

ACCESS TO FINANCIAL SERVICES

***REPORT OF PAT 14
HM TREASURY
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NATIONAL STRATEGY FOR NEIGHBOURHOOD RENEWAL

ACCESS TO FINANCIAL SERVICES: The Report of Policy Action Team 14

Foreword by the Economic Secretary to the Treasury

Large numbers of people in deprived communities across the country do not share the growing prosperity and life chances available to the rest of us, as a result of social exclusion. This affects all aspects of life in these communities: housing, health care, education, and crime, among others. Tackling social exclusion is one of the biggest challenges facing us. It was the theme of Tony Blair's first speech as Prime Minister: it has been and will remain at the top of the Government's agenda.

Financial exclusion means that many in those communities, often those in greatest need, do not have the access to financial services the rest of us enjoy, and are worse off as a result. Income, saving and borrowing facilities and how we access and make use of them through credit lines, mortgages, insurance and pensions, are central to how many people organise their daily lives and plan their futures. Yet almost 1.5 million low income households use no financial services, some of which would make their lives easier and reduce their expenses. Over 2 million adults are affected, mostly those not in employment, living on benefits, often social housing tenants, and often living in deprived communities.

Success in tackling financial exclusion is essential to achieving our wider aims in eliminating social exclusion. This report by Policy Action Team (PAT) 14, set up to look at these problems, offers a range of ways in which to set about that task.

It should be possible to envisage a time when financial exclusion as we know it now would have disappeared entirely. This does not mean that everyone will be using financial services to the same extent. But it does mean that the barriers and constraints on choice that currently limit access would have been substantially reduced; and that people on lower incomes would receive good basic services at a reasonable cost.

PAT 14 makes over 40 recommendations in all, including considering ways in which the post office network could become part of the alternative delivery services seen as the wider way forward. The sheer number of recommendations indicates that there is no single solution to the problem. 'One size fits all' cannot be the right approach to the design of either products or service outlets, because people's circumstances and preferences vary. Diversity and choice are the watchwords.

The way forward lies in developing new and alternative means to deliver and provide access to financial services as well as ensuring that existing services can reach the whole community. It also means ensuring that communities themselves can contribute to progress in helping their members share the access to and use of financial services that the rest of us see as essential and take for granted. It means partnership with other organisations and across a number of Government Departments.

Much of the action is for the financial services industry. The banks in particular have a major task ahead of them, extending services to low-income households and developing delivery channels accessible to people in deprived neighbourhoods.

The report emphasises what the banks can do to remove unnecessary barriers: develop the right products, open up new delivery channels and inform consumers. During the preparation of the PAT report and the wide consultation involved, the banks recognised both the expectations of them and the commercial opportunities. The Government continues to have high expectations and a desire to see practical changes, such as more information on what banks are doing to serve low income households and deprived communities, along with increased availability of basic bank accounts. The banks have to recognise the importance of the role they play, the extent to which we all rely on them and their responsibility to sustain equal and open access to those who wish to use them.

We will work with the banks on developments in response to this report. We do not want to have to legislate, as some have urged, to compel banks to serve all sections of the community. But if voluntary action is unproductive and monitoring shows insufficient progress, it may be necessary to consider other options.

The PAT 14 report does not confine itself to the role of banks and other financial service providers. The Government's response, in the form of a national strategy for neighbourhood renewal, drawing on the reports of all 18 PATs, will be published for consultation next Spring.

At this stage I want to announce immediate action in three areas highlighted in the report:

C *Credit Unions*

We want to see a new central services organisation (CSO) set up to develop credit unions in the Britain. This is a vital link to provide effective impetus to credit union growth, with due emphasis on credit unions serving deprived communities. While details of CSO structure and finance have yet to be worked out, I want to see the current momentum accelerated. I am confident that the credit union movement will respond to the opportunities and work with banks in developing a detailed business plan.

C *Insurance with Rent (IWR) schemes*

IWR schemes have enormous potential for helping people in deprived areas. Under these schemes social housing providers arrange property insurance cover for tenants through group policies. We need to work towards a situation in which nobody is denied insurance because of where they live. That may take some time, but I very much hope that the Government and the industry will be able to agree some challenging targets for extending IWR. I am pleased that the Association of British Insurers is to work with DETR and the Housing Corporation to promote and develop these schemes.

C *Further development of the Social Fund*

Developing the Social Fund could offer hope to low-income households without access to credit from mainstream providers, for whom the only alternative is often borrowing at very high interest rates from moneylenders. For this reason, I very much welcome the recommendation in the report for DSS to explore the scope for further reform of the Social Fund, in order to extend access to the facilities it offers.

My thanks go to the members of PAT 14. I would like to mention in particular the contributions of the outside experts, the excellence of the research material and other information and advice they brought to the team's attention, and the way the team consulted with national organisations and people working locally in deprived communities. Their report is a valuable contribution to the fight against financial exclusion and, ultimately, the wider issue of social exclusion.

Melanie Johnson MP

ACCESS TO FINANCIAL SERVICES

REPORT OF POLICY ACTION TEAM 14

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ACCESS TO FINANCIAL SERVICES: OVERVIEW

About 1.5 million low income households use no financial services. This represents over 2 million adults, mostly not in employment, living on benefits, social housing tenants. Many of them live in deprived communities.

Following the Social Exclusion Unit's report on deprived neighbourhoods, last year, PAT 14, a mixed group of civil servants and outside experts, was appointed by the Treasury in November 1998, to look into the scope for widening access to financial services. It was asked to examine:

- the scope for development of credit unions, building on planned legislative change;
- increasing the availability of insurance services to deprived communities;
- the role of retail banks, Post Offices and other organisations in providing access to and delivery of financial services in deprived neighbourhoods.

This is PAT 14's report. Following are the main findings and some of the key recommendations. The full recommendations are listed at the ends of Chapters 2 to 5.

Reasons for financial exclusion

The reasons poor people use financial services less are complex. Outright refusal by banks or other institutions to do business with them is relatively rare. More often, the problem is mismatch between potential customers' needs and the products on offer. As providers develop new products that are more suitable for low income customers, those who live in poor neighbourhoods should benefit, as well as those in less deprived areas. Product diversity is clearly part of the answer, for all underserved markets.

People in poor neighbourhoods may make little use financial services for reasons that are related to the area itself. Where crime rates are high, property insurance, both household and business, may be unaffordable. Remoteness from major commercial centres, and the withdrawal of financial service outlets from poor communities, may be factors in low income households' non-use of mainstream institutions. The development of new delivery channels can overcome this factor. There is no single solution: again, diversity is of the essence.

Credit unions

PAT 14 found that credit unions can make a difference because they:

- C are open to low income groups;
- C encourage small scale savings;
- C provide low cost credit; and
- C can be a bridge to other financial services.

But the movement covers only a fraction of 1 percent of the population and the credit unions serving poor communities are often making only a limited impact at local level.

PAT 14 makes four main recommendations aimed at promising a better future for the British credit union movement :

(i) DETR and the LGA should work together to ensure that credit union development work at local level results in healthy and sustainable growth;

(ii) HM Treasury should continue to promote its proposed deregulatory measures, to allow credit unions with growth potential to go for it;

(iii) the proposed Central Services Organisation (CSO) should promote itself to all sections of the credit union movement; and encourage broad based development, with due emphasis on credit unions serving deprived communities;

(iv) the FSA should ensure that, in devising the future regulatory system for credit unions, the principle of proportionality is duly observed; and that the feescale applied to credit unions is in accord with a reasonable view of affordability.

Insurance

Low income households use insurance less than average. People in deprived communities often do not use house contents insurance, because of cost, restrictive policy conditions, inconvenient payment methods and lack of information. They find that life assurance deals turn bad when job loss means they can no longer afford the premiums, but cashing in the policy gives them a poor financial return. Door-to-door collection of insurance premiums is in decline, but payment by cheque or direct debit is impossible for people without bank accounts.

PAT 14 believes that one way forward is to build on the success of the Insurance With Rent schemes now operated by many social housing providers. Housing association or local authorities arrange a group policy for an estate, with an insurance firm, usually house contents insurance. The tenants who choose to join pay their premiums with their rent to the landlord, who then pays the insurance company.

These schemes can be extended to include other kinds of insurance and other households in the neighbourhood, depending on the deal done with the insurers. And the payment channels can be expanded, to include post offices or other agencies. The objective should be for everybody in deprived communities to have access to insurance through one of these schemes. On life assurance, PAT 14 notes that the Association of British Insurers is investigating how insurers might provide a policy with protection and long term savings elements which also meets identified needs of flexibility, a short term withdrawal facility and low cost. PAT 14 recommends :

DETR, the Housing Corporation and the LGA should work with the insurance industry to promote Insurance With Rent schemes; and they should explore ways of extending these schemes to neighbourhood private tenants and owner occupiers. Social housing providers and insurance companies should carry out pilot studies to test demand for and viability of extended Insurance

With Rent schemes, involving additional types of insurance besides contents cover.

Banking services

Banking has expanded enormously over the last twenty years, but in nearly one in ten households still nobody has a bank or building society account. For these people, paying bills, handling cheques and getting access to affordable credit are all more difficult and often more expensive than for those that do have them.

They get less information about other financial services than bank customers and are more likely to borrow money at high APRs. Often they do not want bank accounts, because they think they might have difficulty controlling their finances and run up a costly overdraft. Sometimes banks do not want them, because they think the same.

PAT 14 believes the answer is simpler kinds of account that do not allow this to happen. Many people already have these facilities; the challenge is to get more of the population in deprived areas to consider applying for them.

Banks and building societies continue to downsize their branch networks - but they have managed to carry on providing services to ever more people through cash machines and other delivery channels. These alternatives are only just beginning to reach deprived neighbourhoods, but the technology now exists to help improve the situation. These initiatives are to be welcomed, in particular those that make use of the opportunities offered by developing payment systems technology. PAT 14 does not endorse any one of them to the exclusion of others, not least because there has not been the opportunity to evaluate them. In general, however, the more varied the delivery channels available, the greater the consumer choice, hence the greater benefit. There is no single solution.

The Government's decision to pay benefits by automated credit transfer and to computerise the network of post offices is going to make a huge difference. Paying benefits the new way will increase the demand for banking and other financial services, ranging from conventional current accounts to more limited facilities. Computerisation will provide a platform for the post office to be an alternative delivery channel for every community. With an extensive branch network, nearly ten times as many as the biggest of the high street banks, this can ensure that those people who want to continue to draw their cash at post offices will get convenient access. PAT 14 recommends that :

Banks, building societies and other providers should continue to develop and promote basic account services, in the light of the announcement on the future benefit payment system and the future of Post Office Counters services.

Identity documents

People sometimes get refused a bank or building society account because they cannot provide identity documents to show who they are and where they live, or the banks say that only a driving licence or a passport will do. This is often a problem for low-income households. The banks and building societies have agreed to work with the authorities to give prospective customers a better deal in future. They are going to be flexible about the range of documents they will accept, and they are going to ensure that customers get proper

information about what is required. The objective will be that nobody gets turned away without being given a fair chance to establish their identity. PAT 14 recommends that :

The industry associations should work with the Government, the Financial Services Authority and other agencies to revise the guidance on identity requirements, draw their members' attention to the scope for flexibility and issue an information leaflet for the public.

Money advice and access to credit

There is a special need for money advice, and help with debts in particular, when people move off benefits into work. They lose their entitlement to help from the Social Fund and, because they now have a regular income, their debtors start chasing them. PAT 14 recommends that:

DSS should explore the scope for further reform of the Social Fund, to extend existing loan facilities to those in low-paid employment. It should also consider with DfEE how to promote wider access to debt counselling and refinancing, targeted at those coming off benefit to take up employment. The aim would be to involve money advice agencies, private sector finance and the Employment Service in any new arrangements.

Monitoring the outcomes

PAT 14 made over 40 recommendations in all. Assuming they are all taken up, it is possible to envisage a time when financial exclusion as we know it now will have disappeared entirely. This does not mean that everyone will use financial services to the same extent. But it does mean that the barriers and constraints on choice that limit access now will have been substantially reduced.

The following scenario is indicative, rather than prescriptive. So much depends on developments in the different sectors of the financial services industry - and on public attitudes towards the products on offer - that precision is not possible. But the Treasury will need to establish landmarks along these lines, to ensure its monitoring is meaningful.

By the end of 2000

- C Increase in number of banks offering basic accounts
- C Further fall in proportion of households where no-one has a bank account
- C Substantial decline in refusal of bank accounts because of non-standard identity documentation
- C DETR, Housing Corporation and LGA work with insurance industry to promote Insurance With Rent schemes
- C Passage of credit union deregulation measures
- C Development of FSA credit union supervisory framework

By the end of 2003

- C Post Office offering computerised access to bank accounts
- C Continued increase in access to bank services by alternative delivery channels
- C First wave of benefit recipients getting payments by automated credit transfer
- C Credit unions Central Services Organisation up and running

- C Substantial increase in coverage of Insurance With Rent schemes
- C Enhanced Social Fund in operation

By the end of 2005

- C All benefits paid by automated credit transfer
- C Low-income household usage of banking and insurance at similar levels to other social groups
- C Substantial increase in credit union membership among low-income groups

CHAPTER 1: INTRODUCTION

1.1 Following the publication of the SEU report on deprived neighbourhoods¹ the Policy Action Team (PAT 14) was appointed in November 1998, to look into the scope for widening access to financial services. It was asked to examine:

- the scope for development of credit unions, building on planned legislative change;
- increasing the availability of insurance services to deprived communities;
- the role of retail banks, Post Offices and other organisations in providing access to and delivery of financial services in deprived neighbourhoods.

The goal was defined as developing a strategy to increase access to financial services for people living in poor neighbourhoods².

1.2 The problems to be addressed were also outlined in the SEU report:

“Many financial services are less accessible for people living in poor neighbourhoods. Some insurance companies have been accused of “red-lining” particular areas, effectively excluding large numbers of potential customers. Retail banks have closed many local branches, although the proportion of the population with accounts has risen. Local services such as credit unions have sometimes been constrained by regulatory requirements. The net result is that people living in poor neighbourhoods often have to depend on very expensive forms of credit, including “loan sharks”.”³

The target group

1.3 Since the goal is increased access to financial services for people living in poor neighbourhoods, logically the target group is people in poor neighbourhoods whose access to those services is limited. But lack of access is not just an issue for poor urban communities. The household poverty and other circumstances that lead to lack of access are not limited to poor neighbourhoods; and rural areas can also be affected. So, much of the discussion concerns the needs of low income households in general, whether or not in deprived neighbourhoods.

1.4 Poor people are less likely to use mainstream financial services than those in higher income brackets. This applies not just to bank accounts, but also insurance and other services. Recent research sponsored by the Joseph Rowntree Foundation⁴ found that around 1.5 million households in Britain (7 percent) lack any financial products at all and a further 4 million (19 percent) have only one or two. The majority of these are single person

¹ Bringing Britain together - a Strategy for Neighbourhood Renewal: Social Exclusion Unit, September 1998

² *ibid*

³ *ibid*

⁴ Understanding and Combating Financial Exclusion: Elaine Kempson and Claire Whyley, Personal Finance Research Centre, University of Bristol, December 1998

or lone parent households; live in social rented housing; have no-one in work; and consequently, live on low incomes drawn largely from state benefits.

1.5 The reasons poor people use financial services less are complex, but one common thread that has been identified is a mismatch between their needs and circumstances and the products on offer. To the extent that providers are capable of developing new products that are more suitable for low income customers, those who live in poor neighbourhoods should benefit, as well as those in country districts and in less deprived urban areas. Diversity of provision is clearly part of the answer, for all underserved markets.

1.6 Quite apart from the concentrations of low-income people, there may be some factors which are distinctive to poor neighbourhoods. In run-down areas where crime rates are high, property insurance, both household and business, may be unaffordable. Geographical remoteness from major commercial centres, and the withdrawal of financial service outlets from poor communities, may be factors in low income households' non-use of mainstream institutions (although non-traditional delivery channels may help overcome this factor). People in rural areas may have formidable access problems, on a different scale from those affecting deprived urban neighbourhoods. Such factors may not be capable of being overcome by product design alone; alternative delivery channels need to be part of the answer. Again diversity is of the essence.

The team's approach

1.7 The team decided at the outset to look at the various elements identified in the remit separately. They relate to different branches of the financial services industry, where non-use by poor people stems from different factors; and the prospects for increased usage depend on overcoming different sorts of barriers, including some regulatory rules.

1.8 Where possible, the team sought to ascertain what the target population want from financial services, as it would be unwise to assume that they have the same priorities as better-off people. Fortunately, there was a considerable body of research material that helped it in this task. So it tried to establish for each product area the nature of the unmet need, as a prelude to consideration of the extent to which service supply falls short. This area of analysis is referred to in the report as product design. Where there is an identifiable gap between demand and supply, related to lack of appropriate products, the team considered what might be done to close it; and whether there is a need for State as well as industry action.

1.9 The team also considered, in each instance, whether access problems, where they can be identified, are to do with physical location, as distinct from the relevance of available products to the needs of the target group. This is referred to in the body of the report as the issue of delivery channels. Where there is a distinctive problem arising from the geographical position of deprived communities, this is addressed as a distinct issue, again considering what might be done to remedy the deficiency, and whether there is a need for public intervention.

1.10 The team was conscious of the wider context of Government policies that impact on financial exclusion. The New Deal, pension reform and changes to the benefit system seem likely to increase access of poor people to mainstream services. On the other hand,

increasing the extent to which individuals are expected to provide for their own financial futures in the open market may leave the poorest people more at a disadvantage.

1.11 The team also considered how to interpret the stated goal of increased access to financial services. It decided to concentrate on households and their needs, so as not to overlap with the work of PAT 3, whose remit included financial services for people entering self-employment and starting their own businesses, although a firm boundary is impossible to draw. For example, credit unions can lend money to individuals starting their own enterprises; and there are even some credit unions made up exclusively of people who run their own businesses in a defined community. The ways households manage their finances depends on whether or not they use mainstream financial services. Those who do not, as this report explains, suffer material detriment that undermines community regeneration and social inclusion objectives.

1.12 Another important factor is that use or non-use of financial services is not static. For many people, decisions whether to have a bank account or use other services change through time, mainly in response to movement in and out of employment. The issue here is mainly one of product design: whether it is possible for banks and other providers to develop services that suit the circumstances of people when they are out of work as well as when they are in work.

1.13 Whilst it was clear that the overriding goal of social inclusion implies poor people should have access to the same range of mainstream services as the rest of society, it seemed unrealistic to aim for every potential customer to be able to get every possible service. There might always be a hard core of people who will not or cannot use some financial services, as they are delivered at present. The policy objective should be to minimise the size of the group which does not have access to a reasonable range of services, bearing in mind that the targets might be different for different services. In this endeavour, innovative approaches to product design and delivery channels have considerable importance. Achieving the policy objective implies, where relevant, minimising unnecessary barriers, whether explicit or unintended, to people participating in or accessing financial services.

Methods of working

1.14 The full Policy Action Team met seven times between November 1998 and June 1999. Additionally, a lot of work was done in sub-teams, dealing with banking, insurance, credit unions and money advice. The full team meetings benefited from useful presentations by a number of outsiders:

- the Office of Fair Trading team responsible for the report on Vulnerable Customers and Financial Services;
- the Financial Services Authority consumer education team;
- Post Office Counters Limited;
- DTI consumer affairs directorate;
- the Treasury Banking Review team.

1.15 The policy action team held discussion forums for organisations involved with deprived communities (jointly with PAT 3, which dealt with small firm finance) in Birmingham,

Liverpool, Edinburgh and Newcastle. Altogether nearly 300 people from a range of backgrounds attended. Small group discussions formed the core proceedings of each event, enabling participants to focus on defined topic areas - personal banking, credit unions, insurance, small firm finance and small firm support. The team also conducted a formal public consultation, in which it sought the views of a large number of national organisations concerned with financial services, on good practice and how to promote it. Their responses are reflected in the body of the report.

CHAPTER 2: CREDIT UNIONS

2.1 Credit unions can make a contribution to the wider strategy of access to financial services for people in deprived neighbourhoods because they:

- C are particularly open to low income groups;
- C encourage small scale savings;
- C provide low cost credit; and
- C over time, give people the chance to build up a good credit record, so they can apply for the more sophisticated financial products which banks and building societies already provide⁵.

2.2 Three separate initiatives predate the work of the Policy Action Team:

- (a) the Treasury's taskforce on bank assistance to the movement;
- (b) the Government's proposed deregulation package;
- (c) the Local Government Association's initiative on local authority credit union development activity.

These are described in more detail later in this chapter.

2.3 The reason for so much activity is the widespread view that there is scope for development. Credit unions are making a modest contribution now, but they could in principle attract a bigger membership in future. The key challenge is to ensure that people in low income households, especially those in deprived areas, are part of that expansion.

2.4 The credit union movement in Britain, as elsewhere, is essentially made up of:

- (a) community credit unions, ie people living in a locality, or belonging to the same community organisation, serving predominantly - although not exclusively - deprived neighbourhoods; and
- (b) work-based credit unions, ie people working for the same employer, or in the same locality, or in the same employment organisation.

2.5 For the most part, work-based credit unions are made up of people who may not be deprived, although some of them may be relatively low-paid. Being people in regular employment, for the most part in large-scale organisations in the public and private sectors, they are also less likely to be unbanked, although they may prefer to borrow from their credit union, rather than their bank, because of lower interest rates.

2.6 Combating financial exclusion is not simply a matter of promoting or assisting community credit unions to the exclusion of others. Work-based credit unions can and often do include some of the lowest paid people in the workforce. Also, legislative changes in 1996 included

⁵ This would be facilitated were more credit unions to give the relevant information to credit reference agencies, which is probably pretty rare at present; although there is nothing to prevent an individual presenting such evidence of creditworthiness to a bank or building society, when the occasion demands.

the possibility of a new hybrid type of credit union - people living or working in a particular locality, which could bring together people in employment with others who are less well-off. This option is now the most frequently used common bond for newly formed credit unions; and some existing credit unions have widened their scope by adopting it. The package of further changes proposed last year by the Treasury includes further combined types. So work-based credit unions have the potential to benefit deprived neighbourhoods, and poorer people in general. They are therefore part of the solution.

2.7 The most successful community credit unions include a high proportion of people in work. Indeed, long-term sustainability is only achievable by community credit unions if they have an appropriate mix of people in work, providing the savings needed to ensure they have the capacity to lend to less well-off people. Without an adequate savings base, no credit union can perform its core lending function. People in work have an obviously greater capacity for saving than those who are not.

2.8 Looking more widely, it becomes clear that, with the right kind of central mechanism, the necessary strategic investment in community credit unions might be achieved by harnessing the energies of the movement as a whole. This can be done not only through technical assistance, but also through recycling of surplus funds of work-based credit unions, in loans to community credit unions. The development of a central mechanism to assist this process is considered later in this chapter.

The legislative framework

2.9 The objectives of credit unions, as defined by the 1979 Act, are:

- C the promotion of thrift among the members by the accumulation of savings;
- C the creation of sources of credit for the benefit of the members at a fair and reasonable rate of interest;
- C the use and control of the members' savings for their mutual benefit; and
- C the training and education of the members in the wise use of money and in the management of their financial affairs.

2.10 Membership is restricted to those who meet the qualification - the common bond - for a particular credit union. This may be one of four main types: residence in a locality; being a member of, or having an association with, an organisation; working for a common employer or in a locality; and following a particular occupation. The common bond is unique to credit unions and is based on the simple idea that members will know each other and will be able to exert moral pressure to ensure that loans are repaid. Its effectiveness is demonstrated by bad debts being, on average, less than 1% of loans. The fact that loans are to a certain extent secured also makes a difference. This is because the credit union has a lien against individuals' savings, ie in the case of default on the loans, their savings are then forfeit.

2.11 The legislation provides that each share in a credit union is fixed at £1. Also, the maximum saving permitted is £5,000 or 1½% of the total shareholding of a credit union, whichever is the greater. A credit union may accept deposits only as subscription for its shares. It may pay a dividend on shares, not exceeding 8%, after all expenses and taxes have been accounted for. The normal range of dividend payments by work-based credit unions is between 3 and 5%. Community credit unions typically pay dividends in the range 1-3%, once fully established; but many pay no dividend at all for the first three years, or indeed ever.

2.12 In most credit unions loans may be made to members up to a maximum of £5,000 in excess of their share capital. So a member with the maximum of 5,000 shares may borrow up to £10,000. Loans are repayable over two years if unsecured, and over five if secured. Most loans are under £1000. Interest charged on loans may not exceed 1% per month on the reducing balance (12.68% APR maximum). Credit unions may borrow short term from other credit unions and from authorised banks, and may hold their surplus on deposit subject to restrictions. (Broadly they are restricted to current and deposit accounts with building societies and banks). Credit unions may apply to the Registrar of Friendly Societies for a certificate under Section 11C of the 1979 Act which allows them to lend greater amounts to individual members over a longer period. The Registrar needs to be satisfied that there are appropriate policy manuals documenting the systems, and committees in place to manage the functions - in particular loans and internal audit/supervisory committees.

2.13 A Deregulation Order came into force on 1 September 1996 which:

- added a new common bond of living *or* working in a particular locality;
- allowed a simple statutory declaration to amend common bonds;
- increased the amounts that can be saved or loaned, from £5,000 to £10,000 depending on the size of the credit union; and
- gave the Registrar the discretion to permit a credit union to grant individual loans up to a maximum of 1½ times its aggregate shareholdings, if it has adequate management and systems.

Proposals for legislative change

2.14 The Government is actively considering further legislative change to encourage growth in the movement while retaining credit unions' focus on providing financial services to the poorer members of society. In November of last year it proposed a package of measures designed to lift some of the restrictions in the Credit Union Act 1979, in line with this objective.

- (a) Allow credit unions to borrow money from external sources, in addition to their existing powers to borrow from banks and other credit unions.
- (b) Permit credit unions to offer interest bearing accounts, which is not currently allowed.
- (c) Allow credit unions to provide additional basic services and charge fees eg bill payments.
- (d) Abolish the limit on the maximum amount that can be held in youth accounts, currently £750, and lower the minimum age for joining a credit union (without conferring voting rights).
- (e) Make the common bond requirements more flexible by allowing the associational common bond to be combined with the other four types, viz following a particular occupation, residing in a locality, being employed in a particular locality, and working for a particular employer.
- (f) Remove the current 5,000 maximum membership limit.
- (g) Allow credit unions more flexibility to dispose of re-possessed collateral, by allowing them three months or such other period as may be approved, for individual credit unions or case-by-case, by the Registrar.

(h) Extend the repayment periods for loans, to be seven years for secured lending (or twelve for credit unions holding Section 11C certificates) and three years for unsecured lending (or five years for credit unions holding Section 11C certificates).

2.15 Whilst it is clear that these measures *could* enable credit union growth, their effectiveness, assuming they are implemented in due course, will depend on the readiness and capacity of individual credit unions to exploit the opportunities. This cannot be taken for granted. Indeed, there may be a danger of too little response, particularly from community credit unions, unless there is also positive encouragement. Who is best placed to provide that encouragement has been considered by both the Treasury taskforce and the Local Government Association - see below. The Government proposals for deregulation were accompanied by consultation on the options for a new regulatory framework, a topic considered further later in this chapter.

Size of the Credit Union movement

2.16 There are over 800 credit unions in the UK. Those in Great Britain are registered separately from those in Northern Ireland, where most of the movement is closely associated with those in the Republic of Ireland, through the Irish League of Credit Unions. Most mainland credit unions belong to ABCUL (the Association of British Credit Unions Limited). The movement as a whole has been growing rapidly recently - about 50 new credit unions are established each year, with an annual increase in membership and assets of about 20%. The movement is strongest in the North of England, Scotland and Northern Ireland. In mid-1999, the overall picture was as follows:

	No. of credit unions	Members 000s	Assets ⁶ £m
England & Wales	524	130	69
Scotland	135	95	55
Great Britain total	659	225	124
N.Ireland ⁷	174	267	321
UK total	833	492	445

sources: Registry of Friendly Societies(GB), Registry of Friendly Societies(NI)

2.17 Recent research, carried out by John Moores University for ABCUL⁸ and the Local Government Association, reveals that membership numbers in Great Britain are split almost exactly 50-50 between work-based and community credit unions. Over the years, the number

⁶ About 80% of credit union assets are loans to members, the remainder being almost entirely cash and investments.

⁷ 1997-98 figures

⁸ Towards sustainable credit union development - a research project (ABCUL 1999)

of community credit unions has grown steadily; but the average work-based credit union has larger membership and assets than the average community credit union. So, although less than one in six of all credit unions are work-based, they account for over 70% of the assets.

2.18 Compared with a number of other countries, the credit union movement here is less developed.

	population % in a credit union
Republic of Ireland	45
USA	30
Australia	20
Canada	16
UK	<1

2.19 As in Britain, recent membership growth in these countries almost certainly owes much to employment based, as distinct from traditional community based, credit unions. There is much to be learned from these overseas movements, in terms of how they have organised themselves to promote credit union growth; and in terms of appropriate supervision.

Case Study: Dalmuir Credit Union

Dalmuir Credit Union is an outstanding example of a successful community CU, in a predominantly deprived area. It was started 22 years ago by a handful of people meeting in a church hall. Currently it has 6,500 members, predominantly low and middle-income, within a common bond of 40,000, including the whole of Clydebank. It now has its own premises, with 5 paid staff (3 full-time and 2 part-time). It is open every day of the week, including Thursday evening and Saturday morning. Apart from the main premises there are two collection points in community halls. The local council helped with accommodation; and local companies help employees to save with the CU by payroll deductions. But the CU had no grant assistance to establish itself. One important factor providing for financial sustainability is a good balance between those in work and those not, to ensure the large savings pool necessary to supply the loans. Another is a businesslike approach to lending decisions. Normally the savings record of the member provides sufficient evidence to sanction a loan. But, where the risk justifies it, enquiries are made about the member's other commitments; and, occasionally use is made of credit reference agencies. There is firm action against defaulters, with some cases passed to a credit collection agency and even some court actions. The CU is aiming to grow yet more in the years ahead. In the words of one volunteer: "the next five years will include some aggressive marketing with the major factor being more members and more members investing in shares and members obtaining loans".

Small scale development of community credit unions

2.20 With few - albeit notable - exceptions, such as Dalmuir (see box on previous page) community credit unions are not reaching significant portions of their target population. The majority have less than 200 members and the average number of loans on the books of these smaller credit unions is 36. Services are restricted, with 62 percent of all community credit unions only open for six hours a week or less, and a third for three hours or less. Only 17 percent operate from their own premises, with most working from community centres, churches, volunteers' homes or local authority premises. The overwhelming majority think that

volunteer burn-out is restricting their growth. It takes community credit unions on average 9-12 years to get to 200 members and most are not getting past that level.⁹

2.21 A number of factors help to explain the difference between the growth of credit unions in this country, compared with the overseas comparators:

- The movement in Britain is younger, starting in the mid sixties, about 10 years later than in Ireland, and sixty years later than in the US;
- The absence of a single voice and focus for the movement, with the existence of four national representative bodies: besides ABCUL, there is the Scottish League of Credit Unions, the National Federation of Credit Unions and the Association of Independent Credit Unions;
- The top-down promotion, by local authorities, of a number of very small credit unions, which may never have the capacity to become self sufficient;
- The restrictions imposed by the Credit Unions Act 1979;
- By the time of the establishment of the first credit unions in Britain, access to financial services, for example saving through building societies, was more widespread than at the time of their establishment elsewhere.

2.22 The John Moores University research, as well as evidence from the US and Ireland, suggests that the following are important elements for any sustainable credit union:

- C trained paid staff, supported by volunteers;
- C reasonable premises;
- C computer systems; and
- C clear objectives.

2.23 Most community credit unions in Britain lack all four, yet consumer expectations are much higher now than when the US and Irish credit unions were established. If credit unions are to thrive in Britain against this background, they will need to offer the standard of service customers have now come to expect. To a considerable extent, this is a question of size. Bigger credit unions are more likely to be able to afford paid staff, appropriate premises, computer systems, and so on. They are then better placed to attract more members, take in more savings, make more loans, and consider widening the range of services. Provided the basics are right, credit unions are in a much stronger position to act as intermediaries for other financial service providers, as some already do.

Prospects for the future

2.24 The later establishment of the movement here goes some way to explaining its relative lack of penetration. Membership has been growing at around 20% a year recently and has been particularly rapid for work-based credit unions. But given its low starting base, it would take a long time for the movement to develop into anything approaching a significant

⁹ *ibid*

contributor towards tackling financial exclusion, unless its other shortcomings are addressed. But recent developments suggest that this is starting to happen.

2.25 One important factor is that the representative bodies have shown an increasing ability to work together towards the same ends, as demonstrated by their joint representation to Government for changes to the legislation.

Credit Unions Taskforce

2.26 The credit unions taskforce (made up of people from banks, building societies and the credit union movement) was established by the Treasury in July 1998 under the chairmanship of Fred Goodwin, Deputy Group Chief Executive of the Royal Bank of Scotland. Its remit was to explore ways in which banks and building societies can work more closely with credit unions to increase their effectiveness; look at ways to widen the range of services that are provided to credit union customers; and encourage the continued expansion of the movement.

2.27 The taskforce recommended the establishment of a Central Services Organisation (CSO), to promote credit union growth and development in Britain. This would provide services (either directly or outsourced to banks or other organisations on a competitive tender basis) to credit unions who want to take advantage of the economies of scale, and expertise, which it could offer.

2.28 The taskforce made it clear that it did not wish to prescribe exactly what services the CSO should provide, because that should be a matter for its board, taking account of the needs of the movement. But the following might be included:

- back office processing, to relieve volunteers of book-keeping and other essentially administrative tasks;
- assistance with business planning and financial management;
- assistance with member financial education and marketing;
- provision of a treasury management facility;
- assistance with product development;
- recycling surpluses from CUs with an excess of savings to those with an excess of borrowers;
- back office processing for bill payments and other transactions services;
- encouragement and support at each development stage.

Although there will be no compulsion involved, provided the CSO delivers what credit unions want, it seems likely that most credit unions would want to take advantage of its services.

LGA guidelines

2.29 The Local Government Association (LGA) has recognised the need for some local authorities to reassess their approach to promoting credit unions within their locality. It has been developing guidelines to its members stressing the problems associated with top-down promotion. Those guidelines are based on the findings of the report from the John Moores University research which describes how a number of credit unions were set up without

sufficient thought being given to their long term viability, leading to volunteers struggling to cope with a project of which they had little understanding at the outset.

2.30 Those guidelines were written before the publication of the taskforce's report, and so are necessarily aimed at dealing with LAs' approach to promoting the movement as it is at present. But, following the establishment of the CSO, the case for direct LA involvement in the promotion of credit unions within their area should change. The CSO should have the necessary expertise, and economies of scale, to carry out much of this role in future. Although it would still be open for LAs to have their own separate arrangements, the case for doing so when an expert body exists for that purpose would diminish, and LAs wishing to support credit unions financially should consider channelling their money through the CSO. Such a change in LA strategy, however, seems likely to be some way off.

Future regulation of credit unions

2.31 A more effective approach to credit union regulation is both inevitable and desirable. If credit union growth is to be soundly based, there needs to be both effective regulation and effective enforcement. For banks and building societies, the conditions for obtaining and maintaining a licence, backed up by active supervision by the regulatory authorities, have had the effect of protecting depositors and ensuring quality services. There is every reason to suppose that similar regulation for credit unions would achieve similar results.

2.32 Depositor confidence is pivotal to the success of the credit union movement. In the past it has been necessary to organise rescues of individual credit unions that have become insolvent. These have relied on goodwill and cooperation; but this cannot provide the same degree of depositor confidence as a formally constituted share protection scheme. It is well recognised that one precondition for a share protection scheme would have to be far greater regulation than that currently in place. This would be essential, to reduce the exposure of the survivor credit unions who would be responsible for the rescue costs of a failed credit union (assuming the scheme were run along the same lines as the ones we already have for banks and building societies).

2.33 Stronger regulation is the natural counterpart of a stronger credit union movement; but sudden moves might jeopardise the survival of many small community credit unions whose current weakness has been noted. Many of them are concerned about both the standards that might be required and the prospect of higher registration fees and other compliance costs.

2.34 Regulation by the FSA could entail credit unions having to pay very much higher fees than at present, to cover the costs of regulation. But, for many small community credit unions, this would seem unaffordable. One solution might be for the cost of regulating credit unions to be subsidised by other institutions regulated by the FSA. This would give rise to a minimal increase in the fees paid by those other institutions. The FSA should examine this option.

2.35 The FSA and the Treasury should keep in mind the desirability of conserving and developing the community credit unions that exist in this country, as an objective in its own right. Effective regulation needs to be sensitive to the principle of proportionality. And it needs to leave room for weaker credit unions to grow, provided they appear likely to have a viable future, rather than threaten them with extermination. Having said that, neither the FSA

nor the Treasury can be expected to take on responsibility for promoting credit union growth. That is a task for the movement itself, in partnership with those best equipped to assist it.

Case Study: Speke Community Credit Union

Speke Credit Union was established in 1989 to serve the needs of people living in one of the areas of highest social and economic disadvantage on Merseyside. According to its current chairperson, for many years the credit union just struggled and limped along with burnt out volunteers. 1996 was the year of change. New volunteers were recruited and significant Single Regeneration Budget and European Social Fund funding was secured: around £90,000 per annum. This enabled the credit union to re-establish itself in former bank premises in the main shopping centre and to benefit from the support of four staff employed, under ESF conditions, as credit union trainers. It has also expanded the range of services on offer, to including standing orders, direct debits and payroll deduction facilities, through a banking partnership. This much higher and more professional profile has resulted both in increase in membership and growth in assets. Since 1995 membership has grown from 420 to 1850; shares (ie members savings) have gone up from £76,000 to £170,000; and total loans rose from £67,000 to £142,000. The credit union recognises that further development is needed to achieve full sustainable and economic viability by the time the grant funding comes to an end. To achieve this, it has embarked on a new strategic approach. The core factors include:

- C changing the common bond to include living and working in the area, in order to attract members from a number of key industries
- C marketing and promoting the credit union as a financial service for everyone in Speke
- C offering larger loans and a wider range of products and services
- C establishing a closer partnership with the banking sector.

The chairperson regards the key to success as cooperation with other organisations in the community. In particular, partnerships with Britannia Building Society, the Home Owners Friendly Society and CUNA Mutual (a US insurer) are enabling the credit union to offer a wider range of products. This enables it to provide more services to existing members and attract new members, thus securing a platform for further growth.

How Credit Unions can help combat financial exclusion

2.36 Well-run credit unions, where they exist, are recognised as an alternative to other sources of finance, for people who may not regard banks favourably. Credit unions offer services that people need, in terms of savings and loans products that are simple, transparent, flexible and low-cost. For people on the margins of mainstream financial services, they offer the only real alternative to the high-cost credit facilities to which unbanked people traditionally turn. The main problems are that there are not enough credit unions; those that are established are not always being run in a businesslike fashion; and few of those serving poor communities have made a significant market penetration. These are the main problems that must be addressed.

2.37 Credit unions can also offer a wider range of financial services; some already do (for example Speke, see box on previous page) or aspire to do so. Through appropriate partnership with banks and other financial services providers, a credit union might offer bill payment facilities; home contents insurance; mail order agency; and specific savings accounts - eg for holidays and weddings. They cannot supplant banks and other providers,

but they can work effectively with them, to their mutual benefit. The proposed CSO could help promote these partnership arrangements.

Conclusion

2.38 Clearly credit unions could play a larger role in tackling financial exclusion, but changes need to be made to bring this about. The result of the developments predating the PAT could in principle help make a difference:

- proposed legislative changes;
- the Central Services Organisation;
- refocusing of local authority effort, guided by the LGA.

2.39 The movement itself, and other participants, have recognised the need for change, and have started to put this into practice. The establishment of the CSO in particular, as proposed by the credit unions taskforce, would be a significant step towards providing a central focus for the movement, as well as the economies of scale it can offer. Credit unions, local authorities, representative bodies, central government, banks and building societies all need to work together to bring this about.

2.40 It is important, however, not only that momentum is maintained, but also that the direction of change is in keeping with the policy of increased access to services for people in deprived neighbourhoods. Whilst it is to be hoped that work-based CUs serving people who are not financially excluded should continue to grow, assistance - especially local authority assistance - should be targeted to ensure that people in deprived communities get the benefit. This does not mean that local authorities should ignore the contribution that work-based credit unions can make: where there is the capacity for them to provide services to people in deprived communities, this should be encouraged. The DETR might consider whether it might be possible specifically to monitor this aspect. The Treasury, for its part, will need to keep abreast of developments - and to be alert to the possibility of further measures being needed.

Recommendations

1 The DETR and the LGA should work to ensure that credit union development activity at local authority level promotes healthy and sustainable growth that benefits people in deprived neighbourhoods. (to start within the next year)

2 The Central Services Organisation, once established, should endeavour to promote itself to all sections of the credit union movement; and to encourage broad based development, with due emphasis on credit unions serving deprived communities.

3 The Treasury should continue to promote its proposed deregulation measures, to enable credit unions to grow; and continue to keep abreast of developments in the credit union movement, with a view to considering further changes in the legal framework, should the need for them be demonstrated.

4 The FSA should ensure that, in devising the future regulatory system for credit unions, the principle of proportionality is duly observed; and that the feescale applied to credit unions is in accord with a reasonable view of affordability.

5 The LGA should monitor the effects of its guidance on credit union development and consider making the results public. (to start in a year's time)

6 Local authorities should consider ways of ensuring that credit union development agencies make appropriate use of the facilities that might in future be offered by the Central Services Organisation.

CHAPTER 3: INSURANCE

Introduction

3.1 To bring about greater social inclusion of people who live in deprived neighbourhoods, by improving their access to financial services, also means increasing their access to insurance. Insurance - protection against financial risk - is a basic financial service. It is important to everyone. It can provide peace of mind, but it can also enable a more flexible approach to the management of domestic finances. But many potential customers do not use insurance. 25% of households have no contents insurance. 60% of lone parent families have no life assurance.¹⁰

3.2 Improving access to insurance means looking at key products or services that people need: what they are and how they are provided. As elsewhere in this report, there is a presumption that social inclusion will not be successfully achieved by promoting products which highlight or accentuate discrimination. Neither do subsidies, express or hidden, or simplistic solutions offer the best way forward. Inclusion and re-integration in society are better served by offering people a choice among services and service providers. That means promoting innovation and going with the grain of market forces.

3.3 The first part of this chapter looks at :

- C the insurance products people buy
- C how they are provided
- C the uninsured: who they are and why they are uninsured.

The second part looks at potential impediments for would-be purchasers:

- C the impediments created by inappropriate risk assessment, product design and delivery, and customer information.
- C impediments to obtaining home contents insurance.
- C impediments to obtaining family protection insurance

The third part looks at ways in which inclusion might be promoted, the impediments overcome, existing commitments reinforced.

Part 1: What products?

3.4 There are many insurance products. Not all are important for people living in poor neighbourhoods. Key products for them include home contents insurance and family protection insurance (which usually includes some form of long term insurance such as life cover). Some types of insurance are in effect provided at a basic level by the state - against unemployment and sickness, for example. Those on low incomes rely on state provision for these needs, since private insurance is unobtainable or unaffordable; and it is therefore important that this state provision is maintained. For other types of insurance however, such

¹⁰ ABI Annual Report 1998-99

as home contents and life assurance, there is no state provision, so access to these kinds of private insurance for those on low incomes is particularly significant. Table 1 shows what kind of insurance is actually bought.

Table 1: *Percentage of Households with expenditure on certain insurances by income: 1996-97* (lowest quintile means the 20% of households with the lowest incomes).

Type of Insurance	Lowest Quintile %	2 nd lowest Quintile %	All households %
Home building-structure	26	47	61
Contents	45	65	74
Motor	20	52	64
Medical	1	4	9
Mortgage Protection	1	4	13
Holiday	3	7	10
Personal accident	2	3	7
Other	4	12	20
Any Insurance (includes life, long term)	68	87	90

source: *Insurance Facts, Figures and Trends, Association of British Insurers, October 1998, p 9*

How are they provided?

3.5 It is not only the products that are important. The ways in which insurance products are delivered are important too. In large urban communities, home service (where an agent for the insurer calls regularly at the customers' homes) has for many years been an accepted way of doing business.¹¹ The types of insurance sold on a home service business basis have usually been endowment policies (life cover with certainty of cash at the end of the policy term) and whole life (which pays out only when the life assured dies and not before). Both can meet the demand for family protection insurance.

3.6 But, as can be seen in the next table, whilst there is still a sizeable amount of business transacted this way, both numbers of policies issued and total sums insured have been in decline. The reasons for this shrinkage are not entirely clear - an issue explored further in the Annex at the end of this chapter. However, it should be noted that most home service

¹¹ Strictly, "industrial branch business" is "industrial assurance" - that is, life assurance business; here, the term "home service" is used to refer to the way in which policies are sold and premiums collected on the basis of frequent, usually monthly, visits to the policyholders' homes.

business is Ordinary Branch (collected *via* a bank or building society, or cash collected quarterly) which has not declined like Industrial Branch, (but has not risen either, unlike business for higher net worth individuals through other insurers).

Table 2: ¹² *Insurers' Industrial Branch business*¹³

Year	New policies issued (000 s)	New Yearly premium income £m	Sums Insured £m	Total policies in force (000 s) A	Yearly premiums (£m)	Sums Insured (£m) B	Ave. Sum insured (£) B/A
'87	2844	241	4510	57345	1362	24891	434
'88	2082	214	3477	55524	1368	24865	448
'89	1955	224	3622	53133	1367	25584	481
'90	2052	232	3565	51272	1382	25952	510
'91	1782	232	3572	47470	1378	25990	548
'92	1728	228	3540	47069	1382	26195	556
'93	1213	152	2844	44451	1344	25638	577
'94	983	129	2401	42260	1284	24704	585
'95	671	92	1741	37752	1193	23321	618
'96	557	83	1464	35414	1110	22052	623
'97	445	65	1085	33263	1015	20479	616

The uninsured

3.7 People living in deprived neighbourhoods, generally on incomes well below the average, face very hard choices about how they spend their money. The research evidence is that the financially excluded are only too well aware of this. Of course, like everyone else in society, they have to make decisions on the basis of perceived value for money relative to other options: the opportunity cost. But for the financially excluded, to get these household budgeting decisions wrong may have more serious effects than would be the case for somebody who was better off. There is simply less room for mistakes. In making their

¹² Insurance Statistics Yearbook 1987-97, ABI: tables 14 and 15 modified. Further research findings based on MORI market research on Home Service Insurance Companies can be found in Insurance Trends, October 1998, published by the Association of British Insurers.

¹³ There are fewer Industrial Branch companies now still selling Industrial Branch products. Prudential, Pearl and Wesleyan stopped a some years ago; Royal Liver and United Assurance stopped in April/May 1999

decisions, the financially excluded will, and should, set their own priorities. The research indicates that insurance is not seen as the top financial services priority for households. “Home contents insurance is almost invariably a secondary priority, if it is prioritised at all” - “Medium term security - insurance against loss of income, or loss or damage to possessions - was of secondary importance”.¹⁴

3.8 Whilst individuals themselves should determine their own priorities, it is important that there should be informed choice. The decision not to place a higher priority on insurance may rest on doubtful prejudgments, supply-side failures, or both; or a lack of spare money on a regular basis. Exclusion can be a response to pricing, policy conditions and product design factors. Only rarely does it seem to be related to outright refusal of companies to do business with an individual or in a certain area - see below. To challenge existing perceptions, something must be done about the costs of, and availability of, insurance.

Reasons for being uninsured

3.9 Kempson and Whyley¹⁵ have shown that nil and low use of financial services products is significantly correlated with:

- C low net household income
- C receipt of income related benefits
- C length of time since head of household has been in work
- C housing tenure.

3.10 The reasons low income households are not insured include:

(a) *lack of money* Low income households are more likely than those in higher income brackets to regard insurance as optional. But it is not even optional if there is no money left after necessities have been paid for. When incomes fall or belts have to be tightened, insurance may change from an option to a luxury households cannot afford. 49% of those who had no contents insurance said they would like it but could not afford it.¹⁶

(b) *information* Informed choice among customers is based on their beliefs and perceptions. These in turn are based on general financial education, access to information, and advice. 10% of those who were uninsured for home contents said they had never thought about taking it out.¹⁷

(c) *value for money* The insurance industry may need to persuade its customers that its products offer good value for money. 16% of those uninsured for contents insurance thought insurance was poor value for money. This may, of course, be another way of

¹⁴ Kempson and Whyley, Insurance Trends April 1999

¹⁵ Whyley C, McCormick J and Kempson E *Paying for Peace of Mind: Access to Insurance for Low Income Consumers*

¹⁶ *ibid*

¹⁷ *ibid*

saying that for them exclusion reflects not just price, but also policy conditions and product design factors.

(d) *refusal* Another reason for exclusion is sometimes thought to be insurers' "red-lining" certain geographical or postal locations.¹⁸ However, the research¹⁹ indicates only 2% were classed within the "access excluded" band: that is, having favourable attitudes to insurance and no serious financial difficulties, but unable to find a company to insure them because they live in areas of high crime.

(e) *housing type* Housing tenure or type of housing is also particularly significant. As has been shown, the links between financial exclusion and local authority or social housing have also been highlighted by the research. This may amount to an irrational perception that insurance is not appropriate for non-houseowners or a fear of being refused; or it may relate to understandable risk factors, as explained in the Annex to this chapter. Not much is known about the position in deprived *communities* as such, compared with low-income households in general. This is clearly a complex area and indicates a possible need for further research, focused on the uninsured in social housing and in other deprived communities.

Detriments faced by the uninsured

3.11 Kempson and Whyley²⁰ identify two main areas of unmet need - long term financial security and day to day money management. Insurance can make a contribution towards meeting these needs. Whole of life or term life assurance can provide some financial security in the event of the main earner or primary carer dying. Contents insurance can help with day to day management. As to relative priorities, evidence from focus groups taken by the Personal Finance Research Centre indicated that long term financial security - providing for the family in case something happens is seen as more important than medium term financial security as expressed in terms of replacement of lost or damaged household items.²¹

3.12 But the consequences of being uninsured go wider. If a low income household is burgled, for example, but has no contents insurance, this can mean:

- C immediate financial difficulties, ie indebtedness, if basic household goods and cash have to be replaced and other obligations become unaffordable.
- C a need for a higher level of savings in order to be able to make good any loss without recourse to borrowing.
- C restricted choice as to disposable income (arising from the need to build or re-build reserves).

¹⁸ Report of Social Exclusion Unit: "Bringing Britain together: a national strategy for neighbourhood renewal".

¹⁹ Whyley, McCormick and Kempson, *op cit*

²⁰ Insurance Trends April 1999

²¹ Response of the ABI to the Financial Services Policy Action Team, March 1999, p 24

3.13 Problems are particularly acute for households where the income is composed wholly or largely of social security benefits and irregular earnings, (for example arising from being in and out of work, as with seasonal employment). If there is no family protection insurance to provide for, or cushion, dependents, then if the earnings stop because of death, the whole burden of future support is likely to fall on the state or relatives.

3.14 A last example of detriment: some insurances are compulsory - third party motor insurance is perhaps now the most common example. Inability to obtain such insurance at an affordable price may result in more uninsured drivers. Not being able to get third party motor insurance may be an obstacle to re-entering the labour market, if own transport is required. As to wider implications, damages and compensation for uninsured or untraced drivers may have to be paid for by other policyholders.

Part 2: Risk Assessment, Product Design and Delivery, Customer Information

3.16 Given that affordability, perception and lack of information combine to limit take up of insurance, how might these factors be overcome? The aim must be to deliver the right product in the right way to a willing customer. The right product includes one which it is sensible (i.e. profitable) for the insurer to provide. It also means one which offers customers what they want; whose features do not discriminate unfairly against some potential customers; and that is provided to customers in a way which suits them and in a way they choose to budget.

3.17 Some aspects of the key product related issues are summarised in the following table. They focus on risk assessment, product design, product delivery and customer information. More detail is in the Annex at the end of this chapter. But it is important to note that improving access to insurance is not simply a matter of supply side improvements, crucial though they are.

Table 3: *Potential impediments that get in the way of greater take-up*

Risk Assessment	1 Red-lining	1 Reported practice of some insurers to refuse applications from areas of high crime or where there has been a high incidence of claims: note the ABI has been running a scheme since 1988 to find cover for those who claim they are the victims of red-lining. Only a handful of calls in the past few years.
	2 Rehabilitation	2 Where applications may require disclosure of past criminality and that appears to be irrelevant. Insurers should be able to justify how the information they ask for is material or relevant information.
	3 Conditions	3 Requirement for security devices to be fitted, the costs of which make insuring unaffordable for low income households

Product design	<p>1 requirements for paying premiums</p> <p>2 long term products requiring stability of income.</p> <p>3 penalties for early termination or surrender</p> <p>4 no flexibility on payment holidays; 5 putting product into suspense.</p> <p>6 does it provide the cover the customer needs?</p>	<p>1 Direct debit or standing order requirements deny access to the unbanked; and those paying by direct debit or standing order may have to pay an additional charge. Part of a wider issue, but use of cash and premium receipt books would appear to be an administratively expensive alternative. Also, general insurance may require an annual premium.</p> <p>2 Many people on low incomes move in and out of that category: is there scope for flexible insurance packages, similar to flexible mortgages? Note that some work has been done by the industry on a family protection product that would combine insurance, savings and the ability to withdraw some cash for emergencies.</p> <p>3 Early surrender of endowment policies can return less to policyholder than has been contributed. Still sizeable number being sold on home service basis.</p> <p>4, 5 If people on low income move in and out of exclusion, then flexible products (like flexible mortgages: payment holidays and capability to pay more when in funds) would appear attractive.</p> <p>6 Design of suitable products means:- leaving out features that add to cost but may not be valued by low income households; thinking about ease of comprehension (endowment products quite difficult); defining well the range of cover (excesses, upper limits; accidental damage? New for old or indemnity? principal risks only).</p>
Product delivery	<p>1 Home service</p> <p>2 Other marketing channels</p>	<p>1 Note that the service is highly valued; considerable customer loyalty; real advantages to housebound. But unavoidable administrative costs leave little for investment, or core insurance.</p> <p>2 Doubts about the appropriateness of new technologies, but really a question whether people in poor neighbourhoods are getting appropriately targeted information and advice.</p>

Claims Handling	1 Transparent, fair and efficient	1 Perceptions about poor value for money may be based on belief that insurers might try indefensibly to avoid paying claims. Clear product information, and supportive interface with customers, can go some way to overcoming that perception.
Cost	Affordability	The cost of insurance is related to risk. Low income households often face higher risk - eg of burglary or ill health. Hence insurance may be unaffordable.
Customer information and advice	1 Steps towards a more informed customer 2 Information and advice 3 Impartiality and support	1 Could existing advice centres, community centres increase awareness of options and priorities? 2 How to separate information about products from advice on specific products. Particularly an issue with family protection insurances. 3 Could insurers participate more actively in advice and counselling services, through financial support and secondments?

Home Contents Insurance

3.18 Whyley, McCormick and Kempson²² show that a particular characterising feature of the financially excluded is the likelihood that they will live in areas of council or housing association tenanted properties: that is, in social housing. Often this might be in areas where crime rates and the risk of vandalism may be higher. With insufficient savings to replace the most essential goods quickly (e.g washing machines, refrigerators, beds, clothes), people in deprived neighbourhoods may wish to take out home contents insurance. Some may even be able to afford to spend their limited discretionary income on such insurance. But, because insurers price their product according to the experience of actual risk (ie claims paid out) some may be reluctant to offer insurance at an affordable price. However, in addition to the key points mentioned in Table 3, there are other ways of closing this affordability gap: in particular, by making use of appropriate insurance intermediaries in the form of social housing providers.

3.19 A notable development which brings together people living in social housing, their housing providers, and the insurance companies, is the provision of home contents insurance on the basis of Insurance With Rent (IWR) schemes. There are at least 80 local authorities and housing associations that operate such schemes.²³

²² *op cit*

²³ *ibid*

3.20 In these schemes the local authority or social housing landlord facilitates the delivery of insurance and the collection of premiums. This has advantages for both suppliers of insurance and their customers. It can remove the need for many separate financial transactions. It can enable the tenants to deal, initially at least, with an organisation with which they have already an on-going financial relationship. And such schemes can help individuals manage their financial affairs more easily by providing a stable managed framework for payment of rent and premiums. For example, they can, usually, pay in cash - particularly valuable to those who have no bank account. They may also offer marketing opportunities that would otherwise go unnoticed.

Case study: Insurance With Rent schemes on the ground

Calderdale MBC has been operating a household contents policy for tenants since 1993 in conjunction with Independent Insurance Company Ltd. Premiums are charged at a flat rate and can be paid alongside rent. The current weekly premium is 23 pence per £1,000 insured plus insurance premium tax, with discounts for pensioners. The maximum cover of £25,000 can only be increased with permission of the brokers. The Policy includes cover for:

- C new for old replacement cover for all items up to 5 years old (*except items of clothing and household linen which are subject to deduction for wear and tear*);
- C accidental breakage of mirrors, fixed glass in furniture, televisions, video players and recorders;
- C home improvements cover such as fitted kitchens, bathrooms, wardrobes, patio doors etc (*excluding greenhouses or conservatories*);
- C deep freezer contents;
- C theft of keys.

There is no excess charge on the insurance policy, which is particularly attractive to those without access to ready finance. Also the scheme is not based on local postcodes, which means there is no differentiation, through higher premiums, of particular areas of the borough.

Calderdale MBC have been impressed with the take-up level of this scheme, particularly at the outset, and a steady flow of applications has continued. With further marketing planned and the likelihood of reducing premiums this year, it is hoped that the percentage take-up will increase.

Burnley BC operates a similar scheme, where the cost of insurance is payable weekly in each of the weeks when the rent is due. The council also produces a leaflet with a payment chart to calculate premiums.

3.21 There have been some concerns about such schemes in the past. In poorly designed schemes, insurers and local authorities may have incurred claims and costs which made further participation unattractive. Insurers have, the ABI told us, been concerned that as the lower risk individuals in such a scheme move out of the category of the financially excluded, then the overall riskiness of the insured pool increases to the disadvantage of the insurer. Others have said that this has not happened. In practice, a more likely outcome has been that "higher risk" tenants, those with increasing rent arrears, are excluded or lapse. Again, it is

said that the proportion of those who actually participate, as a subset of those who could, is not always high: ABI have estimated take up around 25-30% in the most popular schemes.²⁴

3.22 However, properly functioning, soundly financed, schemes appear to offer benefits to all parties. Such schemes feature express and open management commitment and a closely monitored claims procedure. The issue now is to build on this work. The Association of British Insurers, having commissioned and considered research, now plans follow up work. However, to encourage take up and participation of IWR schemes more could be done to inform prospective customers about the potential of and availability of such schemes in their area.

Targeted marketing and use of existing information channels - one stop shops - might encourage households to consider insuring their home contents. To break through this inertia barrier is a task for the industry and the housing providers

3.23 There also appears to be scope to extend IWR schemes: either by extending the range of insurances offered by these schemes; or by extending the groups who participate.

3.24 The costs and benefits of IWR schemes vary with the way a particular scheme is structured. For example, some local authorities help with applications to join such a scheme, although their role in relation to claims handling should be limited. Again, local authorities and other social housing providers may decide to pass on any commission they might receive from insurers by using it to reduce overall costs of housing provision - the housing budget. Others net off the commission before charging premiums to their tenants. Yet others decide that the commission should be applied to improve crime prevention or fire safety measures in the housing area where premiums are paid. This should in future years help to reduce the costs of home contents and other insurance for the people who live in that area. But there is a role here for insurers as well as local authorities. Insurers could help by devising variations on a standard IWR scheme - taking into account the housing providers' circumstances and needs - so that administration, including premium management and monitoring, were efficiently and transparently managed.

3.25 Whilst the regulatory framework which governs those financial services which feature investments with some linked life cover, would tend to militate against extending such schemes to include provision of insurance-linked to investments, there may be other kinds of general insurance which could be effectively delivered through such schemes. In this connection, and as Table 1 indicates, both buildings insurance and motor insurance are purchased by significant proportions of those in the lowest quintile of income bands. However, buildings insurance would not apply to tenants and local authorities have yet to extend home contents insurance to non-tenants. Moreover, motor insurance might not offer the same benefits in terms of cost, as it would be difficult to purchase block cover, since tenants might have cars of many different types; a scheme offering a standard discount on individual premiums might be the best that could be achieved.

²⁴ *ibid*

Case study: Hereward Housing Association and United Friendly

Hereward Housing Association in Ely, Cambridgeshire, has teamed up with insurance company United Friendly, to offer their housing tenants household contents insurance. Contents cover for £10,000 is offered for £1 a week, with discounts for pensioners, and there is the availability to buy more cover up to a value of £25,000. There is the added convenience of paying by weekly instalments with rent, thereby allowing the cost of payment to be spread across the year (rent accounts must be up to date to be able to take part in this scheme).

United Friendly's Home Insurance Policy provides:

- C new for old replacement cover against major hazards such as theft, fire, storm and flood (*except for clothing and household linen where an allowance is made for wear and tear*);
- C accidental damage to TVs, satellite decoders, videos, audio and computer equipment;
- C breakage of glass in windows and doors;
- C money stolen during a break-in;
- C freezer contents;
- C free 24 hour telephone helpline for insurance claims, emergencies and legal advice.

Hereward approached United Friendly through the experience of another Housing Association working with the Insurer. Hereward are responsible for the collection of premiums from tenants and effectively manage the scheme on a day to day basis, although the tenants remain the policyholders.

In a recent survey carried out by Hereward, 30% of tenants questioned said that they had no contents insurance, but 42% said they would like to see details of a scheme where payments could be paid weekly. Hereward said that "they were pleased to offer our tenants the added peace of mind they clearly wanted and which they could pay for out of their weekly budget".

United Friendly provides a range of insurance products including life insurance, pensions, savings, investments and household insurance to 3 million customers throughout the UK. They have been offering house insurance through rent schemes with social housing providers for the last 5/6 years and they current operate some 20 plus schemes.

3.26 Stand-alone credit payment protection insurance (i.e. insurance which is not provided through the intermediation of the supplier of credit) might also be a candidate for delivery through such a scheme, at least to the extent that the target group get the kind of relatively large scale credit facilities that make such insurance worthwhile. Life assurance cover, provided that it has no investment component, might also come within the range of insurance products which could be delivered by IWR schemes.

3.27 Finally, there is a fiscal dimension. Many general insurance products are subject to Insurance Premium Tax. Buildings, contents and motor insurances are subject to a 5% charge on premiums. In future consideration of the fiscal system, the status of IWR schemes, should be borne in mind.

Longer Term Family Protection Insurance

3.28 How can the concern of people in poor neighbourhoods - that there should be some provision made for financial support for children or dependents if the main income provider becomes unable to provide - be met?

3.29 Certain kinds of life insurance product have traditionally met this concern:

- term assurance, which pays only if the person whose life is insured dies within the period for which insurance has been bought (usually the least expensive option)
- whole of life, which pays out when the person whose life is insured dies (the next least expensive)
- endowment, which is usually term insurance with a savings element, so that at the end of the term, usually 10, 15, 20 or 25 years, unless the person whose life is insured has died and payment has already been made, a lump sum becomes payable (probably the most expensive)

However, savings and insurance should not be seen as inextricably linked. The financially excluded, and those mindful of their needs, should consider the option of separating insurance and savings, particularly as new options for longer term savings, such as the Government's stakeholder pensions proposals, may offer better value for money.

3.30 Again, provision through home service business is significant but appears to be declining. In this connection, it is important not to confuse the difficulties arising from the method of service provision with the inherent features of the products - which may give rise to a different set of issues.

Table 4: New Life Assurance Business 1995-1997²⁵

all figures are in 000's

Year	New endowment policies (industrial business)	New Whole of Life (industrial business)	New life policies (ordinary business) A =B+C	Of which, linked B	Of which, non linked C
1995	544	126	3,473	1,233	2,241
1996	478	79	3,658	1,322	2,335
1997	366	79	3,931	1,302	2,629

3.31 Endowment and whole of life (or even term assurance²⁶), linked and non-linked, kinds of insurance generally require a commitment on the part of the policyholder to maintain a steady stream of premium payments over many years. Single premium payment insurance is thought to be of only limited relevance to people in poor neighbourhoods. But maintaining

²⁵ ABI, Statistics Yearbook 1987-97; Tables 14 and 18 modified.

²⁶ whole of life is taken to mean life assurance under which benefits are payable when the person whose life is insured dies; term assurance refers to life assurance which pays out if and only if the person whose life is insured dies within a specified period. So, other variables being constant, the latter gives more limited but cheaper cover.

a steady stream of payments is not easy. There may be irregular patterns of work. For some people, being in and out of work arises from employment which is seasonal (crop-picking or holiday resorts). Others may do jobs where casual working is the norm. These people may move on and off benefits several times a year. For others again, parenting obligations can impose a different pattern of irregularity of work and income. Pressure on budgets also changes over time as children grow.

3.32 The endowment or the investment linked policy, usually for 10,15, 20 or 25 years, is both a savings and insurance product. It provides a fixed sum of life cover but also acts as a means of saving regularly in the hope of accumulating a lump sum. So there is a real tangible sum to show for the saving, a sum that may help provide in old age. Focus group research indicates that the wish to make provision for additional cash in later years is another priority of the financially excluded.

3.33 On the other hand the whole of life or term life assurance product should be significantly less expensive. It pays out if the life assured dies and not otherwise. But it is sometimes seen as poor value for money because there may be no financial return.

The regulatory framework

3.34 The statutory framework of regulation is an important aspect of the way in which long term insurance products that combine insurance and savings may be designed and delivered. The Financial Services Act 1986 is relevant here in a way that it is not in relation to home contents insurance. That Act provides for a framework of regulation which impacts on the way in which investment products (including long term insurance products which may provide a cash return to the policyholder) are sold. It does so because there is a sound policy basis from which to justify additional statutory regulation, based on the long term commitment; the effective tying up of the policyholder's money; the imbalance of information and understanding between the provider and the customer; and the amounts involved relative to the policyholders personal wealth. In addition, there are the Industrial Assurance Acts. They regulate the way in which life assurance delivered through home service or industrial branch business is provided. The ABI believes that some regulatory barriers result in people not having access to financial services even though many of them would like to, as a result of these government policies.

3.35 It may be thought that some insurers might argue that a no-frills family protection insurance product could be provided at affordable rate if only the burden of statutory regulation was relaxed. The Association of British Insurers say that whilst it is undoubtedly true that the high administrative costs of home service business are not solely due to the regulatory regime, the regime certainly goes some way towards adding to the burden. However, persons interested in consumer welfare could well take a different view, and argue that the reason for statutory protections and regulation is well founded; that the financially excluded are also, relatively speaking, among the more financially vulnerable members of society.

3.36 In connection with family protection insurance that involves a savings as well as an insurance element, such as endowment policies, it seems possible that social security rules on income and capital disregards for means tested benefits result in disincentives to people who wish to try to build up financial reserves from doing so. It is not clear to what extent this does in fact happen, as the amounts of cover being purchased do not appear to be high (see

Table 2 above). Nevertheless, it may be worthwhile to consider afresh the interaction between the benefits system and individuals' attitude towards obtaining insurance and perhaps other financial services. The team also considers that the financially excluded, and those concerned on their behalf, should review the availability of state benefits, particularly in respect of changes which the Welfare Reform and Pensions Bill may bring about, and how attitudes and decision making on insurance and other financial services might be affected in this new state of affairs.

3.37 Returning to family protection insurance, it does seem that there is a situation of market failure in this area. Customers are not always sure what they are buying. They have doubts about whether they are getting good value for money. Suppliers of services suspect that they are constrained in meeting their customers wishes because of the requirements they have to comply with. Regulators and some of those speaking on behalf of consumers generally fear that changing regulation could expose a particularly vulnerable group to undesirable activity.

3.38 Following on from what was said at the beginning of this chapter, the way forward appears to lie in a combination of more innovative product design and delivery, more relevant regulation, and better information and education.

Life assurance: a better designed traditional home service product?

3.39 The possibility of a better designed, better delivered, low cost product providing life cover has been considered by the insurance industry. The response from the Association of British Insurers to the consultation exercise indicated that it had set up two working parties: the first to consider all aspects of financial inclusion: the second to investigate how insurers might provide a policy with protection and long term savings elements which also met identified needs of flexibility, a short term withdrawal facility and low cost. However, concern about the structure of high fixed costs remains.

Better regulation?

3.40 On regulation - or rather deregulation - the insurance industry has been seeking abolition of the Industrial Assurance Acts through the Financial Services and Markets Bill, though with continuing protection for existing customers via rules or guidance from the Financial Services Authority. There is agreement that what is needed is better regulation, more cost effective regulation, as opposed to any complete removal of regulation. The Government has now considered these representations and, in June it announced a repeal of the Industrial Assurance Acts as applied to new business.

Information, education and advice

3.41 Looking beyond the Industrial Assurance Acts to the Financial Services Act, there is likely to be concern about any proposed lessening of conduct of business rules on product information. One person's essential information may be seen by another person as advice.

3.42 Having said that, is it "best advice" to encourage people to make some provision to help them manage their financial affairs? Is it best advice to explain the difference between insurance products where one features a savings element and another does not? It is certainly arguable that information about the role insurance can play, about types of insurance, about their merits relative to an individual's circumstances, falls short of advice.

3.43 In this connection, information of the kind found in the Consumers' Association magazine Which? - which enables individuals to consider the appropriateness of types of credit card having regard to their own pattern of usage - could be used as a model from which to derive similar information on family protection insurance and key features within product types.

3.44 Again, the ABI already provides information leaflets on a range of insurance products or services. Such information leaflets do not extend to the giving of advice or recommend particular product providers. Is this information getting to the right place for potential customers in poor neighbourhoods?

3.45 If people living in poor neighbourhoods may not be making great use of some information sources, how then can information be made available to them in a more accessible way? The existing voluntary networks of money advice and counselling appear to offer a channel for the provision of information of a fairly basic type: such as the basic difference between life assurance where other benefits are payable and those where life cover is the only benefit. However, at present the money advice networks are staffed mainly by experts in debt and credit, who probably know little about insurance. More use of generalist advisers in CABs and independent advice centres are a possibility.

3.46 Several financial services providers - the major banks, and building societies - have been actively supporting money advice services. Their support may be given in cash or in kind. Local authorities too offer information and advice services through consumer protection departments. The ABI itself supports three advice centres. The insurance industry might be more actively involved in these initiatives, but only if they broadened their scope to include advice on insurance products. Standardised information about how to claim and how to pursue a claim if dissatisfied might overcome any suspicion that insurers are reluctant to settle claims.

3.47 A key concern is that information should be accessible before the event; before a contract is concluded. This contrasts with much work done by debt counselling services who tend to come into play once difficulties have arisen.

Part 3: Promoting practical solutions

3.48 The context in which any conclusions are reached is a dynamic one. New developments are happening all the time. Companies and organisations take new initiatives. Underlying market forces continue to operate. But there does appear to be scope for accelerating the rate of change. Most important is that the key players should work together. This includes those who can make known the views of the financially excluded. In this area, that may mean insurers operating with local or community groups and providers of other financial services to devise innovative ways of meeting local needs.

3.49 In that connection, there may be scope for more direct involvement of insurance companies where the company is a large employer near to a poor neighbourhood. Several insurance companies are more actively interested in the social impact of their activities and participate in community initiatives.²⁷

²⁷ For example, the Co-operative Insurance Society and Standard Life.

3.50 Local authorities and social housing providers could consider how they could help promote social inclusion through increased access to financial services and insurance. Crime prevention, where local authorities have duties under the Crime and Disorder Act, and better neighbourhood measures could increase the availability of insurance, and perhaps slow the decline in home service business.

3.51 The FSA, as part of its consumer education work, is going to develop generic information about the role of different products and services, to help people in their financial planning. This will be done by using consumer advice networks as a distribution mechanism for its consumer information and publications. Consumer advice is considered further in the final chapter of this report.

3.52 The Government's aim is to create economic and employment opportunities for all. As part of this the Treasury aims to secure an efficient market in financial services with fair and effective supervision. Other departments take the lead on consumer protection and competition issues. But responsibility for maintaining a framework of financial services regulation which is conducive to the overall aim and objective rests with the Treasury. The Treasury, in association with others such as the Financial Services Authority, necessarily maintains a watching brief on the regulatory framework. Indeed at the present time it is engaged in a major re-engineering exercise which will secure better regulation.

3.53 The Post Office currently offers insurance services on behalf of Royal & Sun Alliance which provide customers with the facility to pay by cheque and cash. It also has the UK's most extensive payment collection network.

Recommendations

3.54 The following summary of recommendations brings together ideas on action that could be taken to improve access for people in poor neighbourhoods to insurance. Although the summary identifies key players, it does not dictate to them what must be done or what the priorities are. It suggests some timings. It is for the players themselves to commit to and own the programme of activity.

1 DETR, the Housing Corporation and the LGA should work with the insurance industry to promote Insurance With Rent schemes; and they should explore ways of extending these schemes to neighbouring private tenants and owner occupiers (from 2000)

2 Local authorities and social housing providers should consider the advantages that might accrue from participation in Insurance With Rent schemes targeted at poor neighbourhoods. (in financial year 1999-2000)

3 NDC pathfinder partnerships should consider whether there is scope for pilot schemes involving Insurance With Rent in their areas. (from this year)

4 Social housing providers and insurance companies should carry out pilot studies to test demand for and viability of extended Insurance With Rent schemes, involving additional types of insurance besides contents cover. (2000-2001)

- 5 Local authorities and social housing providers should exchange information on how the benefits of participation in Insurance With Rent schemes can be most effectively realised: through reduced premiums, crime prevention measures, or other means. (in financial year 2000-2001)
- 6 The ABI should explore the potential of new payment collection networks, such as PayPoint in connection with low cost family insurance; and payment through budget accounts via non-bank channels. (ongoing)
- 7 The ABI should explore the potential for the Post Office to extend its insurance offering in line with the recommendations of this report. (as soon as practicable)
- 8 Insurers and organisations representing insurance companies should work with credit unions to explore the potential for offering general insurance through credit unions. (in financial year 2000-2001)
- 9 Insurers should maintain their commitment to follow up research on financial exclusion but also consider how they might promote limited experiments to test research solutions in practice. (ongoing)
- 10 Insurers and organisations representing insurance companies should consider devising local and national strategies to promote more active involvement of insurers in community focussed initiatives. (in financial year 2000-2001)
- 11 In future consideration of the fiscal system, the status of Insurance With Rent schemes should be borne in mind. (ongoing)

Annex: Risk assessment, Product Design, Product Delivery and Customer Information and Education

The purpose of this annex is to consider these aspects as they affect the access that people living in poor neighbourhoods may have to insurance.

Risk Assessment

A.1 Risk assessment techniques are important because they bear on questions of whether insurers “red-line” certain applicants, on availability generally, and on affordability.

A.2 Like providers of bank accounts and credit, insurers take into account risk when they provide services. With insurance, the risk relates to the probability that claims will be made: how many, how large, and how often. If the probability is high, the premium is going to be high as well.

A.3 The underlying principle of insurance is one of mutuality: people come together to share risk. The service that the insurers provide is to offer a means of “pooling” similar risks. In effect, this means that they seek to identify a group or population of individuals whose members will bring to the pool a broadly equivalent risk. The group has to be large enough to achieve a certain critical mass. For example if it was the case that of 100 men in the age group 50-60 years, one would die before reaching the age of 60, then life assurance could be underwritten profitably on the basis that each of the 100 individuals paid contributions in excess of what was needed to pay benefits to the estate of the individual who did not survive.

A.4 But the risk has generally to be normally distributed. If the risk is abnormally or very unevenly distributed, that is, if some individuals face much higher risks than others, then there will be a need for cross subsidy, with the low risk subsidising the high risk. Insurers have to strike a balance and design their products in such a way as to bring together individuals with a certain level of risk, excluding some, and keeping average premiums low whilst not excluding so many as would invalidate the critical mass principle.

The risk assessment threshold

A.5 The issue here is whether the risk threshold in relation to the kind of insurance products or services which the financially excluded may want is set too high. One aspect of this is so-called red-lining: when acceptance or rejection can be determined on the basis of where somebody lives. In practice, it seems unlikely that simple exclusion by reference to a geographical area designated by a post code would happen very frequently. The key determinant is usually the insurers’ previous claims history.

A.6 Indeed risk assessment by insurers usually involves a number of variables: where one lives may be a variable of more or less importance. Personal history, previous claims history can be as important, possibly more important. The appropriateness of the variables used will be affected by the type of insurance being sought.

A.7 To understand so-called “red-lining” and why, if practised, it would be unacceptable, it is necessary to make a clear distinction between justifiable and unjustifiable differentiation;

between informed and uninformed decision-making. “Red-lining” is usually taken to refer to a supplier’s decision, taken with insufficient reason, not to provide a financial service to individuals living in a defined geographical area. As such, it is uninformed, irrational, and probably contrary to the supplier’s real commercial interest. But “red-lining” is not the same as making decisions whether or not to supply on the basis of, among other factors, information with some relevant geographical reference. For example, it would be rational and informed decision-making if a supplier of contents insurance took into account local crime statistics or a supplier of buildings insurance took into account local geology. But that is subject to the important proviso that the geographical or locality aspect is relevant and significant; or, in accountants’ terms, material.

A.8 An essential feature of successful insurance business is accurate assessment of risk. Failure to pursue accurate risk assessment will result on bad underwriting decisions and uncompetitive pricing. Information that might be used in risk assessment is increasingly available. The emergence of sophisticated and computerised databases allowing a wide range of information to be subjected to more and more refined analysis, presents insurers with opportunities and problems. The opportunity lies in the potential for more accurate assessment of risk. The problems are that more (i) analysis implies higher costs; and (ii) not all the additional information is going to be relevant. “Red-lining” is by definition unacceptable: the use of geographical information, particularly post-code information, needs to be subject to careful scrutiny because it can mislead as well as inform.

A.9 The conclusion to be drawn is that risk assessment methodologies, the weighting placed on variables and the data fed into the equations, should be reviewed regularly. Insurers say this happens already.

The product design barrier

A.10 As in other financial services, product design features can act as impediments to take up. If an insurer requires payment of premiums by direct debit, that may in turn require a bank account to be held by the policyholder. If the insurer requires regular premium payments and the insured has a variable and uncertain income, then the product is unlikely to be suitable. If there is a long term contract which requires regular payments and it is likely that income stability over the long term is zero, then again the wrong product is being sold. If contents insurance is sold with an upper limit on claims far above what is ever likely to be claimed, or with a high “excess” (the sum the policyholder must find before a claim is accepted), then the suitability of that product is questionable. But insurers’ advantage in selling the inappropriately designed product is only temporary. Competitive forces should ensure that products offered to customers reflect the needs and wishes of the customers.

A.11 Further, principles of fair dealing would seem to require that products be designed and sold having regard to what is reasonable and suitable in the circumstances. Insurance products with heavy penalties or charges if there is early surrender can be measured against principles of fair dealing just as credit deals which verge on extortionate credit bargains can be.

A.12 Other aspects of product design may need to be reconsidered. Whilst basic, or benchmark insurance products have their critics, targeted market research and test marketing could reveal what can be offered within the range that customers may be able to afford. For

example, there is sometimes the suggestion that contents insurance in a buildings and contents insurance package is excessive. Insurance industry evidence suggests that under-insurance is more likely to be the case. It is not self evident that those on the margins of financial exclusion have very different needs, but if “accidental damage” cover for home contents is an option (at a price) in some policies, then there is a *prima facie* case for researching the applicability of features of existing products to this somewhat fluid social group of financially excluded people. In practice, it would seem that the types of home contents cover now being offered as part of well-designed Insurance With Rent schemes generally provide what the customer wants.

The product delivery barrier

A.13 Provision of insurance to low income groups living in working class communities has a long history. The decline of home service business may be seen as akin to closure of bank branches, without the off-setting advantages of alternative service provision such as the automated teller machine or payment mechanism. The withdrawal of service providers has the effect of leaving those excluded more vulnerable to higher charges from remaining suppliers or no services of that kind at all. The market at this end of the income spectrum may be less competitive than before.

A.14 Home service business is a labour intensive and administratively expensive way of doing business. It is not entirely clear whether the high administrative costs are entirely attributable to the burden imposed by statutory regulation that is a feature of this way of doing business. The consequence, however, is that after taking account of costs, the amount of each premium available for investment or pooling is relatively small. This means that the benefits on the insurance are correspondingly lower. From the viewpoint of the insured, the products then appear to be poor value for money. On the face of things, this looks like a case of inappropriate product design and delivery.

A.15 Research from MORI commissioned by the Association of British Insurers has pointed to a rather different set of conclusions. The customer base for home service is much older than that for the customer base for the population as a whole. Market penetration among young adults is particularly low. But home service customers, while they may have below average educational attainment, have a higher rate of home ownership. According to MORI, customers have a high opinion of home service providers, significantly higher than the opinion they hold in respect of banks, building societies and other insurance companies. So there is a high level of customer satisfaction and loyalty.

A.16 Not all insurers previously active in the home service area believe that they should withdraw from home service provision. Some are actively reviewing their involvement. There may be a case for outsourcing collection of premiums and using other deliverers of services to the home: post, milk, supermarket goods, care services. At least on the surface, the long term decline in home service provision of insurance contrasts with the survival of the “weekly collected credit” industry. It has been suggested that the weekly collected credit industry survives by charging high rates of interest. It has also been suggested that less competition through some credit providers withdrawing from the market for relatively small loans has enabled these rates to be charged. But given the apparent attractions of valued service, customer loyalty, a certain price inelasticity of demand, the different response of the credit and

insurance financial services providers appears to suggest that there is scope for insurance business to survive on a home service basis.

A.17 Insurers have identified barriers to financial inclusion which are the result of Government policy.²⁸ These may be seen as product design barriers insofar as the product has to incorporate certain information, or product delivery barriers if it is a question of a premium receipt book having to be updated and kept by the policyholder. There are Industrial Assurance Acts which impose constraints on the way industrial assurance is provided. The Treasury has been considering whether there is a strong case for change, taking into account the need to ensure necessary protections and preserve existing customers' rights; and the Government has now announced repeal of the legislation as it applies to new business.

The customer information and education barrier

A.18 Insurance is relatively easy to understand in principle - the idea of pooling risks among a group on the basis of an informed assessment of risk - but often more difficult to understand in practice. Most customers do not look at insurance that way. They see it more simply as paying for a degree of security in case the worst should happen.

A.19 As in other financial services, there are disputes as to what terms and conditions of contract really mean, as to whether performance of their obligations by one or other party to a contract is what a reasonable person would expect. With insurance, there is sometimes confusion as to whether premiums merely pay for the confidence that arises from knowing that if things go wrong some financial security will be in place, or whether there is an investment or savings element to a product - as is frequently the case with longer term life assurance products. Getting the basic understanding right is crucial.

A.20 Regulation and industry self regulation can assist by requiring that more complex products, or those which may require a longer term commitment of large sums, are subject to more extensive control through regulation of selling and marketing, of conduct of business by insurers and insurance intermediaries. But regulation is no substitute for an informed customer: and regulation by itself is no guarantee that appropriate products will be available and will be taken out.

²⁸ ABI Annual Report 1998-99, p 4

CHAPTER 4: BANKING SERVICES

4.1 To promote social inclusion by improving financial services for people living in poor neighbourhoods means encouraging greater use of banking facilities and access to a range of delivery points, for cash withdrawals and other services, whether provided by banks or other organisations. It also means access to appropriate credit facilities, subject to lenders' and borrowers' views on what level of loan, if any, is sustainable, and on what terms.

4.2 Achieving this vision should be subject to three broad principles.

(a) *Non-compulsion*. People who do not want bank accounts should not be compelled to have them; and banks' selection of which sections of the market to serve should be left to their commercial judgement.

(b) *Going with the grain of markets*. Public sector intervention should not restrict competition, by favouring a single service provider or inhibiting innovation and new market entry. It is important that consumer choice is promoted and, where possible, enhanced.

(c) *Cost-effective use of public funds*. Any solutions involving central or local government resources should be designed to ensure best value for taxpayers' money.

4.3 The first part of this chapter sets out the facts about people who do not have bank accounts, the problems they face and the barriers that have been identified. The second part goes on to define good practice and how it might be promoted, in order to tackle the issues that have been exposed.

Part 1: the Unbanked

4.4 There is no precise figure for the number of people who do not use banks or building societies. Different surveys give different results. Research²⁹ published by the British Bankers Association (BBA) indicates that between 6 percent and 9 percent of individuals - about 2½ to 3½ million adults - have neither a current nor a savings account, depending on the data source used; and estimates of the proportion of individuals without current accounts vary between 14.5 and 23 percent. Research³⁰ undertaken for the Office of Fair Trading (OFT) found that in 14 percent of *households*, no one had a current account.

4.5 It is not clear why these figures vary so much. Possibly the words bank or building society account, or current account, mean different things to different people. If the Government wishes to monitor the effects of its policies to combat social exclusion, including financial

²⁹ Access to Current Accounts - a Report to the British Bankers Association: Elaine Kempson and Clare Whyley, BBA August 1998

³⁰ Report on a Survey of Consumers of Financial Services by Peter Atkinson of the Office of Fair Trading (Appendix 4 of Vulnerable Consumers and Financial Services, the Report of the Director General's Inquiry, OFT January 1999)

exclusion - and assuming the proportion of people using banks and building societies is a key indicator - this will need to be resolved, if appropriate through technical amendments to the Family Resource Survey, which is the key source of data, to ensure that the survey can provide reliable measurement of trends. The subject of monitoring is covered in chapter 5.

4.6 There is less disagreement about what kinds of people are unbanked. The BBA research³¹ found that they are predominantly poor and in receipt of means-tested DSS benefits. The large majority are outside the main employment field, with the largest group being over retirement age. A significant group are young people, who have yet to get a job. The others are mostly adult unemployed, sick, disabled, or lone parent women not in work or working part-time. The majority live in social rented housing. This profile was confirmed by the survey carried out for the OFT, as part of its inquiry³².

Detriments faced by the unbanked

4.7 People without bank accounts are disadvantaged when it comes to settling their bills, handling cheques and getting access to credit. They are also more likely to be cut off from information about other financial services products, which bank customers get from branches or by mail. This issue is considered further in chapter 5.

Bill payment

4.8 People with bank accounts can choose to settle their bills by direct debit, credit transfer, standing order or budget account. Traditionally there was no bank charge for most of these services (although this may be changing); and utilities and other companies often give discounts for use of direct debit. According to DTI figures³³, average 1998 gas and electricity bills for people paying by monthly direct debit were about 9 percent lower than for prepayment meters, for a given level of consumption.

4.9 The unbanked have little option but to use less convenient and sometimes more costly methods. If they set money aside each week, keeping it in containers in the home, they face security problems. There are only limited options available for spreading the cost of annual or quarterly bills. Until recently, the number of places people could pay bills in cash - eg electricity and gas showrooms - was shrinking. However, this has been overtaken by the advent of PayPoint a network of some 7,000 agencies in ordinary shops where people can settle utilities and similar bills, for no charge, and various agreements struck between the utilities and the Post Office, which has a network of nearly 19,000 outlets where 93% of bills are accepted free of charge and an extensive range of budget and prepayment accounts are offered.

³¹ Kempson and Whyley, *op cit*

³² OFT, *op cit*

³³ quoted in the Offer and Ofgas Social Action Plan Discussion Document, May 1999

Case Study: the PayPoint bill payment network

PayPoint is a national network for customers of utility and service companies to settle their bills in cash, free of charge. It operates through about 7500 outlets, typically newsagents, neighbourhood convenience stores, supermarkets, service stations and off licences. These are all close to homes or major shopping centres, with extended opening hours, many seven days a week. It currently serves about 1 million people and takes about £600 million per annum. PayPoint deals with customers from all social groups and has established a strong presence with people in social group F, which will closely reflect the population of the 800 most deprived wards. The service is paid for by the utilities and other companies whose bills are paid through the network. Retail agents are provided with an electronic terminal to record the customer details and the amount paid; and to provide a receipt to the customer. As well as simple cash bill payments, customers can buy tokens and charge smart cards or keys to use in prepayment metering and budgeting schemes. Cheques are also accepted for selected bills. Following a successful trial in Northern Ireland, the full national launch of PayPoint took place in London in 1997 and has since been rolled out nationally. Retailers find that PayPoint is a valuable source of increased customer traffic to boost business and build loyalty. They get a commission fee on a percentage basis and they can also benefit from special offers such as lower bank charges. PayPoint believes it has the potential to expand the range of services it offers, for example through partnerships with financial services providers. It has recently reached an agreement with Co-operative Bank, which will enable people to pay council tax and rent through PayPoint outlets.

4.10 A small proportion of bill transactions (7%) at post offices attract a charge to the customer of up to 97p, from the bill issuer. If people use prepayment meters for electricity or gas, they face a higher tariff than other customers. If they settle bills with fuel companies in cash, they may incur additional charges of up to £24 a year, for fortnightly payment, or £48 for weekly, compared with paying by direct debit.

4.11 The difference between paying by the most expensive method, prepayment meters, and the least expensive, direct debit, taking gas and electricity together, averaged £78 in 1998.³⁴ For the low-income population affected, this amounts to a tax of roughly 1 percent on their household income.

4.12 Some companies specialise in handling the bill payments of households who deal in cash. They collect a regular amount from the customer's home; and, if there is insufficient in the account to pay all bills, make advances to cover payments. But the convenience of the service is likely to be reflected in the cost. For example, one bank that offers the home collection facility levies an initial joining fee and a flat rate management fee, as well as a budget deficit charge. So households having difficulty making ends meet may fall further into debt, through the burden of charges being added to the basic cost of meeting the bills.

Handling cheques

4.13 People without bank accounts may have problems when they receive crossed cheques, which can only be paid into a bank account. They may be able to arrange to have the cheque made out in the name of a relative or friend with an account, who can then give them cash. Or they might turn to a cheque cashing shop, which will typically charge a fee between 7 and 9 percent, plus a £2 handling charge. When unbanked people want to issue a cheque, they have to pay the money to a relative or friend with an account, who then issues the cheque.

³⁴ Offer and Ofgas, *op cit*

Access to short term credit

4.14 Low income households often need small amounts of credit, to smooth budgetary peaks and troughs. Although they may be able to borrow from family or friends, they may turn to moneylenders or pawnbrokers - who are very high cost compared with credit cards or bank overdrafts. Licensed moneylenders charge between 100 percent and 500 percent APR, for example, depending on the size of the loan. Unlicensed moneylenders, who thrive on high-crime estates where licensed firms will not visit, are likely to be even more expensive; and to engage in illegal practices to encourage payment, such as taking benefit books or passports as security for loans. Other sources of credit, such as mail order firms, can also be expensive, not through interest charges, but because of higher prices. The Consumer Credit Association, in its response to the public consultation, quoted an example from Littlewoods' mail order catalogue, where the price of an item to be paid over 20 weeks was 29 percent higher than the price of the same item in the same firm's Index Plus (ie cash purchase) catalogue.

Reasons for not having a current account

4.15 Office of National Statistics (ONS) Survey figures quoted in the BBA report³⁵ indicate that around a third of people without a current account have had one in the past but closed it down; the remainder have never had one at all. And for every person who has closed an account, there is another who has one but makes minimal use of it, either because they have suspended it or because the account only has limited facilities. So there is a fair amount of movement. Some people may be in and out of bank accounts several times during their lives. The surveys only record people's status and views at a single point in time (although it does ask people if they have had an account in the past).

4.16 The reasons given by people who have never had a current account divide into several distinct groups.

People who use a savings account instead. Mainly elderly people who are little integrated with financial services generally, including elderly people from some ethnic minority groups who have remained relatively unintegrated due to language differences. Often they did not need a current account when they were economically active, as they were paid in cash; so they were accustomed to managing their personal and household finances in cash. They are apparently content with the limited facilities they get with a savings account.

People who have not got round to opening an account. Mostly young people who are experiencing difficulty getting a foothold in the labour market and so have delayed applying for a current account. This is partly through lack of need, as they tended to be living at home with their parents, and partly because they do not expect to get one if they apply.

Women whose husbands have an account. Women who had never had an account in their own name tend to be those who had married young and whose husbands control and manage the household budget. These include ethnic minorities where this is the cultural norm, eg Pakistani and Bangladeshi women who were not in

³⁵ Kempson and Whyley, *op cit*

employment before marriage; also older working class women who might have worked before marriage, but were paid in cash, and have been full-time housewives since marriage; and women in violent relationships where the man controls everything in the household, including the money. Women in these situations often remained unbanked following marital breakdown or widowhood.

Preference for a cash budget. A substantial group of people have never applied for a current account, either because they prefer a cash budget or for no particular reason. They tend to be the most disengaged from personal financial services generally, living in marginalised inner city council estates, not in work and with little prospect of getting a job. Many believe they would be turned down for a current account and so had never applied for one. Often their belief is an extrapolation from the difficulties they, and others known to them, have faced getting access to credit.

Refused a current account. Compared with the numbers who think they would be refused an account, very few people - only 1 percent of those who had never had one - have actually been turned down. Past difficulty managing personal finances and other factors, such as poor employment record and low income, lead to an adverse credit score, which is the commonest reason for refusal.

4.17 The great majority of those who had a current account in the past, but do not have one now, decided to close it themselves. This happens in a range of circumstances: eg following job loss, after retirement, giving up work due to long-term sickness, giving up work to have children. Others close their accounts having overdrawn or because they fear doing so. Some say they closed their accounts because they either used a savings account or a partner's current account. In only a small number of cases was the account closed down by the bank or building society, for example because of large overdrafts the customer could not repay, or business failure.

Exclusion or self-exclusion?

4.18 The question of exclusion or self-exclusion is an over-simplification, a false dichotomy. As shown by the BBA³⁶ and other research, this is a complex issue.

4.19 Superficially, very few people have been denied access: only three per cent of those without current accounts had either applied and been refused, or had their accounts closed down by their bank or building society. Commenting on this feature, the OFT³⁷ warned that it would be wise not to underestimate the problem. Their inquiry revealed that in a 12-month period, the major banks rejected nearly a quarter of the 2.7 million account applications they received, some 650,000 cases. On the other hand, this figure overstates the problem to some extent, because it represents applications and not applicants. Letters sent to the Treasury complaining about being turned down frequently say that the applicant tried several banks or building societies; and in some cases they say that the applicant eventually got accepted after one or more refusals. So it is difficult to infer from the number of refusals how

³⁶ BBA, *op cit*

³⁷ OFT, *op cit*

many *people* are unbanked because of refusal. Further research - looking at the relationship between applicants and applications - would be needed to shed more light on this.

4.20 Lack of creditworthiness is the main reason for refusal, but it may also underlie the decisions of many of those who look as if they are self-excluded, for example those who have never applied for an account, because they have an impaired credit history, or think other factors will result in a poor credit rating. Further, some of those who say they prefer managing their affairs in cash may be concerned about the penalties they might experience from inadvertently overdrawing an account. The National Consumer Council (NCC) drew attention to this factor, in its response to the public consultation exercise. It believes that more sympathetic treatment by banks of people experiencing financial hardship could help prevent self-exclusion.

4.21 Lack of information may also be a factor constraining choices. Recent DSS research³⁸ into attitudes towards methods of paying benefits included asking for views about banks and building societies. The results included people saying they did not have accounts because of concerns about the costs, the perceived difficulties about withdrawing small sums, and worries about overdrafts and indebtedness. Yet a number of banks already offer basic accounts, used by millions of people, where these concerns should not arise. If people were better informed about what is available, fewer of them might choose to remain unbanked (although clearly other factors are also involved in voluntary exclusion). There is further discussion of the role of basic accounts later in this chapter.

Branch closures

4.22 Shrinkage of bank and building society branch networks, especially withdrawal from low income areas, has often been blamed for contributing to financial exclusion. The Banking, Insurance and Finance Union (BIFU), the Campaign for Community Banking and the Citizen Organising Foundation all emphasised this factor in their responses to the public consultation exercise. The Commission for Racial Equality pointed out that ethnic minority communities are frequently among those whose location in relatively deprived areas limits access.

4.23 The relationship between branch closures and financial exclusion is far from straightforward. Following many years of expansion, the total number of bank and building society branches peaked out in the 1980s and has been declining ever since, as the institutions sought to contain their administrative costs. BBA figures³⁹ show that, taking major British banking groups and building societies together, about one in four branches went between 1988 and 1998. But the proportion of adults with any type of account grew from 90% to 94% over the same period⁴⁰. This was a slower growth rate than in previous decades; but judging by the figures for current account ownership published by the OFT⁴¹, the increase was particularly significant for people in social classes D and E. Research into why people do not

³⁸ Attitudes Towards Methods of Paying Benefits: Andrew Thomas and Nick Pettigrew, DSS Social Research Branch, 1999

³⁹ Annual Abstract of Banking Statistics 1999

⁴⁰ APACS Yearbook of Payment Statistics 1999

⁴¹ OFT, *op cit*

have bank accounts⁴² indicates that only a tiny percentage say it is because of the lack of a nearby bank branch; the BBA suggests under 1 percent of those without a current account.

4.24 The reasons for this asymmetry are far from clear, although some factors can be identified. The banks and building societies that reduced their networks tended to concentrate their customers at branches in major commercial centres. Given bank opening hours, people who are economically active are less likely to favour branches near where they live, as distinct from near where they work or do their shopping. There has also been a huge expansion of Automated Teller Machines (ATMs) at non-branch locations, although typically, until relatively recently, these tended to be located in major shopping and commercial centres, as well as places people pass through on their way to work, such as railway and bus stations. The proportion of adults using ATMs rose from 46% in 1990 to 65% in 1998⁴³. Other delivery channels, alternatives to branch access, have also developed, such as cashback with debit cards purchases and telephone banking.

4.25 Nevertheless, whilst the number of people without bank accounts has fallen, it is possible that the divide between those with and those without has deepened, to the extent that the shrinkage of branch networks has made it harder to access mainstream services. For the sort of people likely to be unbanked, especially those living in the most deprived neighbourhoods, the delivery channel developments outlined above have probably had only a limited impact. As most of them are jobless, bank branches and ATMs in commercial centres near where most people work, or on travel to work routes, may be irrelevant. And if they have local shops, they may well prefer to use them, rather than travel to the major shopping centres where banking facilities might be found.

4.26 The Post Office's extensive network is frequently used by some of the most vulnerable sectors of society to access financial services. The Post Office currently provides services on behalf of a number of banks (as described later in this chapter) and also offers National Savings products.

4.27 PAT 13, which dealt with shops, found that where there were shops in deprived neighbourhoods, their offering was often poor, but people shopped there because they could not access major shopping centres, for example because of low car ownership and poor public transport. Moreover, shops in deprived neighbourhoods, other than those in chains such as off-licences and supermarkets, are less likely to accept debit cards than those in more prosperous areas. The charges, which the shopkeeper has to absorb or pass on in higher prices, might also be a deterrent to those operating on tight margins. Lastly, if people have not got bank accounts, they cannot get cash back at shops that accept debit cards, wherever they shop.

4.28 The complexity of the relationship between branch withdrawal and financial exclusion points to a need for further research. The BBA, in collaboration with the Campaign for Community Banking, has launched a project, to investigate how people cope in areas where

⁴² Kempson and Whyley, *op cit*

⁴³ APACS Yearbook of Payment Statistics 1999

bank branches have closed; and to evaluate the range of options available to banks and building societies seeking to maintain services for the people affected. The research was still in progress at the time this report was completed.

Identity requirements

4.29 Failure to provide acceptable proof of identity can lead to people being refused a bank or building society account. Under the Money Laundering Regulations, financial institutions are required to take reasonable steps to satisfy themselves as to customers' identity. This is an important and necessary guard against the threat from money launderers, and a requirement in EU law. In order to meet this requirement, banks generally require two pieces of documentary evidence, sometimes more.

4.30 More than once in the regional discussion forums, people said that the practical implementation of these arrangements inhibited access to banking for low-income groups. The Homeless Network, the Refugee Council and St Mungo's Housing Association made this point in their responses to our consultation exercise.

4.31 Complaints received by the Treasury on this matter (see the box on the following page) suggest that the problem lies in the practical application of the regulations - rather than the regulations themselves. Frequently people get the impression from their banks that the Money Laundering Regulations require people applying for bank or building society accounts to have a UK passport and a driving licence, which automatically excludes a lot of those presently unbanked. This is a misunderstanding. The regulations require banks to satisfy themselves as to the identity and address of prospective customers. But they do not stipulate which documents would be acceptable. There is a wide range of methods people can use to establish their identity, and many banks and building societies do implement the Money Laundering Regulations effectively while continuing to offer services to the most socially excluded people. But in some instances the flexibility inherent in the regulations is not being applied sensibly.

Case study: complaints about requirements for identity documents

"I have sold my house and the proceeds of the balance was divided between my ex-husband and myself: £21,830.65p. So I thought I would open an account at the bank with said cheque. But to no avail, as the questions they asked are: have I a driver's licence and a valid passport, also a bank account. The simple answer to these questions is no-no-no. First, I cannot drive, hence no driver's licence. Second, no up to date passport; for years now I have not been able to afford any sort of holiday, least of all going abroad. Third, no bank account, for the simple reason I have not had enough money to have a bank account. So I am told by the banks they will not accept my cheque. It seems, at this moment of time, my cheque is not worth the paper it is printed on. I ask you, is this Great Britain, or has the country gone completely mad?" *letter to MP forwarded to the Treasury.*

"I am a resident of the UK and have been living in Australia for the last 8 years. On returning to the UK, the problems began when I tried to open a bank account. I have been to every high street bank and building society just to suffer the same autocratic response. "Sorry you need proof of address in the form of a utilities bill. I have tried to explain that I have just arrived in this country and am renting a room from a private landlord, therefore I do not receive or pay any bills. As far as the banks are concerned there is nothing they can do for me." *letter to the Treasury.*

"I called at your branch yesterday with a friend who wished to open an account. The manager, after consultation, refused to open the account, as my friend, who is from D.R.Congo, has refugee documents but no passport. The bank's policy of refusing to open an account on these grounds, seems to me outrageous, and to further complicate the lives of refugees. I also question the legality of the policy as it will weigh much more heavily on nationals of some countries than others and may, therefore, involve racial discrimination". *letter to a bank manager, copied to the Treasury by the complainant's MP.*

"My particular concern is brought about by our desire to open accounts in joint names. To do this, we are told, we must provide for each name separately, verification of address by submitting original documents from a fixed list. This list is restricted to bills from utilities or the local authority, Inland Revenue Notice of Coding, or a statement from a credit card provider or bank or building society. Two such items (per person) are required. I am sure that we are not alone in dividing our domestic duties in such a way that one of us takes responsibility for financial matters. In our case all bills are addressed to me, our two credit cards happen to be assigned to me and only I receive annual Notices of Coding. On this ruling, therefore, if applied consistently by all financial institutions, my wife, and many thousands like her, is permanently debarred from opening future accounts, and, consequently, we are debarred from opening any future joint account." *constituent complaint referred to the Treasury by MP.*

Building societies and carpetbaggers

4.33 The BSA considers that building societies have a particular problem in relation to financial exclusion, because of carpetbaggers - people who place deposits with building societies in the hope that they will get substantial bonuses in the event of the society converting to a plc. Individual societies have sought to deter these people, by introducing high minimum deposits to open accounts. This has the effect of inhibiting access by low-income customers seeking savings-based accounts, to whom, traditionally, building societies offered facilities for even very small initial deposits. At one time the building societies dealt with the problem by offering low deposit accounts without voting rights; but the Government ruled these out in the Building Societies Act 1997. The building societies want the

Government to introduce further legislation, to deal with the underlying pressure for them to convert in other ways. In the meantime, people seeking to open small savings accounts have fewer options than previously. Some building societies seem to have overcome the difficulty, by asking customers to sign away their rights to any conversion bonus.

Part 2: Solutions

4.34 The concept of a basic account is not new. It was identified in the OFT report⁴⁴ as the way forward; and has become sufficiently well-known that in our regional discussion forums there was considerable interest expressed in it. This was echoed in the responses to the public consultation.

4.35 The essential feature of a basic account that would help the unbanked is the impossibility of the user getting an unauthorised overdraft. This is done by replacing the chequebook, the traditional feature of a bank current account, with an on-line debit card facility. The network of terminals through which the card is used - ATMs and tills in shops - is organised so that transactions not backed by sufficient funds (or an *agreed* overdraft or buffer facility) are refused. If the issuing bank or building society can eliminate credit risk through this feature, then it need not turn people away when their previous credit history or present circumstances show them to be uncreditworthy. Moreover, individuals can have the confidence to use a bank account without fear of incurring charges.

4.36 Many UK banks already offer basic or entry level accounts of this type; and several million customers benefit from the facilities. Until recently the main target group in banks' marketing plans was young people. Banks do not allow credit to under-18s, because repayment is not legally enforceable, so ordinary current accounts are not suitable for them. But the on-line debit card account gives them current account facilities without the bank incurring credit risk.

4.37 Several banks (including Abbey National, Bank of Scotland, Halifax and Woolwich) now offer basic bank accounts to adults who might be refused traditional current account facilities because of credit scoring. Others (including Barclays and NatWest) are planning to do so shortly. This development should make a substantial contribution to the elimination of financial exclusion.

4.38 But some banks see snags. They say some shops (including major national chains) have difficulties with all debit card transactions being authorised (instead of just high value ones, as with conventional debit cards) because this will increase the incidence of card refusal, which can lead to unpleasantness for shop staff. Some banks also say that the current state of technology does not eliminate all risk of an unauthorised overdraft, because there are times of the day when the system has to update itself, when transactions might be cleared that at other times of the day might not be, so leading to inadvertent overdrafts. Finally, some banks have doubts about whether basic accounts can be profitable, as low-income customers are unlikely to maintain substantial balances (from which banks lend to others, to generate net interest income) or to buy other services for which fees and charges are chargeable.

⁴⁴ OFT, *op cit*

4.39 These are no doubt real concerns, but three observations are in order. First, on the viability and profit potential of the product, the banks that do have faith in the potential of on-line debit cards to provide the backbone of a basic account seem to be in the majority. Second, some of the technical doubts were raised about ordinary debit cards when they were first introduced just over ten years ago, since when they have been hugely successful - and acceptable to all shop chains. Third, while customers may be unprofitable at the time they open an account, it is possible that they, or their children, will become so at a later date. In that case, it is to a bank's advantage to have already secured their custom.

The features of a basic account

4.40 To be useful to low income groups, basic accounts would need to offer the following core features:

- income (including benefit payments) paid in by Automated Credit Transfer (ACT)
- cheques and cash paid in by the account holder
- cash out at convenient access points
- bill payment by direct debit, credit transfer or budget account, linked to the account
- no cost to the customer for everyday transactions.
- no risk of unauthorised overdraft.

The following are desirable additional features:

- debit card for shop purchases
- modest *agreed* buffer zone facility, ie free overdraft for a small amount and limited duration, so that, for example, people can withdraw cash from an ATM, even if they have less than £10 in their account.

4.41 There is a potential conflict between prescribing the core features of a basic account and consumer choice. Whilst many potential bank customers might be perfectly content with a standard product, others might prefer something more *or less* elaborate. Moreover, some banks might prefer to compete by offering additional features, whilst others could offer a simpler service. The potential role for an unbundled money transmission scheme, offering basic account facilities outside a bank account package, is discussed later on in this chapter.

Alternative delivery channels

4.42 The shrinkage of bank and building society branch networks, which is probably irreversible, means that alternative delivery channels are going to be increasingly important.

These can be divided into delivery points provided by the banks and building societies themselves, and facilities provided by others. These lists are far from exhaustive.

Banks and building societies own facilities include

- remote ATMs
- telephone banking
- personal computer banking
- kiosks, combining ATM and other services
- mobile bank vehicles.

Facilities provided by others include

- cashback at shops accepting debit cards
- Post Office partnerships with banks
- supermarket partnerships with banks, with a range of facilities on their premises
- PayPoint agencies for settling bills.

4.43 The expansion of the ATM network is proceeding apace. The total number of ATMs has virtually doubled over the last ten years and the proportion located away from bank branches has increased from under 10 percent to nearly a quarter. The economics of delivering cash through ATMs indicate that the momentum is likely to increase. Roughly speaking the cost of a withdrawal at an ATM is about one-tenth of the cost of cashing a cheque over a bank counter. The differential is set to increase, as the cost of the technology comes down. And the new smaller types of machine available can be put conveniently into a wider range of locations. There may be a downside for the socially disadvantaged, however, in the growing practice of charging customers of banks other than the provider for using ATMs.

4.44 Which of the other delivery channels would be of particular use to deprived areas, or low-income groups in general is an open question, that is currently being researched for the BBA and the Campaign for Community Banking. Some alternative delivery channels are already well-established (eg provision of financial services at post offices); others are in their infancy. Some might be of limited usefulness. For example a substantial minority of low-income households do not have a telephone; and deprived areas often lack public phone boxes or suffer from vandalism of what is there. So telephone banking cannot be the solution for everybody, although, since the majority of low-income households do have a telephone, it might be useful for some. Again, only a small minority of low-income households are likely to have a personal computer; but disabled and housebound people in remote and deprived areas do use them, including for banking. So these delivery channels can make a difference.

4.45 The public consultation and regional discussion forums revealed innovation by banks, building societies and other organisations, bringing banking facilities closer to people in deprived neighbourhoods. These are but examples; there is no doubt that other banks, credit unions and local authorities are doing similar things.

- Bank of Scotland is placing ATMs in convenience stores on council housing estates;
- Post Office provides cheque cashing and paying-in facilities to customers of Coop Bank, Alliance & Leicester and Lloyds TSB;
- Speke Credit Union arranges for its members to pay their bills through its bank;
- Newcastle City Council collects its tenants' bill payments with their rent, through PayPoint;
- Coop Bank is placing ATMs in Coop shops.

4.46 These initiatives are to be welcomed, in particular those that make use of the opportunities offered by developing payment systems technology. But it would be mistaken to endorse any of them to the exclusion of others, not least because there has not been the opportunity to evaluate them. That is for their originators and users to do. In general, however, the more varied the delivery channels available, the greater the consumer choice, hence the greater benefit. So there is no single solution.

Automated benefit payment

4.47 The Government's decision on the future system for paying benefits and the automation of the post office network, announced in May 1999, should have a significant effect on the use of banking facilities by low income groups. The first element of the strategy is the computerisation of the post office network, which will enable Post Office Counters to develop network banking and "Modern Government" services. The second element is that from 2003 to 2005, the Benefits Agency will move progressively from traditional paper-based methods to a more modern and efficient way of paying benefits using the existing automated credit transfer system to make benefit payments into bank or building society accounts. This is expected to increase the demand for basic accounts for those benefit recipients who currently do not have one. The Government's intention to maintain access to benefits at post offices will be met by POCL ensuring account holders can access their bank accounts there, as well as other access points.

4.48 The Post Office Counters network has a number of characteristics which make it uniquely well placed to play an important role in the provision of services to the financially excluded. Its network of nearly 19,000 offices (which are frequently co-located with a neighbourhood shop) has a valuable reach into urban deprived areas and it is clearly widely used and trusted by the target groups through the provision of benefit payment encashment services, bill payment and other banking services - on behalf of Alliance and Leicester, Co-Op bank and Lloyds TSB. 28 million customers (half the UK population) make 45 million visits to post offices every week, with some of the most vulnerable (older, poorer, female) making the most frequent visits. 95% of the UK population live within a mile of a post office and 78% of people in social classes C2,D and E live within half a mile (compared to 45% living within half a mile of a bank or building society).

4.49 As part of the agreed strategy, and as endorsed in the White Paper on Post Office Reform, POCL intends to build on the Government's decision to automate the post office network using the Horizon platform to further develop its existing relationships with the banking industry to enable it to offer financial services to customers on behalf of a wider range of banks and building societies. POCL will be working over the coming months to decide how best to develop the technology and the commercial relationships they need, in order to be in a position by 2003 to provide appropriate services to benefit recipients and others, and taking into account advances in the technology and commercial developments in the banking sector. They will be working closely with DSS/BA; and they will be exploring together, for those people who do not currently have a suitable bank account and who do not wish to have one, what other options there are for ensuring that they can get their benefit payments at post offices and other outlets.

4.50 The Treasury's Banking Review Team (the officials supporting Mr D Cruickshank's review of efficiency, competition and innovation in the banking industry) have suggested that a simple money transmission facility could be one way of meeting this objective. The key elements would be: (a) a plastic card, for use in ATM machines or to get cash at shop tills that accept debit cards; and (b) if necessary, Government purchase of the delivery to ATMs or shop tills of cash for benefit payment, building on existing ACT systems; including the missing parts of an ATM or cash back network that would meet the convenience requirements. Both the ATMs or shop tills could be in post offices. The basic money transmission service could be provided by non-banks as well as the banks themselves. This could provide a cost-

effective delivery channel for benefit payments for the unbanked, whilst meeting claimants' service needs and preferences (including the ability to collect benefits in cash at post offices); the Government's commitment to maintenance of a nationwide network of post offices; and the move to benefit payment by ACT as the normal method of payment from 2003 to 2005.

Access to credit

4.51 People in low income households need practical alternatives to expensive credit facilities; and they often need better advice on how to avoid, as well as escape from indebtedness. But they might not be able to repay loans on ordinary commercial terms; and mainstream providers would not therefore be willing to extend them credit. Low income households on tight budgets can ill afford the burden of servicing loans; and the risk of default is high. Unsustainable loans are not in the interest of lenders or borrowers.

4.52 It seems that many poor people neither need nor desire loans. The recent Joseph Rowntree report on financial exclusion⁴⁵, for example, mentions a "good deal of resistance" to the use of credit. But others do need occasional credit, to smooth peaks and troughs in household budgets, or for special purchases. It is important that people in these circumstances are not forced, through lack of choice, into the arms of expensive moneylenders. It is also desirable that, where this happens, rescue is possible.

4.53 In the public discussion forums and the formal consultation, there were several demands for tighter controls on moneylenders. Currently, DTI are reviewing the law on extortionate lending. The Consumer Credit Act provides court remedies for exorbitant interest rates or unfair trading, ie oppressive or exploitative terms. But consumers are reluctant to complain. An OFT report in 1991⁴⁶ recommended a change in the law, but this foundered on disagreements about what constituted excessive interest rates. The DTI remains concerned that the Consumer Credit Act does not adequately safeguard vulnerable consumers and has commissioned research into the problem. This will establish whether extortionate credit is a significant problem, who is at risk and what might be done to protect them. The legislation will then be reviewed, in the light of the findings. The OFT's responsibilities under the Consumer Credit Act have also led it to review the practices of firms who specialise in lending to people with poor credit ratings⁴⁷ and to issue guidelines; and it is currently reviewing credit scoring practice. All these initiatives should be beneficial to disadvantaged sections of the community.

4.54 Access to affordable one-off loans might be through any of the following:

- limited agreed overdrafts linked to basic bank accounts
- graduation from basic bank accounts to ordinary loan and credit card facilities
- mainstream lenders buying out debts with other providers
- loans secured by the borrower's savings
- loan guarantees eg by housing associations

⁴⁵ Understanding and Combating Financial Exclusion: Elaine Kempson and Claire Whyley, Policy Press, December 1998

⁴⁶ Unjust Credit Transactions, a report by the Director-General of Fair Trading on the provisions of sections 137-140 of the Consumer Credit Act 1974: OFT, September 1991

⁴⁷ Non-status Lending, Guidelines for lenders and brokers: OFT, July 1997

- informal savings and loans clubs
- credit unions
- the Social Fund.

Case Study New Horizons Saving and Loan Scheme

Cambridge Housing Society is a 70-year old registered housing association with charitable status, which has launched an innovative saving and loan scheme in conjunction with Cambridge Building Society. The aim is to give the housing association tenants access to competitively priced loans and to encourage regular savings which will attract enhanced rates of interest. New Horizons is not a credit union and was considerably simpler to establish. The housing association has deposited a lump sum with the building society to act as a guarantee fund. This attracts a standard interest. All the housing associations, their partners and their children are eligible to open a savings account through the scheme, with the money being deposited with the building society. There is no requirement for a minimum opening balance. The overall effect is a sort of joint account, with individual savers obtaining the benefits of an enhanced savings interest rate. This is because all the savings are aggregated with the lump sum guarantee fund for the purposes of calculating the tiered interest rate due. Tenants with amounts saved are able to apply for a loan, as a multiple of their savings up to a specified maximum amount. Individual borrowers will have no need to offer any security, and there are no additional credit checks. The building society will be making loans direct to tenants, secure in the knowledge that the guarantee fund is available in event of any default on loan repayments. For a trial period the scheme is to offer a small loan facility of £150 to members, even if they have no savings in their account. The aim is to meet a key need, which has come out of research, which is that people require immediate access to a small loan facility to meet unforeseen crisis expenditure. The interest rate differential between the saving and loan rates makes a contribution to the administrative cost of running the scheme, apportioned between the housing association and the building society. The rates of interest have been set to maintain exemption from the requirements of the Consumer Credit Act. This form of partnership is capable of being replicated between registered social landlords and banks or building societies everywhere.

4.55 Apart from credit unions (see chapter 2) it has not been possible to investigate the extent to which those who are currently financially excluded might realistically have access to affordable credit facilities, or how that access might be improved. This presents something of a dilemma, in terms of identifying the extent of any possible market failure. The key question is whether products are not being supplied that it might be economically viable to provide. To the extent that it might be economic, then in principle a market based solution is possible. But if the product needed is fundamentally uneconomic, then pure market solutions are not possible. If market solutions are not possible, then public sector intervention might be justified. In this context, it seems likely that the circumstances of at least some financially excluded people will always be a barrier to their getting access to affordable credit.

Social Fund

4.56 The Social Fund is administered by the DSS and offers an alternative to commercially-provided credit for people with low incomes. Such an arrangement is needed because means-tested benefits are not intended to be sufficient to cover occasional large expenses, such as replacing broken household appliances or buying a larger bed for a growing child.

4.57 The current scheme dates back to 1988, when it replaced single payments under the Supplementary Benefits scheme with a mixture of non-discretionary payments and discretionary grants and loans. It made 935,000 budgeting loans in 1998/99, averaging £368,

to people on Income Support, repaid by deductions from benefits at source. The Social Fund also made 866,000 crisis loans over that period, average award size £68. The total amount of money available is capped, at local as well as national level. Revised application procedures have recently been introduced, aimed at introducing more transparency and certainty into the decision process.

4.58 Take up of budgeting loans is low among certain groups, in particular pensioners. Perhaps because of the social stigma and perhaps also because their benefit rates are higher, their attitude to credit is different and they are less likely to experience the events that prompt applications. The lack of repayment holidays for Social Fund borrowers might also be a deterrent. Access is further limited because eligibility for budgeting loans is confined to those on Income Support or Job Seekers Allowance (Income Based). For example when people come off these benefits on taking up work, they lose eligibility for budgeting loans, but may not be able to get or afford loans from mainstream providers. On the other hand, this group will have access to crisis loans.

4.59 DSS should consider the scope for further reform of the Social Fund, to overcome its current limitations and reach a wider segment of the population. A private sector partnership - or even some form of privatisation - might be considered, albeit probably with some continuing input from public funds. But any reformed scheme would have to conserve the key strengths of the Social Fund, which include:

- repayment through deductions from benefit at source (or by direct debit or standing order out of a bank account, if the scheme is extended to people in work)
- high recovery rate (currently around 90% of the loans budget)
- availability of loans to those who would never qualify for credit on commercial criteria, eg under 18s, adults with impaired credit histories
- repayment terms that are affordable to those on the lowest incomes.

4.60 There is a special need for help with debts when people move off benefits into work. They lose their entitlement to help from the Social Fund; and their commercial creditors withdraw any forbearance, and expect full repayments to resume as well as additional regular payments off the arrears, that are not always within their means to pay. For many indebted people, the overall effect could well be a disincentive to seeking employment.

4.61 One way of remedying this situation might involve extension of Social Fund facilities to those in lower-paid employment, as well as wider access to debt counselling and refinancing, targeted at those coming off benefit to take up employment. Extending Social Fund facilities might necessitate legislative change; and effective help to those in debt could involve the DSS working with money advice agencies and bank or other private sector finance. It will also have to work closely with the Employment Service, which is already involved in identifying candidates for money advice, including debt counselling - see Chapter 5.

Conclusion: the promotion of practical solutions

4.62 As already indicated, quite a lot is already happening that should have the effect of increasing access to banking facilities for deprived neighbourhoods and poor people in general. The development of the basic account and the spread of alternative access channels bode well for people in deprived neighbourhoods. There are some interesting partnerships between banks and community organisations, for the delivery of banking services capable of

emulation by others. The Government's decisions on the future payment of benefits should also make a considerable difference to the use of banking facilities by low-income groups. All this is to be welcomed.

4.63 A number of people who came to the regional discussion forums and some of the organisations that contributed to the formal consultation were in favour of some kind of obligation on banks to provide services to all sections of the community. But the case for doing this is weak. Over the years, banking has reached ever greater proportions of society, without compulsion; and there is no reason to suppose this process has suddenly come to a halt. Indeed, given the opportunities which technology has opened up, plus the likely effects of the planned change in benefit payments, there is every reason to suppose that it might accelerate. Moreover, it is difficult to conceive how a universal service obligation could realistically be imposed on institutions that have deliberately concentrated on particular geographical areas, for example traditional building societies or the Scottish banks; or specialised in certain types of business, such as investment banking or private banking. The purpose of banking supervision is to ensure banks are run prudently, in order to protect the people who have deposited money with them. Obligations that push that supervision in other directions would undermine this objective.

Informing customers

4.64 Putting aside the suggestion of a universal service obligation, however, does not mean that there is nothing that could be done to make existing good practice more widespread. For example, provision of information to potential customers about available services should help overcome some of the barriers of misunderstanding reflected in the research on why people choose not to have bank accounts. This is considered further in chapter 5, in the section on financial education and money advice. Clearly, the Financial Services Authority faces a considerable challenge, in the fulfilment of its new public awareness objective.

4.65 Banks and building societies themselves must take the major responsibility for telling the public, whether actual or potential customers, about the services they offer. Advertisements, mail shots, literature in branches, staff answers to queries, all play a part. Clarity and accuracy are clearly of the essence, as well as proper transparency regarding costs. The suggestion came up at one of the regional discussion forums that banks should do more to ensure that money advice centres have complete information on local availability of services. If banking is to reach those deprived communities more effectively, they will need to consider not only the quality of the information they offer potential customers, but also appropriate delivery channels. So it would be helpful if banks and building societies could include money advice centres in their mailing lists for informing people about products or services.

Finding out about underserved markets

4.66 Market research is primarily for individual banks and other service providers. Improved access to services, particularly in deprived neighbourhoods, will require innovative approaches to product design, to suit people who have an aversion for traditional bank accounts; and innovative approaches to service delivery, including through non-bank organisations. Trade associations can play a very positive role in this process. For example the BBA's research projects, on why people do not have bank accounts and alternatives to traditional bank branches, could be useful in raising awareness of the opportunities. Trade

associations can also help bring people together at conferences, for example the BSA's recent initiative to promote links between housing associations and building societies.

4.67 Government departments can also play a part, through research. Various pieces of work commissioned by the DSS and the OFT's inquiries over the years have done much not only to raise the tone of the debate about financial exclusion, but also to give potential service providers accurate information about the markets they might aim to serve. It is important that all the departments concerned with financial exclusion in deprived neighbourhoods allocate resources to appropriate research. For example, the DETR might consider finding out more about the extent and nature of financial exclusion in *deprived areas*, in order to construct a baseline for monitoring progress. (At present the available information is mostly about unbanked people in general. It seems highly likely that the problems are more intense in the most deprived areas, but there is little hard information.) DSS should consider finding out more about the movement of people in and out of bank account usage; this will be important in the context of encouraging benefit payments into bank accounts in future, so it should be given a high priority during the next two years.

Removal of barriers

4.68 The principal barriers to use of banking services that have been identified are:

- unbanked people's fears or suspicions leading to their not wanting to have a bank account
- impaired credit history leading to actual or potential rejection by banks of applications by the unbanked
- misunderstanding of what are acceptable identity documents
- need for effective alternatives to traditional branches in deprived neighbourhoods.

The removal of these barriers is to some extent already in progress. But there is still some way to go before anything resembling equal access could be claimed.

Fears and suspicions

4.69 Remedying the gap in public perception of the usefulness of banking services is to some extent a question of financial education. In its work to promote public understanding of the financial system, the FSA should give due weight to the need to help those who do not use banking services overcome the fears and suspicions so many of them apparently experience. It might consider commissioning research, in its next planning cycle, to go more deeply into the reasons for these negative perceptions.

Overcoming the credit history barrier

4.70 In principle, the credit history barrier can be surmounted by the availability of basic accounts that allow no access to unauthorised credit. The scepticism of some banks on this point may indicate a need for further work to develop modern payment technology for the benefit of a wide variety of customers. In the context of the Government's plans for automation of benefit payments, it may be that some people may be unwilling to open a bank or building society account. Further, if the banks cannot fully overcome the problems over basic accounts some predict, then some people might remain unbankable. For these reasons, an alternative payment transmission system, not through individual bank accounts, could well be

necessary. The DSS, in its forward planning for automated payments, should investigate fully both the possible need for such an approach, and the possibility that it could be a more cost-effective solution than reliance on basic bank accounts, accessible through post offices; they should aim to set this in motion as a matter of priority, within the next year.

The identity documents problem

4.71 There has been considerable progress tackling the problem of customer identity checks, since it was first raised during the early part of the team's work. There is now broad agreement between the industry associations, the Treasury, the FSA and the other organisations concerned on the need to tackle public misperceptions of what is required; and for banks and building societies to adopt an approach that does not unwittingly lead to financial exclusion. To build on this consensus, the following should be capable of delivery by the end of 1999:

(i) the guidance issued by the Joint Money Laundering Steering Group should be revised, following discussion with Government representatives and the FSA, to cover in more detail than at present ways in which customers without standard documentation can still establish their identity and qualify for bank accounts;

(ii) the industry associations should draw their members' attention to this flexibility and emphasise that no-one without standard documentation applying for an account should be rejected without the account-holding institution giving them a further opportunity to establish their identity adequately;

(iii) the Joint Money Laundering Steering Group should work with the Government to produce a leaflet for the public to explain provisions to combat money laundering including customer identity procedures, and explaining the flexibility allowed.

Promoting alternative delivery channels

4.72 The Government's decision to promote systems for automated benefit payments should ensure that access is maintained in deprived areas, but this need not and, in our view, should not be the only solution to be developed, not least because not all deprived neighbourhoods have post offices and not everybody wants to use them to get their money. Promotion of alternative delivery channels is primarily for banks and building societies themselves to consider. However, local authorities may have a useful catalytic role to play, for example arranging for ATMs on public premises, visits by mobile bank vehicles, or arranging premises for part time use by a variety of service providers. The options need to be explored, both at national level, to establish the limits of local authorities' powers in this regard, and at local level, to establish what is needed and how it might be supplied. It is recommended that DETR, the Local Government Association and the industry organisations start work on appropriate guidance to local authorities on the promotion of delivery channels for banking services, drawing on existing good practice, where it can be identified, aiming to get the guidance in place within the next year. At local level, one or more of the NDC pathfinder partnerships might explore the scope for a pilot scheme. DETR needs to ensure this is taken forward in the current round of discussions between the PATs and the NDCs. Finally, under

this heading, social housing providers should consider the scope for emulating the Cambridge Housing Society's partnership with the Cambridge Building Society.

Recommendations

- 1 Banks, building societies and other providers should continue to develop and promote basic account services, in the light of the Government's announcement on the future benefit payment system and the future of post office counter services. (ongoing in preparation for 2003)
- 2 DSS should include a range of options, such as a simple money transmission system, in its consideration of cost-effective delivery channels to provide the encashment of benefits for the unbanked; whilst meeting claimants' service needs and preferences (including the ability to collect benefits in cash at post offices); and the Government's commitment to maintenance of a nationwide network of post offices and the move to benefit payment by ACT as the normal method of payment from 2003-2005.
- 3 DSS should continue to monitor benefit recipients' take up of ACT payment.
- 4 DSS and Treasury should consult with those responsible for relevant surveys and assess the reasons for differing estimates of the use of bank facilities; and agree on any appropriate refinements to the Family Resources Survey and identify any other steps which would help secure more accurate monitoring of key aspects. (within the next year)
- 5 DSS should consider exploiting the Family Resources Survey, so as to be able to compare results for deprived areas, on use of banking services, with those for the rest of the country.
- 6 DSS should explore the scope for further reform of the Social Fund, to extend existing loan facilities to those in low-paid employment. It should also consider with DfEE how to promote wider access to debt counselling and refinancing, targeted at those coming off benefit to take up employment. The aim would be to involve money advice agencies, private sector finance and the Employment Service in any new arrangements. (by the end of 2000)
- 7 The industry associations should work with the Government, the FSA, the police and other organisations, to revise guidance on identity requirements, draw their members' attention to the scope for flexibility and issue an information leaflet for the public. (by the end of 1999)
- 8 DETR, the Local Government Association and the industry organisations should work on appropriate guidance to local authorities on the promotion of delivery channels for banking services, drawing on existing good practice. (within the next year)
- 9 NDC partnerships should consider the scope for pilot schemes involving promotion of delivery channels for banking services in their areas. (during the Autumn)
- 10 Social housing providers should consider the scope for emulating the Cambridge Housing Society's savings and loan scheme, in partnership with banks or building societies.

CHAPTER 5: CROSS CUTTING ISSUES

Consumer confidence and the role of the regulatory authorities

5.1 Lack of consumer confidence in financial institutions can be a significant factor affecting self-exclusion decisions by people in low-income groups. The responsibility to promote confidence is primarily for the providers themselves, at industry level as well as individual firms. Financial education and information from reliable independent agencies should make a difference, although it will take time to counteract existing suspicion and hostility among the adult population. Public perceptions are also affected by the media, to the extent that bad news stories, tend to get given more prominence than good. Again, this is for the industry to tackle, although the FSA's financial education role is also relevant.

5.2 The regulators are primarily concerned to protect the public from the consequences of financial institutions being imprudently or improperly managed, or from poor advice or lack of clear information. But there is a risk of rules intended to protect the generality of consumers having the unintended effect of inhibiting access by low income groups. The FSA needs to guard against that risk, whilst not, of course prejudicing discharge of its formal regulatory responsibilities. Having said that, it needs to be pointed out that, apart from life assurance, there are at present few if any regulatory rules on product design or delivery channels for the sectors discussed in the body of this report. Moreover, the FSA will be precluded by the Financial Services and Markets Bill Scope Order from undertaking conduct of business regulation of banking and general insurance products, for example.

Financial education and money advice

5.3 Better understanding of banks and other financial services enables people to make informed choices, so helping to break self-exclusion barriers, and increases the chances of their successfully managing the products they acquire. People's needs for information and advice on financial services occur at different times of their lives; and disadvantaged people are likely to have exceptional needs, requiring special attention. This goes back to financial education in schools; and money advice sought at turning points in people's lives (for example when entering the labour market or re-entering it after a break) or for social and cultural reasons. Yet the existing availability of money advice is patchy. Whilst the FSA is developing its consumer information and education role, there are limits on what it can do.

5.4 In the Financial Services and Markets Bill, one of the four statutory objectives for the FSA is public awareness, which is defined as promoting public understanding of the financial system. The Bill goes on to say that this includes (a) promoting awareness of the benefits and risks associated with different kinds of investment or other financial dealing, and (b) the provision of appropriate information and advice. The FSA published a strategy document⁴⁸ in May 1999, in which it defined its role within consumer education. Under this strategy, it is to develop educational programmes and the provision of generic information and advice on financial services. On the adult education front, the FSA is researching where people go for advice and information at present; and is developing short modular courses on financial literacy for use in adult education or with other partners.

⁴⁸ Consumer Education: a strategy for promoting public understanding of the financial system - FSA May 1999

5.5 At community level, there are money advice agencies to which people typically turn when they are in financial difficulty. Government involvement in this area includes DTI support for the National Association of Citizens' Advice Bureaux. CABs at local level are supported by individual local authorities and other funders on a discretionary basis. The conventional view seems to be that these services are good in some places, but the overall service is patchy.

5.6 The financial services industry supports money advice services through the Money Advice Trust, which funds the provision of free advice at local level. Debt rescheduling advice is also provided by the Consumer Credit Counselling Service, where the creditor pays for the advice on a case-by-case basis; and various organisations that require the debtor to pay.

5.7 The Money Advice Trust is currently planning to develop its activities, to improve accessibility to free high quality independent advice. It is seeking the backing of all the industry associations concerned with the provision of consumer credit, to build a national infrastructure. This will take the form of a network of approved advisers that the public will be able to reach through a national money advice telephone call centre, as well as CABs. This initiative should help remedy the patchiness of existing provision, and be of direct use to poor people in deprived areas.

5.8 The Lord Chancellor's Department is seeking to improve money advice as part of its development of the Community Legal Service. It will do this by providing a framework for local partnerships - Community Legal Service Partnerships - to plan and coordinate the provision of advice services. These partnerships will bring together the local authority, the Legal Services Commission (which is to succeed the Legal Aid Board) and other local funders and providers of advice services, including money advice. Development is underway in fifty local authority areas in England and Wales, which are preparing best practice guidelines in preparation for roll-out to the rest of England and Wales early in 2000. The Lord Chancellor's Department is also developing common quality standards for all the providers participating in the partnerships.

5.9 The DfEE and DSS have been considering how best the Employment Service and relevant DSS services can signpost sources of advice and guidance on aspects of financial management such as pensions and making work pay. The Employment Service and DSS New Deal personal advisers are already able to make calculations of the effects of being in-work on an individual's financial situation. Further, the New Deal for young unemployed people already allows support to debt counselling. These are valuable contributions to raising awareness of the importance of financial services among the target group, especially given the close relationship between use of financial services and being in employment. Further developments of a similar nature could clearly make a difference, for example if DfEE were able to take steps to ensure personal advisers in its employment programmes are equipped to tell the people with whom they deal how to get generic advice on use of financial services, as well as debt counselling, for example in cases where poor handling of personal finances seems to have relevant to employment history.

Ethnic minority issues

5.10 There is disproportionately high representation of ethnic minorities among those making little or no use of mainstream financial services, especially the Bangladeshi, Pakistani and Afro-Caribbean communities.

5.11 But there are important differences, both between ethnic minority communities and between their experience and that of the majority. Research on financial exclusion⁴⁹ indicates that, putting aside the effect of factors other than ethnicity, Bangladeshi and Pakistani communities and recent refugees seem to be the least inclined to use mainstream institutions because of language, culture and knowledge barriers, plus the lack of availability of Islam compliant products.

5.12 The CRE suggested that the regulatory bodies should carry out an assessment of the impact of financial practices on disadvantaged communities and particular groups, with specific reference to avoiding racial prejudice and stereotyping; and this review should include identification of measures to be taken at industry and institution level to ensure information and advice reach disadvantaged communities. But it is not clear who should carry out such an assessment. Promoting public understanding of financial services is within the remit of the Financial Services Authority, but other aspects of the work CRE suggests are not.

5.13 The Director General of Fair Trading's powers under the 1973 Fair Trading Act enable him to investigate practices by suppliers which adversely affect the economic interests of consumers. Such practices include ethnic and other discrimination. More specialised powers exist under the Consumer Credit Act 1974 and the EAA 1979 to investigate practices - including discrimination - in the provision of consumer credit and estate agency, and also to take regulatory action against those who engage in them.

5.14 In general, too little is known about the reasons some ethnic minorities make disproportionately low use of financial services. The barriers need to be researched in greater depth, in cooperation with the communities affected, to get a better idea of the remedies. Responsibility for this, insofar as it would be a market research task, should lie primarily with the industries concerned, but the CRE might have a useful catalytic role to play. CRE is already working with the BBA on banking issues affecting ethnic minority businesses: this cooperation might be extended to cover other aspects of banking. The FSA could also have a part to play, in respect of its responsibility for consumer education. The more the barriers are understood, the better would be any resulting guidelines on good practice.

5.15 Focus group research⁵⁰ indicates that ethnic groups see themselves as disadvantaged when dealing with financial services. This is partly because of their economic position, but also partly because of what they felt was lack of understanding, amounting in some cases to straightforward prejudice. This is an issue that banks and other financial service providers need to tackle vigorously, through their staff training programmes.

⁴⁹ Understanding and Combating Financial Exclusion: Elaine Kempson and Claire Whyley, Policy Press, December 1998

⁵⁰ Qualitative Research into Ethnic Minorities and Financial Services, the report of focus group studies on behalf of OFT by Ethnic Response: Appendix 5 of Vulnerable Consumers and Financial Services, OFT January 1999

5.16 The CRE recommended explicit inclusion of ethnic issues in the Banking Code, with accompanying guidelines on good practice. The team agrees. Maintaining the Banking Code is the responsibility of the associations representing banks and building societies; so they should consider this suggestion in their next review. Guidelines on good practice would need to evolve from research, which might properly be the responsibility of the CRE, although on matters related to consumer credit, the DTI and OFT have responsibility.

Gender issues

5.17 Women are disproportionately self-excluded from financial services, often because they give up using financial services in their own name when they marry. This makes them especially vulnerable following a relationship breakdown. This calls for better consumer education - especially in schools. Women need to be alerted to the advisability of retaining financial products in their own name. In many cases, problems would be avoided if they neither relied on husbands to provide financial products for the whole household, nor opened bank accounts in joint names.

Research needs

5.18 For the industry to succeed in reaching underserved markets, banks and other providers need to understand the anatomy of financial exclusion better. Research over recent years has added greatly to this understanding, but there are gaps that could be filled. For example, the relationship between changes in people's economic circumstances and their use of financial services could be profitably explored, as it is the key to some aspects of product design. Other research needs might emerge in the course of time. It is for the banks and other service providers to decide the extent to which they wish their industry associations to carry out this research, as distinct from doing it themselves.

Monitoring

5.19 It will be necessary for progress on eliminating financial exclusion to be monitored carefully, to evaluate the impact of those developments which are already underway; and to ensure that new initiatives make a difference. The lead responsibility is clearly with the Treasury, but it might consider outsourcing some of this work, particularly where there is a need for professional research expertise.

Recommendations

Regulatory issues

1 The FSA should ensure that, when making rules intended to protect the generality of consumers, these do not inadvertently inhibit access by low income groups. (ongoing)

2 In its consumer education work, the FSA should have due regard to the special needs of low-income groups, bearing in mind especially the evidence of their hostility and suspicion of banks and other financial services providers. (ongoing)

Financial education and money advice

1 DfEE should continue to consult with the FSA and other industry organisations, when drawing up guidance on the components of the school curriculum covering management of personal finances. (in 2000)

2 As part of the new framework for post-16 learning, DfEE should consider how to promote better access to financial education and advice for young people and adults. (in 2000-2001)

3 DfEE and DSS should consider how best the Employment Service and relevant DSS services can signpost sources of advice and guidance on financial matters and debt counselling; and explore how far possible future development of in-work benefit advice might include the provision of money advice. (in 2000-2001)

4 DfEE, when drawing up guidance for the new youth support services, which are intended to provide comprehensive advice and support for young people considering education and training options, should ensure that these services are aware of and make use of locally available money advice services. (in 2000-2001)

5 Associations representing all sections of the financial services industry should encourage their members to support the work of the Money Advice Trust, especially its new national infrastructure project, in order to fund broadening of advice services on offer as well as improving access generally. (within the next year)

6 Banks, building societies and other financial services providers should consider including money advice centres in their mailing lists for informing people about products or services. (as soon as practicable)

Ethnic issues

1 All financial services providers should ensure their staff get appropriate cultural awareness training. (ongoing)

2 The Banking Code and the Mortgage Code should include undertakings on non-discrimination. (next year)

3 The FSA should ensure that financial education programmes include appropriate material to encourage people from ethnic minority backgrounds to make greater use of financial services.

4 ABCUL should consult with organisations representing the Islamic community and consider research into the prospects for Islamic credit unions, drawing on experience in other countries; and the Central Services Organisation, once established, might consider the means of promoting them more widely.

Gender issues

1 The FSA should ensure that financial education programmes include appropriate material to encourage women to make and retain their own financial services arrangements. (ongoing)

Miscellaneous

1 FSA should commission research on the reasons people who do not use financial services have fears and suspicions. (in its next planning cycle)

2 For NDC schemes where access to financial services is developed as a key strategy, partnerships should consider ways of setting up systems for monitoring progress against their desired outcomes, particularly with a view to identifying good practice lessons for other partnerships. (ongoing)

3 The Treasury should ensure that it is in a position to monitor and report annually on the effects of the measures taken to increase use of financial services by poor people, including those from the ethnic minorities. (delivering a first report next year)

4 The Government should consider establishing a central unit to scrutinise new policy proposals for their effects on social inclusion.

Appendix A: Members of the Policy Action Team

David Alexander (Chair) - head of the banking services branch at H M Treasury
Isabel Anderson - member of the Posts Directorate of the Department of Trade and Industry
Alan Brown - member of the Regeneration Directorate of the Department of the Environment, Transport and the Regions
Tania Burchardt - member of the Centre for the Analysis of Social Exclusion at the London School of Economics
Laurie Cairns - member of Planning and Finance Division of the Department of Social Security
Denise Caudle - Director for Education, Skills, Enterprise and Regeneration at the Government Office for the North East
Tony Challinor - head of Cheshire County Council Community & Youth Service
Sarah Graham - member of Planning and Finance Division of the Department of Social Security
Jeremy Jones - head of the banking supervision branch at H M Treasury
Amanda Jordan - Director of Public Affairs at NatWest and adviser to the Social Exclusion Unit
Elaine Kempson - Head of the Personal Finance Research Centre at the University of Bristol
Liz Lawrence - member of the Social Exclusion Unit
Jim McCormick - Director of Research at the Scottish Council Foundation
Geoff Mulgan - member of the Policy Unit at No 10 Downing Street
Shaun Mundy - head of the UK Deposit-takers department at the Financial Services Authority
Amanda Paul - staff member of Black Regeneration Forum, (formerly with BASSAC)
Susan Rice - Managing Director, Personal Banking at the Bank of Scotland
Peter Robinson - head of the insurance branch at H M Treasury
David Sibbick - Director, Posts at the Department for Trade and Industry
Susan Spencer - Director of the Birmingham Settlement
Daniel Storey - member of the Enterprise Team at H M Treasury

Secretariat and Conference Administration

Marion Desborough - member of the banking services branch at H M Treasury

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Appendix C: Consultation Respondents

Abbey National
Age Concern
Alliance & Leicester
Association of British Insurers
Association of Chief Officers of Probation
Association of Friendly Societies
Bank of Scotland
Barclays Bank
Banking Insurance and Finance Union
British Bankers Association
British Cheque Cashers Association
Building Societies Association
Banking Ombudsman
Building Societies Ombudsman
Cambridge Housing Society
Campaign for Community Banking Services
Citizen Organising Foundation
Commission for Racial Equality
Consumer Credit Association
Convention of Scottish Local Authorities
Council of Mortgage Lenders
Development Trust Association
Environment Trust
Equal Opportunities Commission
Family Assurance Friendly Society Group
Federation of Independent Advice Centres
Finance and Leasing Association
Financial Services Authority Consumer Panel
Foundation for Credit Counselling
Grampian Credit Union Ltd
Grampian Support Forum for Credit Unions
Halifax plc
Homeless Network
Institute and Faculty of Actuaries
Lloyds TSB
LA Co-ordinating Body on Food & Trading Standards
Mail Order Traders' Association
Midland Bank
Money Advice Association
Money Advice Scotland
National Association of Citizens Advisory Bureaux
National Consumer Council
National Housing Federation
National Pawnbrokers Association
NatWest
Office of Fair Trading
Paterson, Bob
PayPoint
Provident Financial
Refugee Council
Scottish Homes
SSL
St Mungo's
Tunbridge Wells Equitable
UNISON
Vision 2000
West Bromwich Building Society
Willenhall Community Money Advice Centre