating's pretty good now."

"You can imagine life without a fridge – I suppose an esky would have been the next thing. The loan was just a godsend and it meant I could save more money by stocking up on specials."

## An affordable and sustainable loans program

Progress Loans aims to provide consumers on low incomes with affordable finance to obtain essential items and services such as whitegoods and furniture. It was launched in May 2006.

The program helps those on low incomes to get what they need to live, and provides them with a link to the mainstream banking sector by building a repayment history with a major financial institution.

### Key features

Loan amounts	\$500–\$3000
Loan term	6 months to 3 years
Eligibility	<ul style="list-style-type: none"><li>■ Individuals on low income</li><li>■ Holder of Health Care Card or Pension Card</li><li>■ Demonstrated money management ability through paid utility and other personal bills and no unpaid credit defaults above \$300 within last five years</li></ul>
Interest rate	12.95% p.a. (fixed)
Approval fee	\$40 paid at loan approval (once only)
Purpose	Household items and services, education and self development, medical and dental care

Progress Loans aims to be an 'affordable' loan - the ongoing interest rate is comparable to the rates available on most personal loans. While some forms of microcredit focus on consumers establishing financial stability, Progress Loans is designed for consumers with an income, a demonstrated ability to repay utility and other personal bills and a relatively clean credit history within the last five years. Current employment is not an essential loan criterion.

The pricing of Progress Loans is consistent with the objective of linking participants with the mainstream – a borrower is more likely to establish a positive repayment history with a mainstream lender where they can demonstrate repayment of a loan with a standard interest rate.

It also ensures we can cover the costs of the program so that it is sustainable in the long term. Many small loans programs struggle to survive because they are expensive to run, rely on discretionary philanthropic funding and have insufficient scale to generate sufficient interest and fee revenue.



## Pilot snapshot

The pilot of the program was for a period of 12 months between May 2006 and May 2007. While the pilot period is complete, the program is continuing.

ANZ issued 140 loans during the pilot, and this number has since grown to over 150. The average loan size is \$1,549 and the average loan term is for a period of 24 months.

The majority of participants are public housing tenants and many are new arrivals from North Africa. They generally had little debt but were also relatively 'asset poor' with an average level of assets of around \$10,000. Around 71% of borrowers are women.

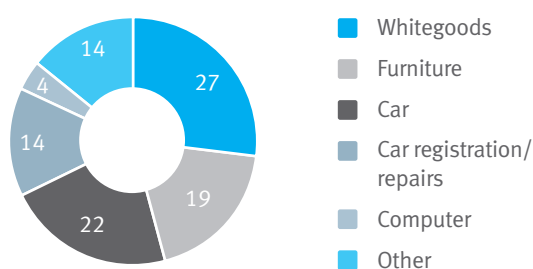
Most participants had minimal access to mainstream financial services, owning only a transaction account. Very few held credit cards or insurance.

### At a glance (May 2006 – May 2007)

Number of loans approved	156
Number of loans drawn	140
Number of applications	225
% of approvals	69%
Number of defaults	0
Collections	0
% men v women	29% v 71%

## Loan purposes

The most common loan purpose was the purchase of whitegoods like washing machines and refrigerators (27%) followed by household furniture (19%) and motor vehicles (22%).



## Loan performance

There were no loan defaults or loans in arrears as at the end of the pilot and this positive performance has continued. Six loans were fully repaid during the pilot.

## What did we find?

The following presents what we see are the key outcomes of the pilot, including some of the lessons we will apply to improve and expand the program in the future.

### Affordability

The loan appears to have been affordable for the majority of customers so far. The repayment performance of Progress Loans customers has been excellent and currently exceeds that of mainstream personal loan products. During the program's pilot between May 2006 and May 2007 there were no defaults recorded and no loans were in arrears as at the pilot's completion. While a small number of customers occasionally fell behind on their repayments, when followed up these customers corrected their repayments very quickly.

Research jointly commissioned by ANZ and the Brotherhood in 2006 suggests that people on low incomes most commonly measure affordability on the basis of their fortnightly budget. Therefore, when discussing a suitable loan amount and term at application for a Progress Loan, the applicant and loan officer will first determine a fortnightly payment that can be comfortably repaid by the applicant.

When broken down into fortnightly repayments of principal and interest, the loan was seen by most customers to be affordable.

ANZ and the Brotherhood will conduct a comprehensive examination into the affordability of Progress Loans as part of a broader evaluation of the program.

## Cost comparison – Progress Loans and ANZ Personal Loans

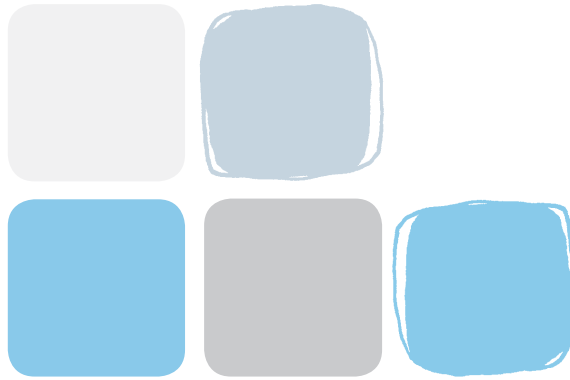
Feature	Progress Loan	Personal Loan (ANZ)
Loan amount	\$500–\$3,000	> \$5,000
Interest Rate (p.a.)	12.95%	12.74%
Approval fee	\$40	\$125
Maximum repayment period	3 years	7 years
Administration fee p.a.	–	\$100
Redraw	No	Up to \$500
Purpose	Household +	Very broad
Builds credit history	Yes	Yes
Interest and fees (even repayment)		
\$500 over 6 months	\$54	\$194 <sup>1</sup>
\$1,000 over 1 Year	\$112	\$295 <sup>1</sup>
\$2,000 over 2 years	\$316	\$601 <sup>1</sup>
\$3,000 over 3 years	\$671	\$1,050 <sup>1</sup>

Note 1: Illustration assuming minimum loan size restriction is ignored.

## Improving financial confidence

Ydes used her Progress Loan to purchase a new washing machine after her old one broke down.

“I paid my loan by myself from my pension. I feel proud to do something for myself. I’m very proud to have a credit reference. Some people don’t trust pensioners because they don’t have much money. But I paid my loan. We need trust. We need confidence.”



### The experience for participants

Feedback received so far suggests the program has provided a range of benefits to participants.

In addition to obtaining the item purchased with the proceeds of the loan, participants were often also making savings in other areas. For instance, some people paid less in repayments under a loan for a washing machine than they were paying to do their washing at a laundromat. Similarly, a new refrigerator often led to cost savings through the bulk purchase of food.

The loan provided some participants with the opportunity to invest in their own futures – for example one couple used the loan for further education to assist their future employment prospects. Others used their loan to fund the purchase or repair of motor vehicles to increase their capacity for more regular work.

For others, the loan was used to ease the burden of a disability. For instance, a mother was able to purchase a car with her loan proceeds to give her disabled child the opportunity to access appropriate health care on a regular basis.

There were also more intangible benefits. While direct contact was largely through the Brotherhood, participants were aware they were repaying a loan provided by ANZ. A common response from participants was pride at having been approved for a loan from a bank and establishing a positive repayment history. The end result for many was increased confidence in dealing with a bank in the future.

### Insights for ANZ

The pilot has given ANZ some invaluable insights into the challenges of providing small loans to people on low incomes.

The first is in relation to credit assessment. Under the program, the Brotherhood is responsible for identifying potential applicants, performing an initial assessment of their capacity to repay the loan, checking income and explaining the product to them. ANZ then takes this information and makes a formal credit decision.

Traditional credit assessment techniques for new customers focus heavily on past credit performance as predictive of future capacity to repay debt. However many Progress Loan applicants have little to no credit history due to their low income, or alternatively have had defaults in the past.

This required a subtle shift in philosophy for ANZ. For these customers, the past does not always dictate a willingness and ability to service future debt. It was observed that despite a lack of a ‘credit history’, they are generally good money managers who are able to budget effectively, and therefore tailor their expenses to allow for scheduled loan repayments, despite their limited resources.

We were encouraged by the Brotherhood, to look beyond past credit performance and consider a wider range of measures to assess applications, such as:

- the applicant’s management of household finances;
- the applicant’s payment of utility and other bills; and
- stability of the applicant’s household budget.

ANZ is drawing on this experience to establish a policy for assessing credit for people on low incomes.

### Financial viability

Financial viability is integral to the program’s long term survival and success.

Both ANZ and the Brotherhood aim for the program to tend towards breaking even over the medium to long term.

We are using the findings of the pilot to understand how we can better cover the operating costs of the program. Our investment in the program is geared towards attracting a greater volume of loans, and therefore generating a revenue which will ensure the program’s long term viability.

Possible measures include:

- support for loan officers to increase the number of loans provided while maintaining the same credit assessment rigour. For example, induction programs, credit policies for low income applicants and information to assist the decision-making processes; and
- recruiting more loan officers to receive and process Progress Loans applications.

## The importance of partnership

Progress Loans is another example of the community and corporate sectors working together for a common objective of advancing the financial inclusion of people on low incomes.

The involvement of the Brotherhood builds a 'bridge' to low income earners. Many people on low incomes have little or no connection with a bank like ANZ and our ability create awareness of Progress Loans is limited. Research jointly commissioned by ANZ and the Brotherhood in 2006 found that many low income earners see large banks as ill equipped to attend to the special needs of the low income segment. This attitude was often shaped by previous difficulties in accessing credit with a mainstream bank.

The Brotherhood brings to the program an understanding of the needs and circumstances of people on low incomes and experience in assessing their ability to repay debt. It has operated low cost and no interest loans schemes for over 30 years, including a small loans pilot for consumers on low incomes in conjunction with Bendigo Bank in 2003.

The involvement of the Brotherhood also establishes a motivation in participants to pay off their loan – a key indicator of success for small loans programs worldwide. This motivation is often drawn from an emotional connection with the community organisation, generated by a trust in its motivation and history of assisting people in similar circumstances to the participant. Several participants in the Progress Loans pilot had previous or existing relationships with the Brotherhood.

Likewise, the involvement of ANZ has in several ways enabled the Brotherhood to better meet the needs of people on low incomes.

ANZ has systems to automate loan contracts, produce statements, track repayments and charge interest and fees. This has allowed the Brotherhood to focus less on administration and devote more resources to expand the reach of the program.

Partnership with a national financial institution also provides the opportunity to establish a model that can be replicated by community organisations around Australia. This approach has been applied to the Saver Plus matched savings program, which was developed jointly by ANZ and the Brotherhood in 2003 and is now being delivered throughout Australia by a range of community organisations.

## Where to from here?

ANZ and the Brotherhood are currently conducting a full evaluation of the Progress Loans pilot, including a study into the social impact of the program.

There are some important questions to address in this evaluation to ensure we fulfil the early promise of this program. Are we declining too many people and excluding those most in need? Is the program assisting people to progress to the 'mainstream'? Can this model be replicated by other community organisations?

A report of this evaluation will be published by the end of 2007.

In the meantime, the program will continue to operate at current suburban Melbourne sites in Fitzroy and Frankston and will be expanded to a new northern Melbourne site in Craigieburn.



## Genevieve's story

Genevieve Sheehan has been managing the Brotherhood's microfinance program since it commenced in 2003. Genevieve meets face to face with Progress Loans applicants, discusses their application with them and works with the ANZ team on assessment of applicants.

"Partnering with ANZ to provide Progress Loans helps the Brotherhood to work towards our vision of an Australia free of poverty. We benefit from ANZ's expertise in lending and financial resources.

"The program assists low income people to feel part of the mainstream economy, to obtain basic necessities and to do something themselves."

## More information

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