Financial inclusion: the way forward

March 2007

HM TREASURY

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Foreword

The United Kingdom has one of the largest, most sophisticated and competitive financial services sectors in the world. It has responded quickly to the demands of a rapidly changing economy – new technologies, higher living standards and changes to the ways people live and work – providing a wide range of financial products to meet evolving needs.

This very success also poses our society a growing challenge. Consumers are becoming more sophisticated, new products and opportunities are becoming available and we are expecting people to take a greater control of their own lives in managing their money and saving for the future.

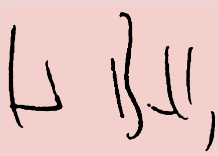
Yet there is growing evidence that the market does not meet everyone's needs – and too many families are being left behind. A small but significant minority of people are unable to access even the most basic financial services and instead find themselves trapped outside the financial mainstream.

For these people, financial exclusion causes extra costs and real disadvantage in three ways:

- first, it makes day-to-day money management more difficult and expensive, and can make it harder to find a job;
- second, financial exclusion makes it harder for families to plan for the future and manage lumpy spending; and
- third, if things go wrong, financial exclusion makes people more vulnerable to financial distress and a spiral of debt, poverty and hardship.

The Government has, since 1997, worked together with financial services providers (including those from the third sector) to help more people, particularly those living on low incomes, avoid these unnecessary costs. As this document details, much has been achieved so far. But there is no room for complacency; more needs to be done, and the challenges are evolving all the time.

We want to see everyone having access to appropriate financial products, and the confidence and capability to use them to make a positive difference to their lives. We are looking forward to working with all stakeholders – with banks and other financial services providers, with third sector providers of affordable credit and money advice, and with voluntary and community organisations – to make progress towards this stretching but crucial goal.



Ed Balls MP

Economic Secretary to the Treasury

1 Introduction and Summary

FINANCIAL SERVICES IN THE UK

1.1 The UK economy has one of the largest, most sophisticated and competitive financial services sectors in the world. It has responded quickly and efficiently to the demands of a fast-changing economy – new technologies, increasing living standards, and changes to the ways that people live and work – providing an array of financial products to meet people's changing needs.

1.2 But alongside this positive development, there is also growing evidence that the market has not been able to meet everyone's needs. While the majority enjoy access to an ever-increasing range of products, a small but significant minority of people are unable to access even the simplest of financial services. For these people, financial exclusion means significant additional cost and loss of opportunity.

1.3 Growing awareness of the problem of financial exclusion has led to an escalating response from Government and the financial services industry. Progress has been made, but more needs to be done, to ensure that everyone has access to the full range of financial services needed to participate in modern social and economic life.

WHY IS FINANCIAL INCLUSION IMPORTANT?

1.4 Financial inclusion is about ensuring that everyone has access to appropriate financial services, enabling them to:

- **manage their money on a day-to-day basis,** effectively, securely and confidently;
- **plan for the future and cope with financial pressure,** by managing their finances to protect against short-term variations in income and expenditure, and to take advantage of longer-term opportunities; and
- **deal effectively with financial distress,** should unexpected events lead to serious financial difficulty.

1.5 People who achieve these goals will enjoy significantly improved life outcomes.

Effective day-to-day money management

1.6 In order to manage their money effectively, people need first, to have access to a transactional bank account, and second, to have the confidence to make full use of it. People who do not have or use a bank account pay more for goods and services, and more to access their money. For example:

- essential utilities, such as energy and telecommunications, cost less for those who are able to make payments regularly from a bank account; and
- cheques can be paid into a bank account for free, whereas those cashed at a cheque-cashing outlet attract a charge of 10 per cent or more.

1.7 And more employers than ever require their employees to have a bank account for payment of wages. Increasingly, being unbanked can be a barrier to employment.

The Government's goal

1.8 The Government believes that everyone should be able to manage their money effectively and securely, through having access to a bank account, and the confidence and capability to get the most from it.

Box 1.1: Vision for financial inclusion

The Government's vision is for a society in which no one is denied employment because they do not have a bank account. Individuals get the best possible price for the goods and services they purchase, using the full range of payment mechanisms from cash to debit cards to direct debits. They do not have to pay to access their money, which is kept securely in a bank,.

When people need extra money to cope with unexpected expenditure, they use short-term sources of credit such as a credit union loan, overdraft or credit card. They can also save, to build up financial assets to provide them with a further buffer against financial pressures. They manage specific risks through insurance covering their home, car or other assets.

Because they are managing their money effectively, people are less likely to get into financial difficulty. Should this happen, they are able to get information, advice and support from financial services providers, and take early action to ensure that the problem does not get out of hand. For those in serious distress, extra advice and support is on hand from specialist advisers, to help them get back in control of their finances.

For society as a whole, with more people able to participate in the labour market and the wider economy, and fewer people experiencing significant financial difficulty, financial inclusion brings real benefits. And helping the financially excluded – many of whom are the least well-off members of society – is an important way to promote social justice.

Planning for the future and coping with financial pressure

1.9 Affordable credit, savings and insurance products help people plan for the future and manage short-term fluctuations in income and expenditure. They can provide a financial buffer – taken for granted by most people – against a range of short-term contingencies, both known and unknown.

1.10 People find it much easier to cope with the pressure of expected or unexpected spending – such as paying for Christmas, or repairing a broken washing machine – if they are able to borrow small sums of money affordably, over a short period of time, or if they have saved even a small sum of money. And insurance can be used to protect against potential losses arising from risks to assets like home contents or a car.

1.11 People without access to these products are often forced into using high-cost sources of lending instead, including home credit ("doorstep lending") or, worse, illegal loan sharks who use fear and intimidation to extort huge sums from their victims.

The Government's goal

1.12 The Government believes that everyone should be able to plan for the future with a reasonable degree of security. Therefore, affordable credit, saving accounts and simple insurance products should be available to all who need them.

Dealing with financial difficulty and distress

1.13 In addition to managing the short-term financial fluctuations that everyone experiences, financial inclusion also enables people to get through the more serious problems that can sometimes arise. Long-term sickness, unemployment, or family breakdown can all lead to over-indebtedness and financial distress.

1.14 People finding themselves in this situation need the help of a qualified money adviser, which is why the Government's strategy for helping people deal with distress has focused on the provision of free face-to-face and telephone money advice.

1.15 Beyond money advice, access to financial services (such as credit, savings and insurance) can provide a buffer against financial distress by preventing small problems from getting out of control. Financial inclusion can also offer a route out of distress through the help and support of financial services providers. This means that providers also have a responsibility to help people through difficulty.

The Government's goal

1.16 **The Government believes that everyone should have the information, support and confidence they need to prevent avoidable financial difficulty, and to know where to turn if they do find themselves in financial distress.**

EXAMPLES OF WHAT HAS BEEN ACHIEVED

1.17 The Government has been tackling financial exclusion since 1997. For example, in 1999, the Social Exclusion Unit's Policy Action Team 14 (PAT 14) recommended the creation of basic bank accounts.[1] The Government worked successfully with the banks to bring these products to the market, and there are now basic bank accounts available from 17 providers. The Government also adopted many of PAT 14's proposals for legislative change to support credit unions, creating a proportionate and risk-based regulatory regime for credit unions under the Financial Services Authority (FSA).

1.18 The Government's first financial inclusion strategy, *Promoting financial inclusion*,[2] was published in December 2004, and included the following key announcements:

- **creation of a dedicated Financial Inclusion Fund of £120 million** for the 2005-08 spending period;
- prioritisation of the three areas of **access to banking, affordable credit and free face-to-face money advice**; and
- the establishment of an **independent Financial Inclusion Taskforce** to advise the Government and monitor progress.

1.19 To increase people's ability to manage their money, in 2004 the Government agreed a shared goal with the banks, to halve the number of adults living in households without access to a bank account, and to make significant progress within two years. The 2002-03 Family Resources Survey (FRS) showed that there were 2.8 million adults living in 1.9 million households without access to a bank account. Early analysis of the latest FRS shows that steady progress has been made: **in 2005-06, the number of adults without access to a bank account had fallen from 2.8 million to 2 million adults living in 1.3 million households**.

[1] *Access to financial services, report of PAT 14*, HM Treasury, November 1999

[2] *Promoting financial inclusion*, HM Treasury, December 2004

Box 1.2: The Financial Inclusion Fund

As part of the strategy launched in *Promoting Financial Inclusion,* the Government established a Financial Inclusion Fund of **£120 million** to progress initiatives to tackle exclusion in core priority areas. The majority of the fund has been allocated, and is now delivering results:

- The Department of Trade and Industry (Department of Trade and Industry) is managing a **£47.5 million** fund to increase the supply of free, face-to-face money advice across England and Wales. Almost **400 advisers** are in place, with a further 150 on the way. **Over 18,000** financially excluded customers have been helped to date.
- The Legal Services Commission are using **£6 million** to pilot methods of money advice outreach. **Over 8000** people have been advised, the vast majority of whom are financially excluded.
- The Department of Work and Pensions (Department for Work and Pensions) is administering a **£36 million** Growth Fund for third sector lenders, allowing them to make **over 15,000** affordable loans to financially excluded people so far.
- To build on the early success of the Growth Fund, the Government is providing a **further £6m** to support provision of third sector credit in under-served parts of the country, to invest in the skills and capacity of staff and volunteers working for third sector lenders, and to support credit unions providing transactional banking services.
- In January 2007, the Government launched the "now let's talk money" campaign, with funding of **£5.4 million** from the Financial Inclusion Fund. The campaign, bring run by the Department for Work and Pensions in partnership with trusted intermediaries across England, Wales and Scotland, is working to reduce the barriers to financially excluded people accessing mainstream financial products and services.
- The Financial Inclusion Taskforce has a budget of **£3 million**, which is being used primarily to conduct research and enhance the knowledge base on financial exclusion.

1.20 To help people plan for the future and cope with financial pressure, the Government has been working to increase the supply of affordable credit through the third sector. The Department for Work and Pensions (DWP) has contracted with more than 100 third-sector lenders to increase the supply of affordable credit across Great Britain. To date, more than 15,000 loans totalling over £6 million have been advanced.

1.21 The Government has also announced a national roll-out of projects to tackle illegal lenders, providing victims with the support they need to help the authorities prosecute offenders, and find legal, low-cost alternatives.

1.22 The Government has also put in place a range of measures to make it easier for people to put aside small amounts of savings. Over 17 million people now save with an ISA. And in 2005 the Child Trust Fund was introduced as a universal savings account into which children are now automatically enrolled at birth. Specifically to encourage saving amongst those on lower incomes, the Government has piloted the Saving Gateway. Evidence from the pilots so far suggests that matching incentives can encourage genuinely new saving and new savers.

1.23 To reach the people who most need help, the Government has, on the advice of the Financial Inclusion Taskforce, launched the "now let's talk money" campaign.

Working through trusted intermediaries (such as housing associations and local charities) the campaign is providing hard-to-reach people with the information and support they need to access financial services. And the Government's long-term approach to financial capability, including a feasibility study into a national approaches to generic financial advice coordinated by Otto Thoresen, is addressing the longer-term issue of improving consumers' confidence and skill in dealing with appropriate financial services.

1.24 To make it easier for people to deal with distress, the Government has focused on making free money advice more available. The Department of Trade and Industry (DTI) has recruited and trained nearly 400 new face-to-face money advisers, with 150 more on the way. These have so far helped more than 18,000 people.

CHALLENGES FOR FINANCIAL INCLUSION

1.25 While there has been real progress, there remains a lot to be done, , and key challenges to be met, if the Government is to achieve its goals for financial inclusion.

1.26 Challenges for effective day-to-day money management include:

- continuing to reduce the number of unbanked people by promoting basic bank accounts;
- ensuring that newly banked people are using their bank accounts effectively;
- continuing to focus on the issue of accessibility of banking services; and
- understanding the impact of developments in the banking market on the Government's objectives for effective money management.

1.27 The key challenges for planning for the future and coping with pressures are :

- increasing the coverage and capacity of third sector lenders so that excluded people nationwide have access to this source of affordable credit;
- making saving work for low-income or financially excluded consumers, through products that meet their saving needs, and through targeted saving incentives;
- investigating the role of insurance as a product for financially excluded customers; and
- successfully increasing demand for financial services through targeted support, increased financial capability, and realising the potential of bank accounts as a route into wider financial inclusion.

1.28 And the challenges for dealing with financial distress effectively include:

- continuing to make progress with the supply of face-to-face advice;
- establishing the potential of new, cost-effective, mechanisms for delivery of advice;
- replicating the success of DTI's pilots to date in the nationwide rollout of projects to tackle illegal lending;
- promoting the role of banks and other financial services providers in supporting people out of financial distress; and

- addressing the impact of low financial capability on people's capacity to deal with distress.

SUMMARY OF KEY ANNOUNCEMENTS AND NEXT STEPS

1.29 The Government is determined to promote financial inclusion. In the long-term, this commitment will involve mainstreaming financial inclusion into Departmental budgets and Public Service Agreements. However, for the next spending period from 2008-11, as evidence from existing initiatives continues to be collected, the Government will:

- **establish a new Financial Inclusion Fund** for new and ongoing initiatives to promote financial inclusion, **maintaining the current level of intensity** of action, with the exact amount of the fund to be determined after the forthcoming Comprehensive Spending Review (CSR);
- **establish a ministerial working group** to determine detailed priorities for financial inclusion policy, and to publish a detailed action plan after the CSR; and
- **extend the life-span of the independent Financial Inclusion Taskforce** to evaluate progress and advise the Government, working to new terms of reference reflecting the post-CSR action plan.

1.30 Partnership with financial services providers is at the heart of the Government's approach to achieving its financial inclusion goals. The Government will therefore engage with the financial services industry over the coming months, to work towards an agreed **action plan** with a particular focus on:

- access to banking and the shared goal;
- effective usage of bank accounts, particularly among low-income and newly-banked consumers;
- how the banks can support an increase in the provision of third-sector credit leading to nationwide coverage;
- the role of insurance products in promoting financial inclusion goals;
- the role of banking as a route into wider financial inclusion; and
- the role of banks and other providers in helping people deal with financial distress.

Key next steps

1.31 The Government will **continue to work with the banks to promote basic bank accounts and further reduce the number of unbanked**, in the light of emerging evidence, including detailed analysis of the 2005-06 FRS, and will report on action agreed with the banks in its detailed action plan

1.32 To advise the Government on how to achieve a nationwide increase in the coverage and capacity of third sector lenders, **the Government has asked senior representatives from the banking sector to work with the Financial Inclusion Taskforce to consider how to achieve a nationwide increase in the coverage and capacity of third sector lenders.** This group will consider the roles of Government, the private sector and third sector lenders in increasing coverage, in the light of emerging evidence on the Growth Fund and other initiatives. The group's findings will be presented in the detailed action plan following the CSR.

1.33 Building on the early success of the Growth Fund, and to further boost the capacity of third sector lenders in a number of different areas, **the Government announces that a further £6 million will be made available to credit unions and CDFIs through the DWP's Growth Fund.**

1.34 Following consultation and detailed evidence-gathering, **the Government has concluded that an extension of Community Investment Tax Relief would not be the most effective means of supporting an expansion in the supply of affordable personal loans at this time.** This issue will remain under review as the above options for increasing the coverage and capacity of third sector lenders are considered.

1.35 In response to Brian Pomeroy's review of Christmas saving schemes, the Government announces:

- **the DTI has secured agreement from the hamper industry to establish an industry-led scheme to ensure that consumers' interests are fully protected through the establishment of secure, ring-fenced accounts.** This will be implemented as soon as possible;
- **£1 million will be made available for the Office of Fair Trading to conduct a consumer awareness campaign in the coming months on Christmas saving schemes and mainstream alternatives,** from the current Financial Inclusion Fund;

1.36 In order to investigate how insurance can be made an integral part of financial inclusion policy, the Government will work with the Association of British Insurers and the Financial Inclusion Taskforce.

1.37 To maintain progress being made in the provision of money advice by the DTI's face-to-face money advice projects, **the Government commits to ongoing support for the provision of money advice in the next spending period.**

2 Financial inclusion and why it matters

Financial services and financial exclusion

2.1 Financial services provide consumers with a wide range of tools for making the most of their money, for example, allowing them to make and receive payments, store money securely, save and borrow, and manage risk.

2.2 In the UK, the last 20 years has seen unprecedented growth in financial services, driven by a number of related factors.[1] These include:

- **long-term economic growth and stability**, with an upward trend in living standards, wealth and disposable income;
- **liberalisation and globalisation** of financial services markets, leading to increased competition, choice, and value for the consumer;
- **a principles-based regulatory framework** balancing consumer protection with needs of the industry for proportionate regulation;
- **new types of financial services providers and intermediaries**, from supermarkets, to car manufacturers, to internet comparison websites; and
- **new delivery channels**, such as the internet and telephone.

Financial exclusion – who is affected?

2.3 As a result, the UK economy has one of the largest, most competitive and most sophisticated markets for financial services in the world. But there is growing evidence that the market is not able to meet everyone's needs. A small but significant minority cannot access even the simplest financial services, meaning that they pay more to manage their money, find it harder to plan for the future and cope with financial pressures, and are more vulnerable to financial distress and over-indebtedness.

2.4 Both Government and the financial services industry have responded to tackle this growing problem, known as "financial exclusion". Progress has been made in increasing the availability of appropriate products and services. But more needs to be done, by the Government and by financial services providers, if everyone is to have access to the financial services they need to participate in modern social and economic life.

2.5 Extensive research has shown that people living on low incomes are those most likely to be affected by financial exclusion.[2] This finding is confirmed by recent Financial Inclusion Taskforce survey research, as reported below.

[1] The Government's view of the vital role of financial services is set out in *The UK financial services sector: rising to the challenges and opportunities of globalisation*, HM Treasury, March 2005

[2] Examples include: *Payment of pensions and benefits: a survey of social security recipients paid by order book and girocheque*, Department for Work and Pensions, 2001; and *In or Out?* Financial Services Authority, July 2000

Box 2.1: Two case studies of financial services growth in the UK

Mortgages: The UK has one of the most diverse, competitive and complete mortgage markets in Europe. There are around 160 active mortgage lenders, and 11,000 intermediaries in the UK. [3] In total, these accounted for lending of approximately £345bn in 2006 across thousands of different mortgage products. [4] There is also great diversity in the sources of mortgage funding including retail deposits, mortgage backed securities and covered bonds.

The market is constantly innovating, to the benefit of consumers who are able to access finance suited to their needs. Alongside competitive mainstream mortgage lending the UK provides access to mortgage credit for buyers with low housing equity, or uncertain incomes. These products have historically been difficult or even impossible to obtain in other European countries. [5]

Products that allow consumers wishing to buy their home using Shari'a-compliant structured home finance are also becoming available in the UK. FSA regulation is being extended to the whole of this market from April 2007.

Supported by mortgage market growth, levels of home ownership in the UK rose from 52 per cent in 1971 to 70 per cent in 2005. In 2005, 18.4 million households were living in owner occupied properties. [6] In 2006, there were 11.7 million mortgages outstanding, up by 1 million from 1997.

Saving: The savings market has developed significantly in recent years, with innovation leading to a range of products that more closely meet consumer needs. Two Government initiatives in particular – the Individual Savings Account (ISA) and the Child Trust Fund – have contributed to this development.

- Individual Savings Accounts were launched in 1999 as a replacement for Personal Equity Plans and Tax-Exempt Special Savings Accounts. Over 17 million people – more than one in three adults – now have an ISA, more than twice the number who ever held a TESSA or PEP, and there are over 450 ISA providers. ISAs also have higher levels of take-up among lower-income groups and the young compared to their predecessors. Building on this success, the Government has made ISAs a permanent feature of the savings landscape and has announced that it will implement reforms to simplify the regime and increase flexibility for savers. These changes will come into effect in April 2008 – alongside an increase in the annual ISA investment limits, creating more opportunities for more people to save.
- The Government launched the Child Trust Fund in 2005 as a universal savings account for all newborn children born on or after 1 September 2002. Around 2.5 million children have a Child Trust Fund account [7] and there are now 120 providers and distributors of Child Trust Funds.[8] Early evidence from providers suggests that there have been significant additional contributions into children's accounts. Furthermore, a number of products have been launched since 2005 designed specifically to address the needs of children born before the introduction of the Child Trust Fund.

[3] Financial Services Authority estimates

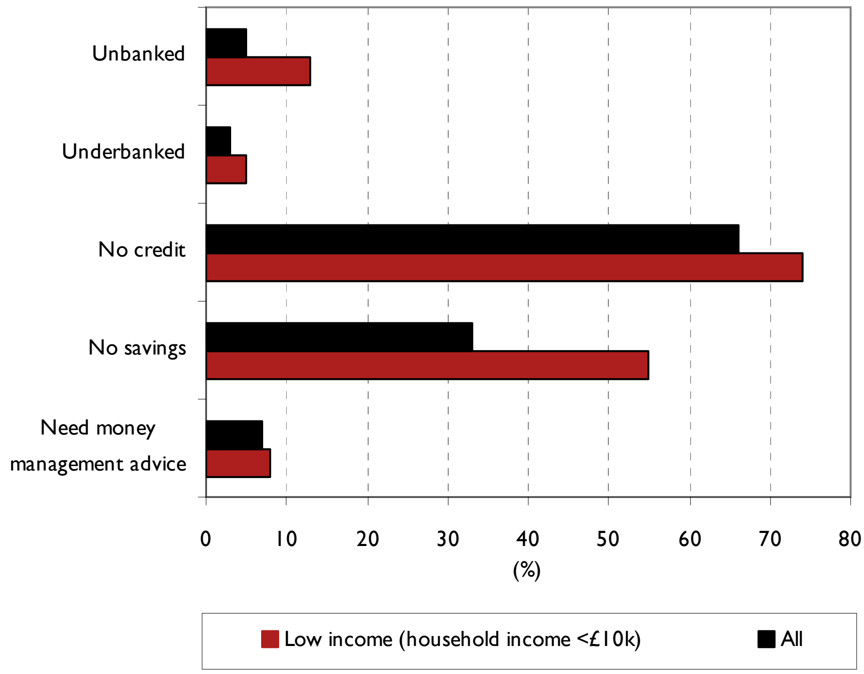
[4] Council of Mortgage Lenders statistical table ML1

[5] Mercer Oliver Wyman study for the European Mortgage Federation, Figure 3.11, October 2003

[6] Department of Communities and Local Government data: http://www.communities.gov.uk/pub/7/Table101_id1156007.xls

[7] HMRC quarterly Child Trust Fund statistics: http://www.hmrc.gov.uk/stats/child_trust_funds/child-trust-funds.htm

Chart 2.1: Financial inclusion of vulnerable groups



Note: In addition to identifying households who have no access to a bank account (the unbanked) the research also identified households who may have access to an account, but are not making full and effective use of it ("underbanked" households).

Source: HM Treasury analysis of Financial Inclusion Taskforce data

2.6 As Chart 2.1 shows, the Taskforce's research[9] found that low income households were disproportionately likely to be excluded from financial services, and in particular:

- more than twice as likely to be unbanked (**13 per cent**, compared to **five per cent**); and
- significantly more likely to have no savings (**55 per cent**, compared to **33 per cent**).

2.7 The Taskforce survey allows further analysis of the different patterns and degrees of financial exclusion experienced by various vulnerable groups (see Chart 2.2).[10] This shows that different groups appear to be vulnerable to financial exclusion in different ways. For example:

- **benefit recipients, social renters and the unemployed** were all more likely to be unbanked and have no savings than the norm;
- **older people** were far more likely to be "underbanked" and have no credit; and

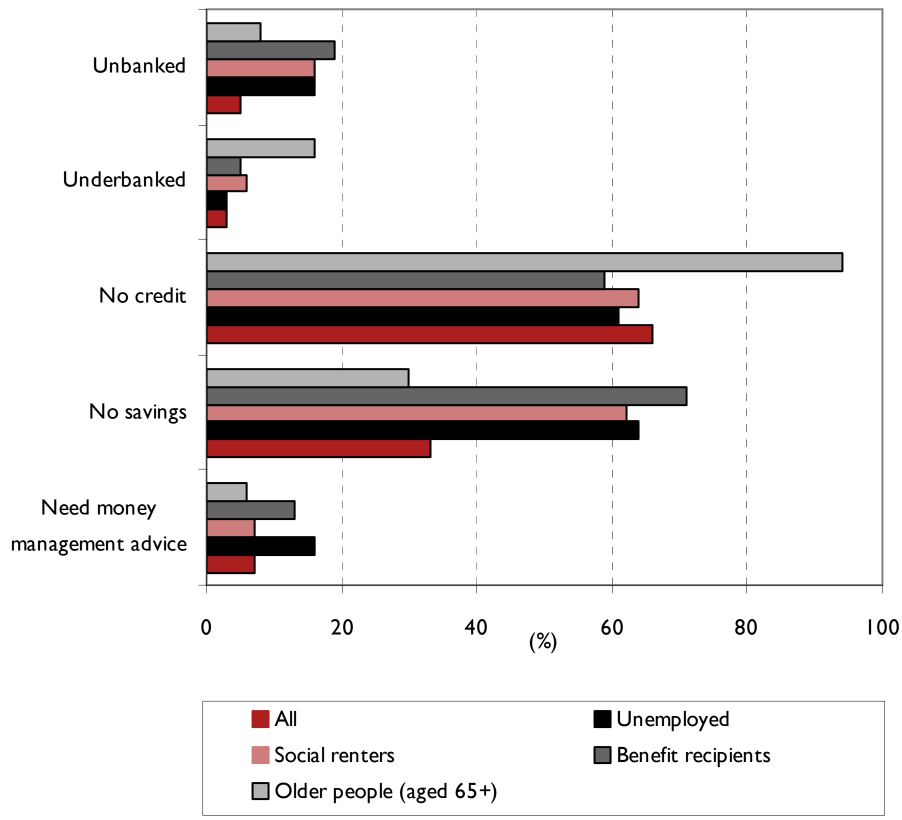
[8] Full lists of providers and distributors are available on the Child Trust Fund Website: http://www.childtrustfund.gov.uk

[9] *Access to financial services for those on the margins of banking*, Financial Inclusion Taskforce, November 2006

[10] The vulnerable groups analysed were: the unemployed; benefit recipients (those receiving income support or jobseekers' allowance); social renters (those living in rented local authority, housing association or other registered social landlord accommodation); and older people (those above the age of 65).

- **benefit recipients and the unemployed** were more likely to need money management advice.

Chart 2.2: Financial inclusion of vulnerable groups



Source: HM Treasury analysis of Financial Inclusion Taskforce data

2.8 Qualitative research provides more information. One barrier to banking inclusion can be the attraction of alternatives such as the Post Office Card Account (POCA). The POCA, despite its lack of functionality, is seen as a simpler and more accessible option than a bank account for receiving state and local authority benefits.[11]

2.9 The finding that older people were more "underbanked" than the norm also fits with qualitative research, which suggests that older people often prefer to operate in cash, rather than payment methods such as direct debit.[12]

2.10 The low use of credit by older people is also unsurprising, given the frequent finding that older people, while not facing a constrained supply of credit, do have very negative attitudes towards its use.[13]

2.11 More detailed analysis enables investigation of the extent to which different factors can explain or predict financial exclusion.[14] Regression analysis allows

[11] *Financial inclusion deliberative workshops*, Financial Inclusion Taskforce, May 2006

[12] *Financial exclusion among older people*, Help the Aged, 2006; *Understanding older people's experiences of poverty and material deprivation*, Department for Work and Pensions, July 2006

[13] *Financial exclusion among older people*, Help the Aged, 2006; and, *Social Fund use amongst older people,* Department of Work and Pensions, 2002.

[14] Factors considered in multivariate regression analysis were sex, marital status, employment status, accommodation tenure, benefit receipt, age and income

calculation of the likelihood of each factor being associated with different types of financial exclusion, controlling for the effect of all other factors.

2.12 Amongst the factors tested as a predictor of unbanked status:

- social renting had more than three times the likelihood of predicting unbanked status than other forms of housing tenure;
- benefit receipt doubled the odds of being unbanked;
- household income of less than £10,000 a year, and between £10,000 and £20,000 a year, doubled the odds of being unbanked compared to higher levels of household income.

2.13 The same pattern emerged for savings as for banking status. Benefit recipients, social renters and those on low and low-middle incomes all had significantly increased odds of not having savings, other factors being equal. By contrast, benefit receipt was the only factor which predicted increased likelihood of needing money advice. [15]

FINANCIAL INCLUSION: THE BENEFITS

2.14 People with access to appropriate financial services and the confidence to use them are able to significantly improve their welfare and life outcomes by:

- **managing their money on a day-to-day basis,** effectively, securely and confidently;
- **planning for the future and coping with financial pressure,** by managing their finances to protect against short-term variations in income and expenditure, and to take advantage of longer-term opportunities; and
- **dealing effectively with financial distress,** should unexpected events lead to serious financial difficulty.

The benefits of effective day-to-day money management

2.15 For people to be able to manage their money effectively they need access to a transactional bank account, and the confidence to use it.

2.16 Bank accounts provide a range of payment mechanisms, enabling lower prices for goods and services. An increasing number of services – including energy utilities and telecommunications – provide substantial discounts for those who pay by direct debit.

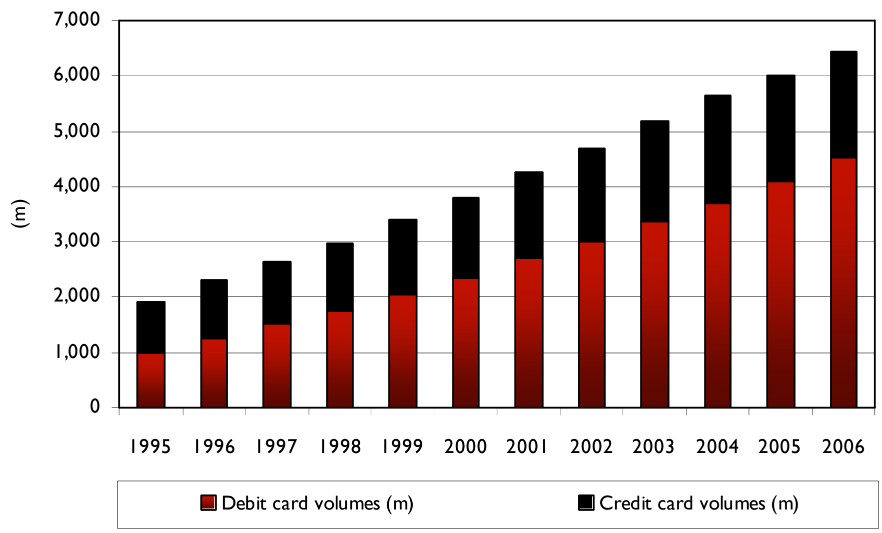
2.17 Payment cards – especially debit cards linked to a bank account – are increasingly used for the purchase of goods (see Chart 2.3). They offer convenience, and, as more purchases take place on the internet, are increasingly important for cost-effective shopping.

2.18 Effective money management also means convenient, cost-free access to money. Whereas wages can be paid directly into a bank account without cost, people without a bank account have to pay a commission – up to 10 per cent – to cash a wage cheque at a specialist outlet. Once money has been paid into a bank account, people

[15] Due to the low base size for the underbanked, the results of the multivariate analysis cannot be reported with certainty for this variable. For credit, regression analysis did not yield a valid predictive model, meaning that the factors tested do not, by themselves, explain the use or non-use of credit.

enjoy convenient access to their money through the cash machines. Storing money in a bank also offers security and peace of mind.

Chart 2.3: Volumes of debit and credit card transactions in the UK



Source: APACS

2.19 Technology has revolutionised the way that banking services are delivered, and continues to do so. However, there remains an important role for physical access, including through Post Offices, not least because of the wider advantages this offers communities, particularly in rural areas.

2.20 Firms are moving increasingly to electronic payments. Over 90 per cent of employees' salaries are paid directly into a bank account.[16] As a result, having a bank account has increasingly become a *de facto* requirement for employment, and essential to participating in the modern economy.

The benefits of planning for the future and coping with financial pressures

Short-term planning

2.21 Affordable credit, savings and insurance can all help people plan for the future and manage short-term fluctuations in income and expenditure. They provide a financial buffer against a range of short-term contingencies, both known and unknown.

2.22 People find it much easier to cope with the pressure of necessary expenditure – such as Christmas, or repairing a washing machine – if they are able to borrow small sums of money affordably, over a short period of time, or if they have saved even a small sum of money up over time. Saving money in an account offers the additional benefit of interest payments, and the security of storing money in a regulated financial institution. And insurance can protect against losses arising to assets like home contents or a car.

2.23 Those without access to these products are often forced into using high-cost credit, such as home credit, pawnbrokers or mail order catalogues (see box 2.2).

[16] In 1987, 50% of people were paid directly in a bank account by their employer. Today, the figure is over 90%, with all but the self-employed and those working for the smallest firms likely to be paid in this way (*The way we pay 2006: UK automated payments,* APACS, July 2006).

Box 2.2: The use and cost of non-mainstream credit

As part of its recent investigation into the home credit market, the Competition Commission has published findings on usage and estimated cost of non-mainstream types of credit..[17]

Home credit companies, also referred to as doorstep lenders, lent £1.5 billion to around 2.3 million customers in 2004. Loans, usually for several hundred pounds, are repaid in weekly instalments (typically £10-25) through agents. APRs vary from around 150 per cent to 500 per cent for short-term loans; customers typically pay a total cost of credit of between £40 to £80 per £100. The Competition Commission recently concluded that the consumer detriment of high prices is substantial, and made a number of recommendations to increase competition.

Agency mail order is one of the most popular sources of credit for those on low incomes – research shows that in 2004, over 20 per cent of low-income households had used this type of credit.[18] Weekly or monthly repayments are made through agents. Agency mail order credit can be advertised as 'interest free' but prices for goods can be far higher than from high street outlets.

Pawnbrokers are used by about 600,000 customers a year, who are required to deposit an item of value as security for a loan. The majority of loans are for a six-month redemption period, with interest rates of seven to 12 per cent a month. A loan of £200 over four months would cost around £56. An estimated 29 per cent of customers fail to recover the pawn.

Cheque cashers may advance money against a borrower's cheque. Charges vary from £6 to £14 for a £100 cheque. There are around 400 cheque cashers in the UK with 1,500 outlets.

Sale and buy-back is a service offered by some lenders whereby the customer sells an item to the lender and can then buy it back at a higher price within a short period of time. There are more than 100 outlets in the UK, often combining sale and buy-back with pawnbroking and cheque cashing services.

Rental purchase shops allow customers to spread the cost of buying goods, either by paying in weekly instalments or monthly by direct debit. The advertised APR is normally around 30 per cent, however the good is often more expensive than on the high street. Customers are also strongly encouraged to take out insurance, which will add to the cost of the loan. The largest provider has over 130 stores.

In addition to these legal non-mainstream sources of credit, a minority of people are forced to resort to borrowing from **illegal lenders**. Research [19] has estimated that there are some 165,000 UK households using illegal lenders, concentrated in areas of high crime and social problems, that are often not served by legal home credit lenders. Borrowers on average pay a total cost of credit of £185 per £100 borrowed, and APRs can run into several thousand per cent. Late or missed payments are frequently punished with disproportionate and often arbitrary charges, and the use of intimidation and violence to elicit payment are common.

Longer-term planning

2.24 Longer-term planning also requires access to appropriate forms of credit, saving and insurance. For example, people can:

- **borrow money over the long-term** to buy a house with a mortgage;
- **make their own private pension provision**, in addition to state pension benefits, or accumulate assets in an ISA, a house, or a business; and

[17] Unless otherwise stated, data is drawn from *Home Credit Market Investigation*, Competition Commission, November 2006

[18] *Affordable credit: The way forward*, Sharon Collard and Elaine Kempson, February 2005

[19] *Illegal Lending in the UK*, Department of Trade and Industry, November 2006

- **use basic life insurance cover** to ensure that their family can meet the costs that arise in the event of their death.

The benefits of being able to deal effectively with financial distress

2.25 Financial inclusion also means being able to deal with the more serious difficulties that can arise when things go wrong, through either:

- **a single unexpected and traumatic event** with significant financial impact, such as unemployment, long-term sickness, or family breakdown; or
- **the gradual build-up of smaller-scale financial pressures**, which become collectively unmanageable.

2.26 In either case, the result can be unmanageable debt, with mounting interest and no prospect of repayment. Financially included people have access to a number of sources of support to prevent them from getting into financial distress, and to help them if they do, including:

- their banks and other financial services providers;
- independent intermediaries and advice providers such as Independent Financial Advisers (IFAs);
- a wide range of financial information websites; and
- other sources of information such as the FSA.

2.27 Financially excluded people do not have access to these sources of help. Therefore, readily available, specialist money advice is needed to ensure that they have access to help to deal with financial distress, should it arise. And in the longer-term, increasing inclusion will widen the range of help which they can access.

2.28 People who get early help when they encounter financial difficulty will face significantly reduced costs in interest, penalties, fines and legal costs. Getting help early also minimises stress and other health problems related to financial difficulty.

Social benefits of financial inclusion

2.29 Financial inclusion reduces the costs of money management, planning for the future, and dealing with financial distress. Research suggests that the "poverty premium" – the total cost borne by low-income families as a result of financial exclusion – can amount to more than £1,000 in the course of a year and that this is a major contributor to childhood poverty.[20]

[20] *The poverty premium: how poor households pay more for essential goods and services* , Save the Children and Family Welfare Association, February 2007

Box 2.3: Financial inclusion "case studies"

The following fictional examples show how being brought into the financial mainstream brings real benefits for three people at different stages of their lives.

Vikesh is 18 years old and has recently joined a New Deal programme undertaking vocational training to set up his own business carrying out home repairs. He has no bank account, and manages in cash, buying equipment on hire-purchase, paying weekly in cash. Vikesh is saving up to buy a second-hand van, but managing in cash, he finds it hard not to spend all his money.

Vikesh's New Deal personal adviser suggests that he open a basic bank account. He provides him with a letter to verify his identity at the local bank branch. With his new account, Vikesh saves money on his mobile phone by getting a contract and paying by direct debit. He is more confident about managing his finances, but still needs some capital to get his business going. Vikesh talks to a Community Development Finance Institution specialising in business start-ups. He discusses his business plan and is able to get a £2,000 loan to purchase a van and upgrade his equipment.

Dawn is a 30 year-old single mother, living in a housing association flat. Dawn works part-time, finding jobs through a temping agency, and also receives Child Tax Credit paid into a POCA. Dawn budgets carefully, but finds it harder to make ends meet at Christmas or at the start of the new school year. Last year, Dawn used a catalogue to buy children's clothes and other essentials, and the debt is still outstanding. Now, when she needs extra money, she uses the local doorstep lender, but worries if she can't make the repayments she may be forced to turn to a loan shark.

When Dawn starts struggling to pay her rent, her housing officer arranges an interview. She tells Dawn that she can get free advice on her debts at the local Citizens Advice Centre. Dawn books an appointment, and the adviser tells her about more affordable credit from the nearby credit union. The credit union gives Dawn a loan to pay off both her catalogue debt and her doorstep loans. They also encourage her to open a bank account to have her wages and tax credits paid into. She decides to try it after learning that she is able to pay in her wage cheques for free. Dawn uses the money she is saving in cheque-cashing fees to pay off her credit union loan more quickly.

Margaret is 64 years old, a widower living in a rural village. Her husband used to take charge of the finances, but now Margaret has to manage herself. Margaret has a bank account, but isn't confident enough to use it. Instead, she withdraws her pension each week from her POCA and pay her bills in cash. Margaret worries about carrying so much cash – especially when her winter fuel payment arrives – but isn't comfortable paying her bills any other way.

At Margaret's local community centre she is given information on some of the benefits of bank accounts. She is particularly surprised to learn that she can use her bank account at the Post Office. As a result of this advice, Margaret books a meeting with her bank and they arrange direct debits to pay all her bills, meaning she can take advantage of savings on her utilities. She now carries a lot less cash after making money withdrawals and feels a lot safer as a result. With the money she is saving on her bills, Margaret has set up standing orders to pay money regularly into her two young grandchildren's Child Trust Funds.

THE CAUSES OF FINANCIAL EXCLUSION

2.30 In general terms, financial exclusion arises from:

- problems with the supply of appropriate financial services products; and
- problems with demand for financial services among potential consumers.

Problems with the supply of financial services

2.31 Supply problems contributing to financial exclusion include:

- the market not supplying products appropriate to consumers' needs;
- the market not supplying products with adequate consideration of consumers' interests; and
- the market not making appropriate products easily accessible.

2.32 A lack of appropriate products is a common supply problem. For example, low income customers often require credit which provides small sums over a short period. Because of the high set-up cost of mainstream credit agreements, it may not be profitable for banks and other commercial lenders to provide such loans.

2.33 Similarly, most mainstream insurance products such as home contents or car cover are designed for payment of premiums directly from a bank account automatically excluding unbanked consumers.

2.34 And some people choose not to engage with financial services for religious or cultural reasons. For example, Islamic Shari'a law prohibits payment or receipt of interest, meaning that most saving or credit products are not appropriate for those who follow Shari'a law.

2.35 Products may be provided with inadequate consideration of consumers' interests. Non-mainstream credit products providing the basic features required by financially excluded customers are available. However, as Box 2.2 shows, such products can feature high costs or unfair terms and conditions.

2.36 Accessibility problems can arise in a number of ways. For example, basic bank accounts were created to increase access to appropriate banking products in the UK. But these accounts were inaccessible for many financially excluded customers. Until new guidelines to anti money-laundering regulations were introduced last year, many excluded consumers did not have the forms of identification needed to open a basic bank account.

2.37 Another example is saving. Simple accounts exist for saving small sums of money regularly. However, for some people living on a low income, the bus fare to the nearest bank branch may make the cost of regular saving too high for it to be accessible, and for those living in rural areas, lack of transport may create accessibility issues.

Problems with demand for financial services

2.38 Even when financial products do meet the needs of excluded consumers, they may be unaware that these products exist, or of the benefits they can bring, and therefore be unwilling to invest the time and effort needed to take them up (see box 2.4).

2.39 Often, lack of demand results from people believing that they will not be served by financial services providers. This belief can be based on prior experience of having been turned down, or on hearsay or prejudice. In many cases it is reinforced by social and cultural preferences for alternatives, such as Christmas hamper saving schemes (see box 2.5).

2.40 Finally, lack of demand for financial products may arise because people do not have the financial capability to make well-informed decisions. In these circumstances, many opt out altogether, and operate primarily in cash. Further analysis of this was set out in *Financial capability: the Government's long-term approach.*[21]

Box 2.5: Home collected savings schemes and credit products

Financially excluded people often have a preference for using financial products where payments can be made to agents calling door-to-door. This preference can be seen in the high use of home credit by low income households. Research for the Financial Inclusion Taskforce has shown that in addition to offering appropriate low value, short term loans, many financially excluded people value being able to deal with someone from their local community in their own home.[22]

The appeal of a convenient face-to-face service is also evident in the use of Christmas savings schemes. Research prepared for Brian Pomeroy's review of Christmas savings schemes shows that in addition to valuing the discipline of budgeting for Christmas, the 'coming to your door' element, both with respect to agents collecting money, and delivery of goods/vouchers as the end of the year, is seen as a key attraction.[23]

Financial products that recognise the importance of face-to-face delivery clearly have value for consumers. However, it is important that the cost of face-to-face delivery is transparent, and that consumers are aware of alternatives that may provide personal service more affordably.

THE CASE FOR GOVERNMENT ACTION

2.41 The Government's three goals for financial inclusion are that:

- **that everyone should be able to manage their money effectively and securely, through having access to a bank account, and the confidence and capability to get the most from it;**
- **everyone should be able to plan for the future with a reasonable degree of security. Therefore, affordable credit, saving accounts and simple insurance products should be available to all who need them; and**
- **everyone should have the information, support and confidence they need to prevent avoidable financial difficulty, and to know where to turn if they do find themselves in financial distress.**

Market failures, inefficiency, and inequity

2.42 Many of the barriers to these goals being achieved are market failures (cases where the market is unable to achieve efficient outcomes by itself), including:

- externalities;
- market power; and
- information asymmetries.

2.43 Undersupply of appropriate products can result from market failure. Mainstream lenders, for example, are not prepared to provide short-term, low-value loans to financially excluded customers, in large part because of the reputational risk of

[21] HM Treasury, January 2007

[22] *Financial inclusion deliberative workshops*, Opinion Leader Research for the Financial Inclusion Taskforce, May 2005

[23] *Consumer workshops on hamper schemes and savings clubs*, Opinion Leader Research, March 2007

charging a cost-based (and therefore high) price for such a product. This reputational externality means that mainstream commercial lenders exit the market, leading to undersupply.

2.44 Problems with products that do not adequately reflect consumers' interests may also be the result of market failure, resulting from market power. In this case, a single provider, or a number of providers operating together, exert sufficient influence on the market to be able to benefit unfairly and to the detriment of consumers.

2.45 Demand-side market failure occurs where financially excluded people lack the information needed to take up products which have been designed with their needs in mind. This problem may be exacerbated by low levels of financial capability, which can also be a result of market failures.

2.46 Beyond consideration of individual and social costs or inefficiencies, financial exclusion is a matter of social justice. Evidence presented above shows that vulnerable groups are most likely to be excluded. Consideration of equity and social justice therefore compels action to help some of the poorest members of society.

Priorities for Action

Chart 2.4: Promoting the Government's financial inclusion goals

Financial Inclusion Goals	*promoted by*	Financial Services Product(s)	*leading to*	Policy Priorities for Government
Effective day-to-day money management	→	Transactional bank accounts	→	Access to banking services
Planning for the future and coping with financial pressures	→	Affordable credit, saving, and insurance	→	Access to affordable credit, saving and insurance products
Dealing effectively with financial distress	→	Specialist money and debt advice	→	Access to appro-priate money advice

2.47 Chart 2.4 shows that the Government's priorities for action, on both the supply and demand side of the policy equation, should be to promote:

- access to banking services;
- access to affordable credit, saving and insurance services; and
- access to appropriate money advice.

2.48 The case for action is strengthened by consideration of the secondary impacts of policy action. Table 2.1 shows that action in each of the priority areas will also impact the other two financial inclusion goals. These secondary impacts arise because of the overlapping nature of the Government's goals for financial inclusion policy, and present a compelling case for coordinated, strategic action.

Table 2.1: Direct and indirect impacts of policy priorities on financial inclusion goals

Policy Priorities for Government

Financial Inclusion Goal	*Access to banking services*	*Access to affordable credit, saving & insurance*	*Access to appropriate money advice*
Effective day-to-day money manage-ment	**Everyone able to manage their money through a transactional bank account**	Financial benefits of using affordable credit, saving and insurance mean greater disposable income	Money advice may lead to take-up of banking products
Planning for the future and coping with financial pressures	Relationship with a bank may facilitate access to other bank products	**Everyone able to plan for the future using appropriate credit, savings & insurance**	Money advice may lead to take-up of appropriate credit, saving and insurance products
Dealing effectively with financial distress	Bank relationship provides point of first contact and a valuable resource for advice and signposting in times of distress	Use of appropriate credit, saving and insurance tools can prevent manageable problems deteriorating into financial distress	**Everyone who needs it has access to specialist money and debt advice**

Key:	**Primary impact**	Secondary impact

3 PROGRESS AND NEW CHALLENGES

3.1 For the last decade, tackling financial exclusion has been a policy priority for the Government. Key milestones have included:

- the creation, in 1998, of Policy Action Team 14 (PAT 14) to focus on the issue of access to financial services;
- introduction of a range of reforms to promote saving, including through Individual Saving Accounts and Child Trust Funds;
- piloting, through the Saving Gateway, of matched saving incentives targeted at people on lower incomes;
- improvements to consumer credit protection through the 2003 White Paper and the Consumer Credit Act 2006; and
- the creation, in 2004, of a dedicated Financial Inclusion Fund of £120 million and an independent Financial Inclusion Taskforce to evaluate progress and advise the Government.

3.2 But while progress has been made, more needs to done. For each of the Government's goals – day-to-day money management, planning for the future and coping with financial pressure, and dealing effectively with financial distress – new challenges are emerging which must be tackled by the Government, the financial services industry, and other stakeholders.

EFFECTIVE DAY-TO-DAY MONEY MANAGEMENT

3.3 The Government's goal is that everyone should be able to manage their money effectively and securely, through having access to a bank account, and the confidence and capability to get the most from it.

Progress to date

3.4 Bank accounts are essential for effective day-to-day money management. Since 1997, progress has been made in a number of areas:

- the creation of appropriate products for financially excluded customers;
- a reduction in the number of people without a bank account;
- removal of barriers to excluded customers opening bank accounts;
- increased access to banks' services through automatic teller machines (ATMs) and the Post Office network;
- improved service standards, especially for excluded customers; and
- the entry of new players into the banking market with the potential to reach excluded customers.

3.5 In 1998, PAT 14 was set up within the Social Exclusion Unit, to focus on the issue of access to financial services. One of PAT 14's recommendations was the creation of a bank account to meet the needs of low-income and unbanked customers.[1] The banking sector and the Government worked together to develop the basic bank account, which by 2003 was being offered by all the major retail banks. Today, there are 17 providers offering basic bank accounts in the UK.

3.6 In 2004, the Government announced a goal, shared with the banks, to halve the 2.8 million adults living in 1.9m households without access to a bank account, and to make significant progress within two years.[2] The Financial Inclusion Taskforce has reported that steady progress is being made towards this goal.[3]

3.7 Early assessment of the 2005-06 Family Resources Survey (FRS) supports the Taskforce's assessment of steady progress. FRS data suggests that in 2005-06, the **number of adults without access to a bank account had fallen from 2.8 million to 2 million adults living in 1.3 million households**. The Taskforce will report fully once detailed analysis has been conducted.

3.8 Ease of opening a bank account, particularly basic bank accounts, is a critical factor in reducing the numbers of unbanked. In 2005, the Banking Code – the voluntary code of practice to which all leading UK banks subscribe – was revised to include a commitment to offer a basic bank account to any customer who asked for one, or whose needs would best be met by one. The Banking Code Standards Board (BCSB) has assessed the extent to which banks are following the new Code finding that "there has been an improvement across the industry."[4]

3.9 The BCSB also found a number of areas in which the process of opening a basic bank account could be made easier. As a result, in August 2006 the BCSB agreed a number of additions to the Code guidelines, including:

- a requirement that basic bank account literature be easily available in branches;
- a limit of ten working days for processing a basic bank account application once identification and verification checks are complete; and
- the introduction of in-branch identification and verification procedures so that valuable documents do not have to be surrendered by applicants.

3.10 The BCSB also recommended that banks allow a wider range of identification for account opening, to help those without a passport or drivers' licence. In March 2006, the Joint Money Laundering Steering Group (JMLSG), a body made up of the leading financial services trade associations, finalised new risk-based guidelines for anti-money laundering regulations. [5] As a result, since August 2006, people applying for basic bank accounts can use new forms of identification, including letters of entitlement to benefit, or references from trusted individuals.

3.11 The terms on which basic accounts are operated are also important. In November 2006, the Office of Fair Trading (OFT) Payment Systems Task Force issued a

[1] *Access to Financial Services, Report of PAT 14,* HM Treasury, November 1999

[2] The baseline for the shared goal is taken from the 2002-03 *Family Resources Survey* (FRS). Neither the 2003-04 nor the 2004-05 FRS could be used for assessment of progress against the shared goal due to a data collection issue making comparison with the baseline impossible. This issue has been resolved for the 2005-06 and subsequent editions of the survey.

[3] *Report on progress towards the shared goal,* Financial Inclusion Taskforce, March 2006; *Update to the Economic Secretary to the Treasury,* Financial Inclusion Taskforce, December 2006. Both Taskforce reports can be accessed www.financialinclusion-taskforce.org.uk. The Taskforce conducted its assessments of progress using ONS omnibus survey data.

[4] *Survey of Subscribers Providing Basic Bank Accounts*, Banking Code Standards Board, November 2005

[5] www.jmlsg.org.uk

report on improving the current cheque clearing cycle.[6] The report, agreed by banks, building societies and consumer groups, included reforms which mean that, by November 2007, basic bank account customers who receive cheques will be treated on the same basis as other customers.

3.12 The Government's commitment to financial inclusion includes access to remittance services, which for many migrant workers, long-term immigrants, and unregistered workers constitute an essential financial service. Remittances are person-to-person transfers of money sent from one place or country to another. In the UK, migrants often send money home to family and friends in their country of origin. Remittance flows, which have grown globally by 73 per cent since 2001, are an increasingly important source of finance to developing countries.[7]

3.13 Following the public consultation on the Treasury's review of money service business supervision, the Government announced further measures to tackle the risk of criminal exploitation of the sector in a risk-based and proportionate way, as part of a comprehensive strategy to tackle criminal and terrorist finance published in March.[8]

3.14 Ease of access to cash is important for customers. In 2006, UK consumers withdrew around £171 billion in over 2.9 billion ATM cash withdrawals. About 34,000 free ATMs currently account for 96 per cent of cash withdrawals in the UK, with the remaining withdrawals made at the more than 26,000 charging machines.[9]

3.15 In May 2006, the Treasury invited Treasury Select Committee (TSC) chair John McFall MP to lead a working group on ATMs.[10] The group found that a small but significant number of areas are currently without convenient access to free ATMs, and concluded that around 600 new free ATMs would effectively meet this gap. The group also found that transparency rules did not meet an "at-a-glance" standard. The group's December 2006 report announced: [11]

- commitments by several ATM operators to supply free ATMs in low-income areas identified by the Working Group as lacking convenient access;
- a market-based financial incentive to encourage operators to place or retain free ATMs in deprived areas[12] ; and
- an agreement to strengthen transparency rules for charging ATMs, so that customers can immediately distinguish them from free ATMs.

3.16 The Economic Secretary to the Treasury has written jointly with John McFall MP to all local authorities and Members of Parliament, inviting them to consider suitable sites for free ATMs in key low-income areas. LINK (the national ATM network) has recently reported that nearly 400 of the new ATMs are either in place, or under contract for installation.

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[6] www.oft.gov.uk/News/Press+releases/2006/159-06.htm

[7] *Global economic prospects: economic implications of remittances and migration,* World Bank, 2006

[8] http://www.hm-treasury.gov.uk/media/042/B2/financialchallenge_crime_280207.pdf

[9] Source: LINK data

[10] The TSC published a report on ATMs in 2005: *Cash machine charges,* Treasury Select Committee, March 2005; http://www.publications.parliament.uk/pa/cm200405/cmselect/ cmtreasy/191/191.pdf

[11] *Cash machines – meeting consumer need* , ATM Working Group, http://www.hm-treasury.gov.uk/media/727/4C/atm_working_group_final.pdf

[12] Banks and building societies currently pay an 'interchange fee' when machines operated by other companies are used to access their accounts. As part of the December 2006 announcement, a 30-50% fee premium per transaction will be paid to cash machine operators establishing ATMs at sites with lower customer-use in lower-income areas.

3.17 New entrants in the market could have a significant impact. The launch in 2006 of current account products by credit unions, in partnership with the Cooperative Bank, has increased choice for transactional banking. Nine credit unions are currently offering the product, which includes a debit card and allows full ATM access (in addition to affordable credit through credit union loans). Also of interest are early plans for the community banking model in the UK. One example of this is the Community Banking Partnership, currently being piloted in Birmingham.

3.18 At the same time, the Financial Inclusion Taskforce has reported that a number of banks have indicated that they are increasingly viewing the market for free basic bank accounts as part of their wider commercial strategies.[13] Commercial viability, balanced with consumer choice and transparency, is vital to a sustainable financial inclusion strategy.

New challenges for money management

3.19 While progress has been made, significant challenges remain. These include:

- continuing to reduce the number of unbanked people by promoting basic bank accounts;
- ensuring that newly banked people are using their bank accounts effectively;
- continuing to focus on the issue of accessibility of banking services; and
- understanding the impact of developments in the banking market on the Government's objectives for effective money management.

3.20 Latest FRS data demonstrates that progress is being made with reducing the number of unbanked people. But there is no room for complacency. Research shows that the costs to individuals of being unbanked rise as the number of unbanked people falls.[14] There is therefore an ongoing imperative to bring as many adults as possible into banking, especially young people participating in the economy for the first time.

3.21 As more people move from being unbanked to banked, the extent to which they are using their accounts effectively becomes increasingly important.[15] A key issue is whether people, particularly those on low-incomes, are using the facilities – such as direct debit to pay for essential utilities – that provide the benefits of banking.

3.22 Ongoing accessibility of services is as important as initial access. While recent progress has been made, for example through the installation of new free ATMs, it is vital that outlets where people can access their bank accounts remain accessible.

3.23 A number of developments in the banking market have the potential to significantly impact people's ability to manage their money effectively. These include:

- new technologies, for example, mobile telephone banking and pre-paid debit cards (see Box 3.1) ;
- new market entrants, such as credit unions and community banks; and

[13] *Update to the Economic Secretary to the Treasury from the Financial Inclusion Taskforce,* December 2006. This report can be accessed at www.financialinclusion-taskforce.org.uk

[14] *Policy level responses to financial exclusion in developed countries: lessons for developing countries,* Personal Finance Research Centre, May 2006

[15] *Three steps to inclusive banking: compliance, standardisation and innovation*, National Consumer Council, November 2006

- new products, such as specialised remittance accounts.

3.24 These, and other, new developments present both opportunities and challenges for the Government's financial inclusion goals. For example, evidence from the United States shows that remittance services can form the basis of a profitable business model for low-cost community banking services in areas with high migrant populations. Therefore, it is crucial that the Government and others understand the impact of these developments, and are in a position to respond appropriately.

Box 3.1: The end of cash?

In February 2007, the *Economist* published a special report,[16] detailing how cash transactions are being replaced by cheaper and more convenient electronic payments in many parts of the world. Over the next 15 years, the *Economist* argued, cash may be used only by those without a bank account or a mobile phone.

- Mobile phones are already being widely used to send money home by migrants, and in countries such as Kenya and the Philippines mobile phone banking projects have been set up to allow those without bank accounts to access financial services and payment systems. Worldwide payments using mobile phones are projected to reach $37 billion by 2008.
- Pre-paid cards are another increasingly used method of making purchases. In the United States, cards account for more than half of all transactions, and the market for pre-paid cards already exceeds $180 billion. In the UK, the market is less well developed, but the success of products such as the Oyster card, which is widely used to pay for journeys on public transport in London, demonstrates their potential;
- Online payments systems are also growing fast. PayPal, owned by eBay, allows customers to send and receive money online in over 100 countries, and has more than 120 million accounts. Many utility companies and high street stores also offer discounts for purchases that are made via the Internet.

While these new technologies are unlikely to completely replace cash transactions in the short-term, those with a preference for managing in cash may find themselves more and more in the minority. As transaction costs for electronic payment come down, managing with cash may also become increasingly expensive. The challenge for financial inclusion will be to ensure that policies are specifically targeted at those at most risk of being left behind by these developments.

PLANNING FOR THE FUTURE AND COPING WITH FINANCIAL PRESSURES

3.25 The Government's goal is that everyone should be able to plan for the future with a reasonable degree of security. Therefore, affordable credit, saving accounts and simple insurance products should be available to all who need them.

3.26 Progress has been made, including:

- increasing the supply of affordable credit through the third sector;
- improving consumer protection in the credit market;

[16] *Economist*, February 15th 2007

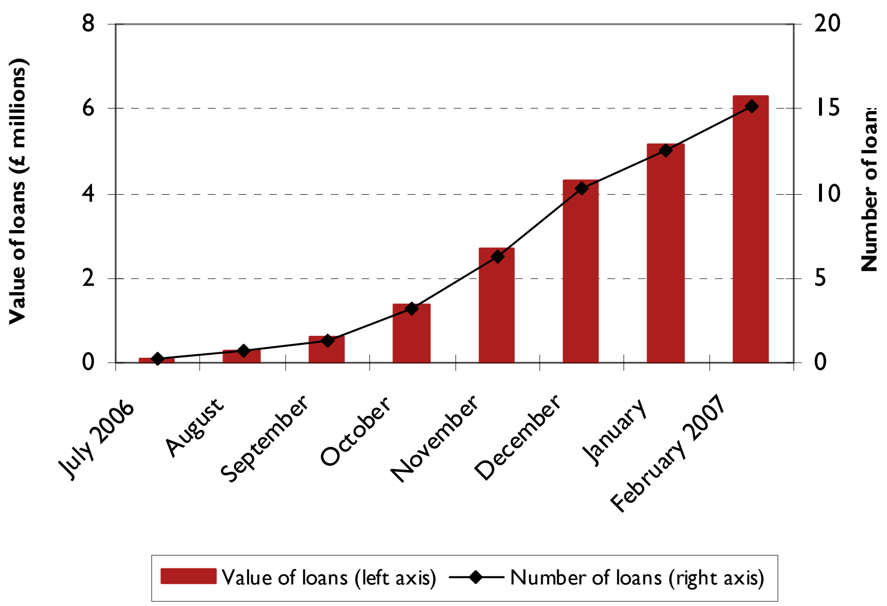
- increasing access to saving products and understanding the saving behaviour of low-income customers;
- developing appropriate insurance products to meet the needs of financially excluded consumers; and
- promoting demand for financial services products.

Progress with promoting third-sector affordable credit

3.27 Since 1997, progress has been made in the financing and regulation of third sector providers of affordable credit. PAT 14 recommended that the Government take action to promote credit unions. A number of measures were implemented, including establishment of a bespoke light-touch regulatory framework for credit unions under the Financial Services Authority (FSA) through the Financial Services and Markets Act (2000).

3.28 Since 2006, the Financial Inclusion Fund has provided Growth Funding for third sector lenders. The Growth Fund is a £36 million Department for Work and Pensions (DWP) initiative, which has contracted with over 100 third sector lenders[17] around Great Britain. The Fund provides capital for lending to financially excluded customers, with revenue support to meet costs. Crucially, capital is on-lent without any requirement that the borrower first save for a set period, ensuring that the most excluded customers can borrow immediately.

Chart 3.1: Cumulative Value and Volume of Growth Fund loans



Source: DWP

[17] There are two types of third sector lender. **Credit unions** are mutual financial organisations offering savings and loan facilities to their members. They legally obliged to define a group of people who share a 'common bond' from whom they can recruit their membership and to whom they can provide services. **Community Development Finance Institutions** (CDFIs) are not-for profit organisations providing lending facilities at competitive rates in disadvantaged communities. Most CDFI activity is focused on lending to small businesses, but there has been a rise in recent years in the level of personal lending.

3.29 The initiative has been running since June 2006, and is gathering momentum (see Chart 3.1). To date, over 15,000 loans have been made, totalling more than £6 million. The Fund is comfortably exceeding its target of making 60 per cent of loans to financially excluded customers. Early indications on levels of delinquency – the extent to which people are unable to pay back loans – are good. Growth Funded lenders have also helped around 500 unbanked customers open bank accounts for the first time.

Box 3.2: Innovation and partnership[18] in the delivery of affordable credit

Places for People is one of the largest Registered Social Landlords in the UK, with 57,000 homes. In June 2006, Places for People set up a finance arm to administer personal loans of between £250 and £3,000, recognising that tenants with access to affordable credit would be less likely to experience significant rent arrears. Places for People is also offering mortgages to all tenants through an arrangement with the **Cooperative Bank**. [19]

There is also innovation in the methods of delivery and outreach work employed by third sector lenders, for example by entering into partnerships with local housing associations. Members of the **Wearside First credit union** are able to make loan repayments at 25 locations belonging to the **Sunderland Housing Group**. [20]

The PEARLS monitoring system provides a series of financial ratios to monitor the financial stability of credit unions, and generates a series of management information for future strategic planning. PEARLS was introduced to Britain in 2002 with the support of a grant from **Barclays**. The first nine credit unions piloting PEARLS benefited from reduced loan delinquency and operating expenses, and a growth in assets and membership. Barclays has now made a further investment to ensure more credit unions have access to the PEARLS system.

HBOS has entered into an arrangement with the CDFI East Lancashire Moneyline (ELM) to provide systems that allow customers the opportunity to start saving. Customers are offered the option of making an additional small payment with their loan repayments which goes into an HBOS savings account that can be accessed through ELM.

Royal Bank of Scotland (RBS) have partnered with the east London-based CDFI Fair Finance, providing capital for making affordable loans to financially excluded individuals. A member of the RBS Community Development Banking team is vice-chair of the Fair Finance board.

Lloyds TSB have supported the development of South Coast Moneyline (SCML), a Portsmouth-based CDFI, providing funding, premises and seconded staff. Lloyds TSB are now supporting a Community Banking Partnership between SCML and Portsmouth Housing Association.

Home collection is a highly desired feature of credit for many individuals and families (see box 2.2). However the cost of such loans from private sector providers is high. The **Joseph Rowntree Foundation** has recently commissioned research examining the feasibility of a not-for-profit model of home collected credit. The research is expected to conclude in autumn 2007.

3.30 The Government has also taken action to enable third sector lenders to manage the cost of lending to low income consumers, through the Eligible Loans Deductions Scheme. Approved lenders are able to claim repayment by deduction from benefits for customers who are more than 13 weeks in default, subject to safeguards. This reduces the credit risk, and therefore cost, of lending to benefit recipients. The scheme was

[18] Source: *Financial inclusion: credit, savings, advice and insurance*, Treasury Committee: Evidence, November 2006

[19] Places for People, press release, June 2006

[20] *Credit Union News*, ABCUL, July 2006

implemented in December 2006, and 57 credit unions and seven CDFIs have been approved to date.

3.31 The Government has also increased the maximum interest rate which credit unions are able to charge, from one to two per cent per month. This change, implemented in June 2006 after consultation, reflects the fact that lending to financially excluded customers without a requirement of prior saving (as is the case with Growth Fund capital), unavoidably carries higher credit risk and cost for the lender.

3.32 Many local authorities are providing funding and support to third sector lenders. The Government has incorporated financial inclusion into the Local Authority Beacon Scheme. Three awards of beacon status under the theme "Promoting financial inclusion and tackling over-indebtedness" were made on 20 March 2007:

- **Leeds City Council** funds the city's credit union, and has located customer services and credit union collection points on the same site to create a "one-stop shop" facility;
- **Sheffield City Council** has facilitated private sector funding by launching an investment bond, with funds raised supporting a Moneyline (CDFI) that operates from the same premises as a local credit union; and
- **South Tyneside Metropolitan Borough** has increased the number of credit union collection points in the community and publicised local credit and advice services in a leaflet entitled "Your Money and You".

Progress with improving consumer protection for credit

3.33 As well as support for third sector lending, action has been taken on the regulation of credit more generally. In the White Paper, *Fair, Clear and Competitive: The Consumer Credit Market in the 21st Century*[21], the Government set out an extensive programme of reform of consumer credit legislation. The resulting Consumer Credit Act (2006) will strengthen consumer protections and create a fairer, more competitive credit market as it is implemented in 2007 and 2008.

3.34 The Competition Commission published a report on the home credit market in December 2006. The Commission reported that, as a result of a lack of competition, consumers using home credit are paying significantly in excess of the cost of capital for access to credit.[22] The Commission proposed a number of remedies, focused on:

- compulsory data sharing by home credit lenders;
- transparency for customers, including through regular statements; and
- ensuring customers are offered fair early settlement rebates.

3.35 The Department of Trade and Industry (DTI) has accepted the Commission's recommendations around transparency, and will implement them in April 2007 through Statutory Instruments under the Consumer Credit Act (2006). The DTI has also consulted on proposals for further and wider data sharing in the credit industry, and will publish the results of this consultation in due course.

[21] Department of Trade and Industry, December 2003

[22] *Home credit market inquiry: final report*, November 2006. The Competition Commission found that consumers were paying an excess of £9 for every £100 lent, compared to what would be expected in a perfectly competitive market.

Progress with saving and insurance

3.36 An essential element in planning for the future is availability and access to suitable saving and insurance products. The Government has increased access to savings through a number of different products:

- Individual Savings Accounts (ISAs) were introduced in 1999 to extend the savings habit and to distribute tax relief on savings more fairly. Over 17 million people now have an ISA, including one in four people from low-income groups;
- building on this success, the Government has made ISAs a permanent feature of the savings landscape and has announced that it will implement reforms in April 2008 to simplify the regime and increase flexibility for savers. To encourage further saving in ISAs, Budget 2007 announced that with effect from April 2008 the overall ISA annual investment limit will rise to £7,200 of which up to £3,600 may be held in cash.;
- Child Trust Funds were introduced in 2005 as a universal savings account into which children born on or before 1 September 2002 are auto-enrolled at birth. Around 2.5 million accounts are open;
- the Saving Gateway, which aims to encourage saving among lower-income households and promote engagement with mainstream financial services is being piloted. Evidence from the first pilots suggests that matching – a Government contribution for each pound saved – provides a more understandable, transparent and equitable framework of support for savers and can encourage genuinely new savers and new saving;[23]
- the second Saving Gateway pilot is now drawing to a close. Early evidence suggests that the scheme has brought some individuals into contact with a bank for the first time, and that savers have found the experience useful in familiarising themselves with the mechanics of saving; and
- the Pensions White Paper[24] announced the introduction of Personal Accounts from 2012, providing access to employees to a simple, low cost retirement savings vehicle.

3.37 In November 2006, the Christmas hamper and voucher company Farepak collapsed, resulting in tens of thousands of people losing money they thought they had "saved" for Christmas. The Government responded by:

- launching a DTI investigation, with the OFT and the FSA, into the causes of Farepak's failure;
- working with private companies to increase support for Farepak victims provided through the Farepak Response Fund, set up by the Family Fund, an independent charity. The Farepak Response Fund collected over £7 million;
- asking Brian Pomeroy, chairman of the Financial Inclusion Taskforce, to conduct a review of Christmas saving schemes, to learn the lessons of the collapse of Farepak, and to consider the implications of hamper schemes

[23] *Incentives to save: Encouraging saving among low-income households*, University of Bristol, Personal Finance Research Centre, March 2005

[24] *Security in retirement: towards a new pensions system*, Department of Work and Pensions, May 2006; http://www.dwp.gov.uk/pensionsreform/whitepaper.asp

and other Christmas saving vehicles for Government policy on saving. The review is published alongside this document,[25] and makes a number of recommendations, which are summarised in Box 4.1.

3.38 PAT 14 recommended in 1999 that insurance with rent schemes – which bundle insurance premia with rent for tenants of registered social landlords – should be established in more areas of the country. In 2001, the Housing Corporation and the ABI published good practice guides for insurance with rent schemes.[26] Today, there are hundreds of insurance with rent schemes in operation.[27]

Progress with demand for financial services

3.39 For financial services to be used effectively as a means of planning for the future and coping with financial pressure, consumers must understand what products are available, uses to which they are suited, and how to access them. Demand and capability are therefore an important part of achieving this financial inclusion goal.

3.40 Based on its research into demand problems in 2006, the Financial Inclusion Taskforce recommended that the Government develop a campaign to promote and support demand for financial products among hard-to-reach groups, working through trusted intermediaries such as social landlords, community groups and local government.

3.41 The campaign, entitled "now let's talk money", was launched in January this year by the DWP, with a £5.4 million budget from the Financial Inclusion Fund. The first stage of the campaign is working with intermediaries, in areas of high financial exclusion, to help provide excluded clients with information, advice and support in taking up financial services products. Later stages of the campaign will target excluded people directly, through appropriate local media, informing them of the benefits of financial products, and where they can get support.

3.42 Financial capability is an important component of demand. The FSA's 2006 baseline study showed that low levels of capability pose a particular challenge for those who are already financially excluded or at risk of becoming excluded.[28] Lack of confidence in dealing with financial products can, for example, deter the engagement needed to build the skill and experience required to cope with financial pressure.

3.43 In January 2007 the Government published its long-term approach to raising financial capability in the UK,[29] setting out its long-term aspirations to ensure that:

- all adults in the UK have access to high-quality generic financial advice to help them to engage with their financial affairs;
- all children and young people have access to a planned and coherent programme of personal finance education, so that they leave school with the skills and confidence to manage their money well; and

[25] *Review of Christmas Saving Schemes,* HM Treasury, March 2007

[26] *Insurance for all*, Housing Corporation, 2001; *Insurance with rent - a good practice guide for local authorities*., ABI, 2001

[27] Norwich Union and Royal and Sun Alliance are two of the main underwriters of insurance with rent schemes. Norwich Union currently underwrites over 100 schemes, and Royal and Sun Alliance nearly 200 (source: company data)

[28] *Financial capability in the UK: establishing a baseline,* FSA, www.fsa.gov.uk/pubs/other/fincap_baseline.pdf

[29] *Financial capability: the Government's long-term approach*, HM Treasury, January 2007

- a range of Government programmes is focused on improving capability, particularly among those who are most vulnerable to the consequences of poor financial decision-making.

3.44 To take forward the issue of generic advice, identified as a priority element of the Government's long-term approach to financial capability, the Government has asked Otto Thoresen, Chief Executive of AEGON UK, to head a feasibility study to research and design a national approach to generic financial advice. The study will report around the end of the year and will feed into the Government's action plans on financial capability and financial inclusion.

New challenges for planning for the future and coping with financial pressure

3.45 While progress has been made in a number of areas, key challenges remain if the goal of helping everyone to plan for the future and cope with financial pressure is to be meaningfully realised. These challenges include:

- increasing the coverage and capacity of third sector lenders so that people nationwide have access to this source of affordable credit;

- making saving work for low-income or financially excluded consumers, through promotion of products that meet their saving needs, and through targeted saving incentives;

- understanding the role of insurance as a product for financially excluded customers; and

- successfully increasing demand for financial services through targeted initiatives, increased financial capability, and realising the potential of bank accounts as a route into wider financial inclusion.

3.46 Much of the Government's work to promote access to affordable credit has been focused on the third sector. However, coverage remains patchy. The key challenge will therefore be to increase the coverage and capacity of credit unions and CDFIs so that they provide affordable credit to excluded consumers nationwide.

3.47 During the TSC inquiry into financial inclusion, the bank chief executives expressed their commitment to support the third sector in achieving a significant increase in coverage and capacity.[30] The support of the banks will be a vital asset in meeting this challenge. The Government will also review legislation affecting third sector lenders to ensure it provides sufficient flexibility to allow them to grow and attract capital.

3.48 A further, longer-term challenge for saving policy will be how best to take forward the Saving Gateway scheme, to encourage saving among individuals who do not usually save, and to promote wider engagement with mainstream financial services.

3.49 For insurance, a relatively new priority for financial inclusion policy, the initial challenge will be to investigate the nature of the problem of exclusion from insurance and how this might be tackled, including:

- **which types of insurance** are most needed by financially excluded consumers;

[30] *Financial Inclusion: credit, savings, advice and insurance*, Vol.2, TSC, November 2006

- **the barriers, including cost**, to excluded consumers taking up these insurance products; and
- **how these barriers might be overcome**, drawing on evidence on the success of initiatives such as insurance with rent schemes, and new approaches such as risk-reduction projects.

3.50 Demand is a relatively new area of focus for financial inclusion policy. One immediate challenge, therefore, is to gather evidence on the effectiveness and feasibility of different approaches to promoting demand from:

- **local intermediary-led work** such as "now let's talk money"; to
- **larger initiatives** such as a potential national generic financial advice network; and through to
- the Government's **long-term approach** to financial capability.

3.51 As progress is made with increasing the number of people with a bank account, an emerging challenge is ensuring that newly banked consumers are establishing a relationship with their bank leading to wider financial inclusion, through credit, saving and insurance products, where appropriate.

DEALING EFFECTIVELY WITH DISTRESS

3.52 The Government's third goal for financial inclusion is that everyone should have the information, support and confidence they need to prevent avoidable financial difficulty, and to know where to turn if they do find themselves in financial distress.

3.53 Progress has been made towards this goal in a number of areas, including:

- the Government's strategy to tackle over-indebtedness;
- provision of free face-to-face money advice, and the piloting of money advice outreach;
- projects to tackle illegal loan sharks; and
- delivery of money advice through cost-effective remote channels.

Progress to date

3.54 In 2004, the Government published a strategy to minimise the number of consumers who become over-indebted and improve support for those who have fallen into debt.[31] Current priorities include:

- increasing levels of financial capability and awareness;
- a modern regulatory framework for credit, encouraging competition and innovation, while stamping out irresponsible lending and unfair practice;
- ensuring access to appropriate debt advice when people need it; and
- reducing the number of debt cases brought to the courts and improving the efficiency and speed with which cases are handled.

3.55 Access to free face-to-face money advice is crucial to enable vulnerable

[31] *Tackling Over-Indebtedness Action Plan*, DTI/DWP, 2004

consumers to deal with financial distress. As part of its 2004 financial inclusion strategy, the Government has committed £47.5 million from the Financial Inclusion Fund to increase the supply of free face-to-face money advice. The DTI has contracted 16 project partners to provide money advice in England and Wales, including a number of regional partnerships, and two nationwide projects – one delivering advice to clients with disability, and the other to clients in rural areas. A final project is providing training to all newly-recruited advisers.

3.56 To date, almost 400 new advisers have been recruited and trained, and advice has been provided to more than 18,000 clients. By April 2007, the number of advisers will exceed 500.

3.57 The Government is also piloting approaches to making money advice available in easily accessible locations, including family and children centres, housing offices, credit unions, community centres and prisons. The Legal Services Commission (LSC), part of the Department of Constitutional Affairs, has contracted with 22 pilot projects, financed by £6 million from the Financial Inclusion Fund. The projects commenced in April 2006.

3.58 Recent monitoring data shows that over 8,000 clients have already been helped, the vast majority of whom are financially excluded. The first phase of independent evaluation found that outreach users overwhelmingly welcome the offer of outreach advice, because of the "one-stop shop" convenience, as well as the trusted relationship they have with staff at outreach locations. [32]

3.59 The DTI has also been running pilots tackling illegal money lenders, who are often active in areas with a high concentration of crime and social problems. Established in Birmingham and Glasgow in 2004, the projects have provided the victims of illegal lending in the West Midlands and Scotland with the support they need to:

- bring **enforcement action against illegal lenders**; and
- connect victims to **legal local alternatives**, especially credit unions and CDFIs.

3.60 The projects have so far identified over 200 illegal lenders and carried out over 100 investigations resulting in 19 court cases, nine prosecutions, and the recovery of over £1 million in victims' assets. In total, over 1,700 victims have been helped, saving them over £3 million in interest and penalties.[33]

3.61 In December 2006, the Government announced that the operations of the two pilots would be extended into the financial year 2007-08, and expanded to cover three new areas: South Yorkshire, Merseyside and West Yorkshire, with funding of £1.2 million committed from the Financial Inclusion Fund. Building on this expansion, the Government has recently announced that the projects will be extended to every region of England and Wales, with additional focus on providing victims with the information and support they need to seek out and find legal providers of affordable credit.

[32] *Putting money advice where the need is,* LSRC research paper no.16, March 2007

[33] *Evaluation of the illegal money lending pilots,* Department of Trade and Industry, February 2006

Box 3.3: 20 years of National Debtline

National Debtline (NDL) is the product of a partnership of government, the private sector and the not-for-profit sector pulling together to deliver a successful and effective service. Set up in 1987, over its history NDL has helped almost 400,000 clients, nearly 100,000 in 2006 alone. Expansion plans continue, with the aim of reaching the capacity to help 230,000 clients by the end of 2009.

The latest independent evaluation (2006) shows high levels (over 95 per cent) of client satisfaction. Only 10 per cent of NDL's callers would have preferred face to face advice if it had been available. Advice given has a lasting impact, with over 80 per cent of clients reporting that the arrangement originally set up with creditors had been maintained over the following two to three years. 26 per cent of clients were out of debt by year two and 43 per cent by year three. These figures are very similar to more expensive third party mediated solutions such as Individual Voluntary Arrangements (IVAs) or Debt management Plans (DMPs).

Over the past 20 years, the number of people dialling the service has always outstripped capacity. 2007 will be a turning point, funding and external factors allowing. By the autumn, NDL expects to be able to assist nearly all who want its help.

3.62 In addition to face-to-face delivery, there are also other channels through which advice on debt and money management can be delivered. The Money Advice Trust runs National Debtline, a free and independent telephone helpline for people with debt problems in England, Wales and Scotland. In 2006, National Debtline helped nearly 100,000 people with their debt.[34]

3.63 It is now also possible for people experiencing debt difficulties to receive advice online. The Consumer Credit Counselling Service (CCCS), which already provides telephone based and face-to-face advice, has now developed 'Debt Remedy' software to facilitate the provision of free debt advice over the internet. Launched in August 2006, more than 35,000 clients have already been advised using this system.[35]

New challenges for dealing with financial distress

3.64 Progress is being made with the supply of advice and other support for people in financial distress. However, significant challenges remain if the Government's goal of ensuring everyone is able to deal effectively with financial distress is to be met. These include:

- continuing to make progress with the supply of face-to-face advice;
- understanding the potential of new, cost-effective, mechanisms for delivery of advice;
- replicating the success of DTI's pilots in the nationwide rollout of illegal lending projects;
- promoting the role of banks and other financial services providers in supporting people out of financial distress; and
- addressing the impact of low financial capability on people's capacity to deal with distress.

[34] Source: Money Advice Trust

[35] Source: CCCS

3.65 Initial evidence suggests that the DTI's face-to-face money advice projects, and the LSC's money advice outreach pilots, are making a real difference to thousands of people with debt and money problems. The challenge for financial inclusion policy will now be to consolidate and continue this progress, informed by ongoing evaluation of the effectiveness and value for money of these initiatives.

3.66 In addition to ongoing delivery of face-to-face money advice, the Government needs to consider the question of whether more cost-effective remote methods of delivery – including through telephone and computer-based applications – can be made relevant and effective for financially excluded consumers.

3.67 The illegal lending pilots in Scotland and the West Midlands have shown the extent to which the victims of illegal lending can be helped through targeted interventions. The Government has already announced roll-out of these projects to every region of the country. The challenge therefore, will be for the nationwide rollout to replicate the results achieved by the pilots across the country.

3.68 Banks have an important role in helping people deal with financial distress. The banks have signed up to the principle, under the Banking Code, that they will treat people in financial distress fairly and sympathetically. This is one of the priority areas identified by Mike Young for his 2007 independent Review of the Banking Codes. The Government has submitted its response to the Review, encouraging the Review to strengthen the provisions of the Code in this area, for example by requiring that banks make customers in financial difficulty aware of sources of free money advice.

3.69 Looking forward, as more people are brought into engagement with mainstream financial services, the challenge for the Government and for banks and other financial services providers, will be to maximise the extent to which a relationship with a financial services provider helps people to deal more effectively with financial difficulty and distress.

4 Responding to the challenge

4.1 The previous chapter detailed progress made to date towards these goals. But the Government knows that there is no room to be complacent. There is much work to be done if the Government and industry are to meet and overcome the challenges standing in the way of financial inclusion, and the improvement in people's lives that it promises.

Government's commitment to financial inclusion

Policy framework for 2008-11

4.2 The Government is determined to promote financial inclusion. In the long-term, this commitment will involve mainstreaming financial inclusion into Departmental budgets and Public Service Agreements. However, for the next spending period from 2008-2011, as more evidence from existing initiatives continues to be collected, the Government will:

- **establish a new Financial Inclusion Fund** for new and ongoing initiatives to promote financial inclusion, **maintaining the current level of intensity** of action, with the exact amount of the fund to be determined after the forthcoming Comprehensive Spending Review (CSR);
- **establish a ministerial working group** to determine detailed priorities for financial inclusion policy, and to publish a detailed action plan after the CSR; and
- **extend the life-span of the independent Financial Inclusion Taskforce** to evaluate progress and advise the Government, working to new terms of reference reflecting the post-CSR action plan.

4.3 The ministerial working group will evaluate policy options in the light of emerging evidence from new and ongoing initiatives. It will be chaired by a Treasury minister, and will include ministers from Departments with a key role in delivering financial inclusion, including the Department for Work and Pensions (DWP), Department of Trade and Industry (DTI), and the Department of Constitutional Affairs (DCA).

Working with the industry

4.4 The Government believes that work to widen take-up of financial services must be undertaken in partnership with banks and other financial services providers. This belief in partnership informed the Government's approach of working with the banks to agree a shared goal. Today, partnership remains at the heart of the Government's approach to achieving its financial inclusion goals.

4.5 The Government will therefore engage with the financial services industry over the coming months, to work towards an **action plan,** with a particular focus on:

- access to banking and the shared goal;
- effective usage of bank accounts, particularly among low-income and newly-banked consumers;
- how the banks can support an increase in the provision of third-sector credit leading to nationwide coverage;
- the role of insurance products in promoting financial inclusion goals;

- the role of banking as a route into wider financial inclusion; and
- the role of banks and other providers in helping people to deal with financial distress.

4.6 The Government will report on the results of its work with the industry, including possible new targets or goals where appropriate, in the detailed post-CSR action plan.

NEXT STEPS FOR FINANCIAL INCLUSION

4.7 The last chapter set out the challenges to the Government's financial. This section sets out the next steps that the Government will now take to meet these challenges.

Next steps for effective money management

4.8 The challenges for effective day-to-day money management include:

- continuing to reduce the number of unbanked people by promoting basic bank accounts;
- ensuring that newly banked people are using their bank accounts effectively;
- continuing to focus on the issue of accessibility of banking services; and
- understanding the impact of developments in the banking market on the Government's objectives for effective money management.

4.9 Access to banking remains a key element of the Government's financial inclusion strategy. Early analysis of the latest Family Resources Survey (FRS) shows that the number of unbanked people in 2005-06 had fallen to 2 million adults, living in 1.3 million households. The Government will **continue to work with the banks to promote free basic bank accounts and further reduce the number of unbanked**, in the light of the following emerging evidence:

- the Taskforce's detailed report and evaluation on the 2005-06 FRS data;
- the Banking Code Standards Board's evaluation of the impact of recent changes to Banking Code and money laundering guidelines; and
- the ongoing independent review of the Banking Codes, being carried out by Mike Young, to which the Government has already submitted a response.

4.10 The Government will report on further action agreed with the banks in its detailed action plan after the CSR.

4.11 The action plan will also look at how bank accounts are used. To understand the scale and scope of the challenge posed for financial inclusion by the issue of bank account usage by low-income newly-banked customers, **the Government and the Financial Inclusion Taskforce will work with the banks to collect data on account usage by basic bank account customers**. This evidence will inform work with the banks to tackle the issue of usage, including a possible goal or target on usage, with a view to reporting steps to be taken in the detailed action plan.

4.12 Easy access to banking services is important in encouraging people to open and use bank accounts. Following the early indications of good progress, which have seen 400 new free cash machines in place or under contract for installation, the Government will publish an update on further progress made against the ATM Working Group's recommendations in the summer.

4.13 The DTI will also shortly publish plans for the Post Office network, securing a network of around 12,000 Post Offices at which basic bank accounts and selected other accounts can be accessed.

4.14 Finally, the Financial Inclusion Taskforce will, in response to a recommendation from the TSC, conduct mapping of bank branches, Post Offices and other outlets for financial services, cross-referenced against census and other demographic data on the prevalence of financial exclusion.

4.15 To understand the potential impact of developments in the banking market – including new technologies, and new entrants into the market – on financial inclusion, **the Government has asked the Financial Inclusion Taskforce to conduct a banking market study** to inform the Government's detailed action plan.

4.16 The Government will approach the DFID-funded UK Remittance Task Force, which works to inform remittance service providers and users, to ask if it will consider how remittance services fit with existing financial service products offered to migrant communities by banks, money service businesses, credit unions and CDFIs, and whether products can be designed to help bring more people into the banking system.

Next steps for planning for the future and coping with financial pressure

4.17 The challenges for planning for the future and coping with pressure include:

- increasing the coverage and capacity of third sector lenders to provide excluded people nationwide with access to affordable credit;
- making saving work for low-income or financially excluded consumers, through promotion of products that meet their saving needs, and through targeted saving incentives;
- understanding the role of insurance as a product for financially excluded customers; and
- successfully increasing demand for financial services through targeted initiatives, increased financial capability, and realising the potential of bank accounts as a route into wider financial inclusion.

Affordable credit

4.18 The Government's affordable credit strategy has focused on supporting the third sector. Early progress suggests that this is a viable approach, but much more support is needed if the third sector is to become a nationwide option, available to everyone. The banks have expressed their commitment to supporting this approach.

4.19 Therefore, to advise the Government on how to achieve a nationwide increase in the coverage and capacity of third sector lenders, **the Government has asked senior representatives from the banking sector to work with the Financial Inclusion Taskforce to consider how to achieve a nationwide increase in the coverage and capacity of third sector lenders.** This group will consider the roles of Government, the private sector and third sector lenders in increasing coverage, in the light of emerging evidence on the Growth Fund and other initiatives. The group's findings will be presented in the detailed action plan following the CSR.

4.20 For 2007-08, building on the early success of the Growth Fund, and to further boost the capacity of third sector lenders in a number of different areas, **the Government announces that a further £6 million will be made available to credit unions and CDFIs through the DWP's Growth Fund**. The new funding will be used:

- to support **new lenders** in parts of the country where supply of third sector affordable credit is insufficient;
- to support the **emergence of new banking providers**, through financial support for credit unions investing in transactional banking capability; and
- to fund increased investment in the skills of third sector lenders' staff and volunteers through a **capacity-building programme**, as announced in the 2006 Pre-Budget Report.

4.21 The Government recognises that an appropriate and flexible regulatory framework will be key to allowing third sector lenders to grow and attract investment. In November 2006, the Government announced **a review of mutuals legislation**, including the Credit Unions Act. The review, which will be published in April 2007, will consider:

- the **"common bond"** restrictions that define the geographical areas in which credit unions can operate;
- whether to allow credit unions to accept **corporate deposits**; and
- the impact of allowing credit unions to create **subsidiaries** on reducing risk and facilitating product innovation.

4.22 The Government established the Community Investment Tax Relief (CITR) in 2002 to support investment in small businesses and social enterprises in deprived communities. The Government has considered whether an extension of the CITR scheme to the personal lending activities of third sector lenders would be appropriate. **The Government has concluded that an extension of CITR would not be the most effective means of supporting an expansion in the supply of affordable personal loans at this time.** This issue will remain under review as the above options for increasing the coverage and capacity of third sector lenders are considered.

Saving and the Pomeroy review

4.23 In December 2006 the Government asked Brian Pomeroy, chairman of the Financial Inclusion Taskforce, to conduct a review of Christmas saving schemes, to learn the lessons of the collapse of Farepak, and to consider the implications of hamper schemes and other Christmas saving vehicles for Government policy on saving. The Pomeroy review is published today.

Box 4.1: The Pomeroy review of Christmas saving schemes

Recommendation: The DTI should urgently ensure that secure arrangements are put in place by hamper scheme companies in order that customers' prepayments are effectively protected.

Recommendation: the OFT should consider whether there are any competition issues that need to be addressed in the hamper scheme market.

Recommendation: the Government should encourage providers, particularly the Post Office and the credit unions, to compete in this market and to develop innovative ways of attracting hard-to-reach customers.

Box 4.1: The Pomeroy review of Christmas saving schemes (continued)

Recommendation: informal savings schemes should be given greater emphasis within the scope of the Government's financial capability and inclusion work, including the Thoresen review of generic financial advice, the DWP's "now let's talk money" initiative and the FSA's financial capability work.

Recommendation: in view of the uncertainty that has been caused over Christmas savings schemes, and the risk that this may prevent people who would otherwise have saved for Christmas from doing so, the Government should consider mounting a specific campaign to make consumers aware of their options

Recommendation: "the Government and its relevant agencies should ensure they become aware of, and well informed about, all methods of saving, whatever legal form they take, and that they consider them when thinking about risks and consumer protection. The Government should also take steps to improve the data available on the hamper scheme market and other forms of informal saving, possibly through the Family Resources Survey or the new Wealth and Assets Survey."

4.24 The review has made a number of recommendations (Box 4.1). In response, the Government announces that:

- **the DTI has secured agreement from the hamper industry to establish an industry-led scheme to ensure that consumers' interests are fully protected through the establishment of secure, ring-fenced accounts.** This will be implemented as soon as possible;
- **£1 million will be made available for the Office of Fair Trading to conduct a consumer awareness campaign in the coming months on Christmas saving schemes and mainstream alternatives,** from the current Financial Inclusion Fund;
- the **OFT has agreed to investigate the findings of the Pomeroy review in full, and whether a further inquiry into competition in the market for Christmas saving schemes is needed,** following preliminary analysis on competition as part of its work for the DTI on Christmas saving schemes;
- following encouragement from the Government, and support from the Growth Fund, credit unions are now offering Christmas saving accounts with a lock-in. The Post Office also has plans to launch a Christmas saving account. The Government has asked the Financial Inclusion Taskforce to monitor developments, and consider what further detailed actions are needed to expand community-based provision of saving;
- the Thoresen review will consider how to provide better generic advice on informal saving;
- the financial inclusion campaign, "now let's talk money", is working with local charities and community organisations to promote credit unions as an alternative to hamper schemes;

- the FSA will enhance the saving information on its MoneyMadeClear website[1] by including information about Christmas hamper schemes; and
- the new Wealth and Assets Survey will collect information on informal saving. The Government will use the first results of the survey, due by the end of the year, to inform any further data gathering.

4.25 The second round of Saving Gateway pilots will be reporting in Spring 2007. In addition to the evidence gathered through these pilots, the Government will also take account of the lessons learned on consumer preferences from the Pomeroy review of hamper schemes, in considering next steps for matching incentives and the Saving Gateway. Announcement on next steps will be made in Summer 2007.

Insurance

4.26 In order to investigate how to make insurance an integral part of financial inclusion policy, **the Government will work with the Association of British Insurers and the Financial Inclusion Taskforce to address key questions**, including:

- **which types of insurance** are most needed by financially excluded consumers;
- **the barriers, including cost**, to excluded consumers taking these insurance products up; and
- **how these barriers might be overcome**, drawing on evidence on the success of initiatives such as insurance with rent, and consideration of new approaches such as risk-reduction projects.

Demand for financial services

4.27 The Government will evaluate evidence from the "now let's talk money" campaign on the efficacy of the intermediary-led approach to promoting demand for financial services amongst those in the hardest-to-reach groups. Of particular interest will be the potential for local intermediary partnerships, such as those being established by the campaign, to be established on a self-sustaining basis.

4.28 Generic financial advice provides people with the basic information to help them make informed and appropriate decisions about financial products. Otto Thoresen's feasibility study will consider how vulnerable groups, including the financially excluded, can be served within a national approach to generic financial advice. The Thoresen review will report back around the end of the year.

4.29 The Government's long-term approach to financial capability will also work towards enhancing people's capacity to make the right choices with respect to financial services. The Government's ministerial group on financial capability will consider the importance of financial capability in preventing financial distress and will publish an action plan at the end of the year.

4.30 **The Government will work with the banks and the Financial Inclusion Taskforce to evaluate the role of banking as a route to wider inclusion.** The Government will examine evidence on the extent which basic bank account customers are upgrading to full service current accounts, taking out a credit card, opening a saving account, or buying an insurance product from their bank.

Next steps for dealing effectively with financial distress

4.31 The challenges for dealing with financial distress include:

[1] www.moneymadeclear.fsa.gov.uk

- continuing to make progress with the supply of face-to-face advice;
- understanding the potential of new, cost-effective, mechanisms for delivery of advice;
- replicating the success of DTI's pilots in the nationwide rollout of illegal lending projects;
- promoting the role of banks and other financial services providers in supporting people out of financial distress; and
- addressing the impact of low financial capability on people's capacity to deal with distress.

4.32 To maintain progress being made in the provision of money advice by the DTI's face-to-face money advice projects, **the Government commits to ongoing support for the provision of money advice in the next spending period.** Options will be developed by the ministerial working group, taking into account the ongoing collection of evidence from the current projects (including outreach pilots). Detailed plans will be published in the action plan following the CSR.

4.33 The question of how cost-effective, technology-led delivery of advice can be effectively used to within a national approach to generic advice will be considered by the Thoresen feasibility study. The Government will, in the light of the findings of the Thoresen review, consider how non face-to-face channels can be used to deliver money advice to more financially excluded people.

4.34 The Government has announced that **illegal lending projects will be rolled-out to every region of the country**. The DTI and the Treasury are now working with local authorities and their representative bodies to identify suitable regional bases for the projects, and to make them operational as soon as possible. In addition to extending their coverage, the Government will also require projects to expand the support they provide to victims of illegal lending, so that they find it easier to access legal, mainstream alternatives such as credit unions. Further announcements will be included in the Government's detailed action plan after the CSR.

4.35 The role of banks in helping people in financial distress is one of the priority areas identified by Mike Young for his 2007 independent Review of the Banking Codes. The Government has submitted its response, encouraging the Review to strengthen the provisions of the Code in this area, for example by requiring that banks make customers in financial difficulty aware of sources of free money advice. The Government awaits the results of the Review in this area with interest.

4.36 In the meantime, the **Government will work with banks** to understand the processes by which they seek to identify and support those in financial difficulty.

CONCLUSION

4.37 To conclude, financial inclusion remains a growing problem in the UK. The Government and the financial services industry have taken some positive first steps towards tackling this. However, there remains much to do if the Government's goals for financial inclusion are to be achieved.

4.38 The Government is determined to achieve these goals, and has announced a positive new policy framework for 2008-11, including a new Financial Inclusion Fund to maintain action at the current level of intensity. The Government will continue to work toward promoting financial inclusion, with the aim of ensuring that no one gets left behind as the UK moves forward into the 21st century.

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