

# Tackling financial exclusion – ethical solutions

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Banking the unbanked: *Where are we now?*  
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# Defining exclusion

- Not just about numbers of people with financial products, it's about:
- removing the barriers that restrict access to fair and affordable products and services
- needs being met effectively by providers (state/ 3<sup>rd</sup> sector/ private)
- consumers being financially capable and aware
- consumers protected against risks and shocks life throws at them

# Background – the scale of financial exclusion

# Scale of financial exclusion

- Exclusion affects between 5-8 million households in UK
- overall impact £800-£1,000 pa for vulnerable households – higher bills etc (source: FWA)
- affects local communities (doorstep lenders alone cost Hackney economy up to £1.6m a year through high charges)
- widening income/ asset gaps and use of sophisticated risk pricing/ segmentation exacerbate problem
- millions face bleak financial futures
- core areas are: banking services; credit and debt; providing for the future; protection against risk; dignity and security in old age/long term care

# Banking services

- 2 million adults (1.3 million households) without access to bank account (HMT 2005/6) – further 4 million use accounts infrequently
- free ATM/ bank branch deserts in deprived areas
- low income groups 4 times more likely than higher income groups to withdraw small amounts of cash frequently – incurring effective charges of 10-15%
- basic bank accounts – huge variation in performance of individual banks
- branch closures – negative multiplier effect in vulnerable communities (NEF/ CCBS)

# Financial awareness/ capability

- Excluded consumers face many barriers to access - restricted options compounded by low levels of awareness/ confidence
- 7 million in UK literacy standards expected of 11 yr olds
- excluded consumers less exposure to/ experience of financial services, less confidence, vicious circle eg:
  - basic bank account customers low levels of awareness of direct debit facilities
  - 65% of pre-payment customers unaware they pay higher fees
  - general lack of awareness of which bills can be paid without fee, TV black box – unaware of interest paid
- financial literacy campaigns need to be practical not high-level

# Debt and credit

- total UK personal debt £1.4 trillion (130% of disposable income)
- debt burden, restricted access to fair and affordable credit disproportionately affects vulnerable consumers
- sub-prime market: SVRs 3.5% above base rates, penalty charges for arrears, evidence of major misselling
- sub-prime arrears up to 20 times mainstream level, sub-prime lenders quicker to repossess
- debt servicing costs higher than in 1990s, FTB 34% of income, FTB HPER 5.4 times record levels

# Debt and credit continued

- 2.3 million use home credit, APRs 180-500%
- 165,000 use illegal loan sharks
- credit crunch and increase in utility/ household bills affecting vulnerable consumers
- on some measures, 1 in 3 households will be classified as non-standard risks, more priced out of/ denied access to affordable credit
- sub-prime market set to expand, equity release, sale and rent back schemes and debt consolidation companies growth areas
- but alternative solutions not yet developed scale to cope – expect substantial increase in consumer detriment

# Other factors

- 48% of UK population no savings to speak of
- half population insufficient provision for retirement, over 60% no investments
- protection gap £2.3 trillion
- 1 in 3 <£20k no life insurance
- only 12% have IP
- 1/3<sup>rd</sup> no contents insurance (50% in certain deprived areas)
- restricted access to objective financial advice

# Causes of financial exclusion

# Main causes of financial exclusion

- A range of factors combine to create an exclusion/ provision gap
- the main cause of exclusion is income/ asset related ie. large groups of consumers cannot afford financial services
- UK a polarised society
- income and asset gaps are widening
- stark regional differences – inside/ outside M25
- generational issues
- gender
- minority ethnic groups disproportionately affected

# Demand side factors

- A range of demand side factors can cause consumers to 'self-exclude' from the market including:
- financial capability and low levels of awareness (see previous slide – consumers may not be aware of options available to them)
- trust and confidence: again low levels of trust and confidence can mean that consumers are reluctant to take up products and services
- net effect is that consumers have to be 'persuaded' to engage using expensive advertising and distribution
- pushes up unit costs for industry, excluding yet more consumers.

# Supply side factors

- Supply side factors include:
- profitability/ shareholder expectations
- competition inefficiencies: huge oversupply in the market
- distribution inefficiencies: eg. £1bn on marketing, £7bn on commission to sell products and support financial advisers
- industry notorious for designing complex products, terminology
- regulation hasn't struck the right balance between efficiency and consumer protection eg. Northern Rock and credit crunch
- factors combine to push up unit costs, providers unable or unwilling to serve lower income/ higher risk consumers on viable commercial terms

# Regulation and public policy

- Industry lobbying and sponsored research has set the tone for policy response (see 'All Gone Now', French, Leyshon, Signoretta, Nottingham University)
- mind-set that exclusion and branch closures are natural and inevitable (if unfortunate) consequences of liberalised markets
- government fear of being accused of 'nanny-state' interventions
- industry has largely captured public policy response
- UK authorities as a result rely on voluntary partnership measures and self-regulation such as the Banking Code in key areas, unlike USA, France etc
- self-regulation and partnerships not necessarily bad but too weak in key areas

# Solutions

# General approach

- Targeted public policy regulation
- default position market based solutions but need objective assessment of market limitations
- targeted financial capability initiatives
- public/ private partnerships between institutional funders and 3<sup>rd</sup> sector
- alternative business models, affordable credit and insurance products
- build capacity in 3<sup>rd</sup> sector

# Public policy regulation and banking

- Where no realistic expectation that markets can deliver, intervention is needed
- access to banking should be universal right
- banking code inappropriate for dealing with financial exclusion because of commercial imperatives
- provides limited protection in terms of access to basic banking, and impact of branch closures
- suffers from lack of transparency and accountability
- the case for universal service obligation and CRA style obligation in UK is compelling

# Access to advice

- National Financial Advice network
- funded by public/ private partnership (levy on firms),
- complement private sector capacity
- small coordinating body, advice delivered through participating 3<sup>rd</sup> sector agencies by general financial planners
- advice/ guidance on pensions, benefits, debt, general help with financial issues
- lead on financial awareness initiatives

# Credit – crisis management

- 4 million vulnerable to interest rate changes/ sub-prime
- task force to monitor and coordinate response
- increase funding for advice agencies to fend off vultures
- FSA needs to require lenders to treat customers fairly on arrears, repossessions, interest rate relief, redress for consumers
- secured lending under single regulatory regime
- sale and rent back schemes urgently regulated
- safety mechanisms such as ISMI/ PPI reformed
- FSA/ OFT examine unfair contracts

# Credit – medium/longer term solutions

- UK sub-prime market will expand – radical interventions needed
- expand DWP growth fund, create loan shark rescue fund
- benchmark home equity/ PPI plan
- reconsider interest rate price caps
- new institutional funding mechanisms to provide sustainable capital for 3<sup>rd</sup> sector eg. credit unions
- HMT underwriting £25-40 bn on Northern Rock, 1/100<sup>th</sup> of 1% of UK pension fund assets = £100m
- capacity building for 3<sup>rd</sup> sector, financial management skills etc

# Summary and conclusions

- Financial exclusion major public policy problem in the UK
- in a more uncertain, unpredictable world, millions are vulnerable and/ or face bleak financial futures
- problem is set to grow as mainstream market abandons unprofitable/ riskier consumers
- radical, innovative solutions needed based on robust government interventions where needed and new partnerships between institutional funders/ 3<sup>rd</sup> sector
- thank you and questions.