

# Making the Poverty Premium History

**A practical guide for business and policy makers**

**The Poverty Premium: when households in poverty pay more for everyday goods and services. First coined in the 1960s it may be an old concept but it remains an important social issue today. And for the poorer households affected it is a real and pressing problem. We estimate that the average low-income household in 2016 paid a poverty premium of £490. Of course, there is no such thing as an average low-income household – depending on households' needs, preferences and circumstances, some will have paid less while others will have paid more. Much more.**



**Personal Finance  
Research Centre**

# Why make the Poverty Premium History?

First and foremost, the poverty premium is a real and current social issue. It represents fundamental disadvantage for those least able to afford it. And it compounds the very experience of poverty.

**It costs the average low-income household £490 per year.** But for more than one in ten of these poorer households it costs *at least* £780. And we didn't have to look hard – among the people we spoke to – to find examples of households paying an estimated £1,300, £1,850 and over £2,250 per year. This includes the extra low-income households might end up paying for their household fuel, insurance, their grocery shopping as well as access to cash and borrowing.

This is not the hypothetical cost of the premium, it is the **lived cost to households**: low-income households spend these sums, and they do so as a direct and indirect result of their poverty and low incomes. And, we know that the ongoing increase in the cost of living will only add more pressure to households with limited, and even decreasing, incomes.

These are not insignificant sums. £490 or £780 might represent a family holiday, furnishing a new flat, or keeping a household in clothes, shoes and adequately warm through the winter. For some, including the 'just about managing', the difference could be having a savings buffer to smooth out the pinch points in the household balance sheet or not having to work unsociable hours.

Unfortunately, we also know that many **low-income households avoid the poverty premium by going without altogether**. This includes the things that society considers essentials, like a new mattress; for some things, even buying second-hand is not the solution. What households go without cannot

be accounted for within the poverty premium. But, it highlights, nonetheless, how central the poverty premium is to the experience of poverty.

## What does the poverty premium currently look like?

Based on new research, the biggest contributors to the poverty premium are:

- **Household energy**: billing methods and switching.
- **Insurance**: area-based premiums, monthly billing and insurance for specific items.
- **Higher-cost credit**: use of rent-to-own, payday, home collected, pawn-broking and subprime loans, and subprime credit cards, mail order, and Christmas hamper schemes.

Our measure of the poverty premium also included:

- **Grocery shopping**: difficulty accessing good value shops.
- **Access to money**: use of fee-charging ATMs, cheque-cashing and pre-paid cards.

Other premiums identified previously – such as pay as you go mobile phones – were not included in our measure as there was insufficient evidence in 2016 that they persisted as premiums.

For more information about what was included please see our full research report: <http://www.bristol.ac.uk/media-library/sites/geography/pfrc/pfrc1615-poverty-premium-report.pdf>

# Towards tackling the poverty premium?

**This guide is not a blueprint for solving the complex problem of poverty itself. However, tackling the poverty premium is a clear and important pillar for tackling its repercussions, alleviating the strain it causes households and helping households to avoid the cycle of poverty.**

Instead, this guide offers an evidence-based foundation for addressing the poverty premium which considers the particular roles of business and government. It focuses on the three most significant areas of the poverty premium: **household energy**, **insurance** and **credit**.

There are 18.9 million people living in households below or near the poverty line across the UK.<sup>1</sup> Tackling the poverty premium can improve outcomes for these individuals and households, reduce strain on public services and have positive impacts for the social capital and resilience of their communities and the wider economy.

At an average of 2.3 people per household,<sup>2</sup> the elimination of the poverty premium could potentially release an extra £4,000m per year into the local communities and economies that need it the most.

To give an example, nearly half of all children in Washwood Heath in Birmingham live in households in poverty.<sup>3</sup> Reducing the poverty premium by half in these households alone could put around **£1.7m** back into the community each year.

A typical narrative might be to censure these sectors and the existing providers serving them. While it is true that the existing provision within these sectors can be disproportionately – and arguably unfairly – expensive to low-income households, it is often meeting an otherwise unmet need.

For example, the home-collected loan model of lending is an important source of borrowing for its customers and it is valued by them. But it is expensive to deliver. For a not-for-profit option to be feasible, it would need a large subsidy, charge an APR of at least 100% and cross-subsidy from other products.<sup>4</sup>

We believe that it is more helpful to understand why the poverty premium arises at all, and to consider where there is scope – through intervention from business, policy and regulation – to reduce or eliminate it.

The purpose of this briefing, therefore, is to constructively examine the problems in each of these sectors and consider how market forces, policy and regulation could work more effectively to support households in poverty. It does so following extensive consultation with experts.

See the further information given on the back page for details of the methodology used and the experts from business, policy and regulatory organisations whom we have consulted in producing this report.

# Why do poorer households pay more?

**When poor people pay more for goods and services this appears – superficially at least – to be driven by consumer choice. However, our research has shown that poverty premiums arise in complex ways. At its core, the poverty premium represents a mismatch between the needs and circumstances of low-income households and the markets that serve them.**

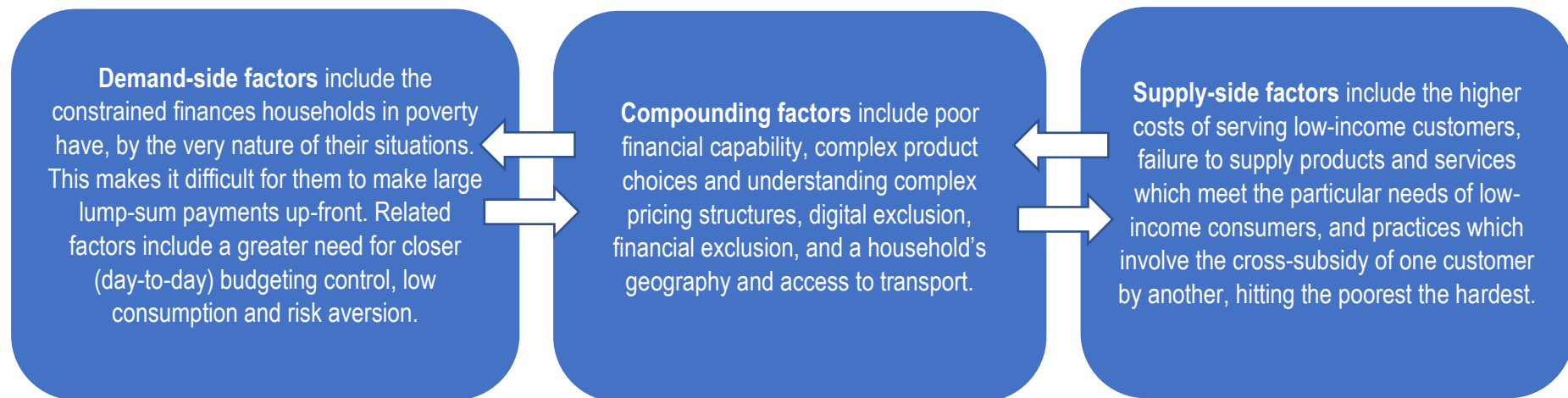
Our framework for understanding the causal and contributory factors identifies demand factors, supply factors, and compounding factors that are disproportionately present or impactful among low-income households (although they might also affect higher-income groups).

While some premiums, then, are likely to arise more-or-less through consumer choice (or, more specifically, need) others may be more-or-less imposed on consumers.

For example, while some households may choose to retain paper billing as a helpful budgeting tool, others may have pre-payment meters imposed on them.

Most important is the way these factors interact. For example, a low-income household may end up paying more for their energy needs because they need to budget closely (which a pre-payment meter affords them); they are financially excluded, including as a result of prior arrears (which makes other payment options unavailable to them); they are digitally excluded or have low financial capability which, in the context of complex tariffs and evolving markets, makes comparing more difficult; and they are risk-averse, which makes switching in the more complex markets unattractive, aside from the fact that the alternatives open to them personally may not be any more attractive.

The graphic below summarises some of the main factors.



# What are the priorities for action?

**The most problematic premiums are those which are commonly incurred (widely experienced), highly costly (deep), or both. The costs associated with short-term credit use are particularly high, and the premiums associated with different forms of insurance highlight different experiences of poverty. And the single biggest area contributing to the poverty premium is the provision of domestic energy, because it is both wide and deep in its reach.**

## Energy

In our 2016 research, around a third of low-income households used pre-payment meters for their electricity or gas. A further minority used standard billing, often to help them retain control of their spending. Both are more expensive than paying by monthly direct debit. Even customers on the best pre-payment meter tariffs pay more than those on fixed-term deals paid by monthly direct debit.

To benefit fully from these deals, customers must also switch regularly. However, higher rates of digital and financial exclusion among low-income households make it more difficult for them to do so. Some three-quarters have not switched fuel supplier in the last two years, at an estimated cost to them of £233 a year. Customers on pre-payment meters, in particular, are least able to switch.

The recent introduction of a temporary 'safeguard tariff' cap for pre-payment meters may go some way to reducing the switching premium for these customers, and give them greater certainty against rising costs.<sup>5</sup> But it cannot redress the balance across the market. A bolder aim would be to

ensure that all low-income customers have access to good-value tariffs, which don't rely heavily on switching, regardless of how they choose to pay.

## Insurance

In our 2016 research, 64% of the low-income households with home contents insurance paid for it monthly, as did 57% of those with a car insurance. This increased the average cost of insurance compared with paying annually, upfront, by around 10 per cent (though can be up to 44 per cent APR in some cases). This is due to the credit charge associated with paying by instalment, when a lack of affordability puts paying for insurance annually out of households' reach. Living in a 'high risk' area adds to this premium, and the cost associated with this is particularly high for car insurance. And, despite evidence of considerable financial exclusion from insurance (often self-exclusion), a minority of low-income households are apparently over-insured (paying for both home contents and white goods insurance); a premium borne of households' risk aversion. Based on the evidence, there is a clear case for affordable insurance provision which suits the particular needs of low-income customers and does not systematically disadvantage them based on where they live or their methods of payments, the low values they have to insure and the non-standard risks they may face.

# What are the priorities for action?

## Short-term credit

Credit is something that many low-income households try to avoid: fewer than one in five low-income households in our 2016 research used higher-cost short-term credit in the last 12 months. For those who did use it, the estimated cost in interest ranges from £120 per year for payday loans to £540 for home-collected credit. The use of short-term credit is driven largely by exclusion from mainstream lenders but also the need for low-value borrowing and a desire for close budgeting control.

Better access to affordable credit has long been an objective of financial inclusion. Yet the FCA recently estimated that over four million people use some form of unsecured high-cost credit, at a value of £8.3bn.<sup>6</sup> In contrast, the Community Development Finance Institution (CDFI) market lent a total of £20 million in personal loans,<sup>7</sup> and the reach of credit unions appears to be similarly constrained. Figures from short-term lending industry trade body the Consumer Finance Association suggest that the introduction of a cap on the total cost of payday loans in January 2015 has reduced the number of low-income households taking them out quite considerably.<sup>8</sup> However, Citizens Advice have reported that those unable to access payday loans are now more likely to default on major household bills.<sup>9</sup> Together with the scaling back of the Government's Social Fund, a retreat towards higher-income customers in the payday lending sector<sup>10</sup>, as well as in the rent-to-own and home-collected loans sectors over recent years, underlines the ongoing question for policy of how to ensure that lower-income households have somewhere to turn to for affordable credit.



# A case for market intervention?

**In so far as the causes of the poverty premium are complex, so the solutions needed are also likely to be complex – as well as bold. Relying on market forces alone is not working: effective markets need a level playing field, but that is not occurring in practice; at least not across the income spectrum. Low-income consumers do not have sufficient purchasing power to drive markets for their benefit. Increasing ‘marketisation’ will only deepen this disadvantage, especially for the most vulnerable households.**

This contradiction is already well-recognised: the National Audit Office has noted that *“the regulator’s duties to protect vulnerable consumers can conflict with the measures designed to benefit consumers in general”*.<sup>11</sup> Proposals that rely on improving the awareness, skills and perceptions of low-income consumers themselves, to make them ‘better consumers’, are likely to offer limited purchase – since their behaviours are borne of need and circumstance. And schemes that stigmatise or condescend this customer base might just have the opposite effect than intended. It is important to challenge our assumptions about the actions low-income households take: although they might not reflect the collective middle and high-income perspective, our research consistently shows that consumers make the decisions that work for them, in the short if not long term.

Take the example of **energy switching**. We know that three-quarters of low-income households had not switched fuel provider in the last two years, missing out on an estimated saving of £317 a year.

Switching has become commonplace in some sectors, such as for insurance and mobile phones. So, we might ask, why don’t we just encourage low-income households to switch their fuel supply?

Put simply, the problem for energy switching, as it is for bank accounts, is that people just do not do it on the whole. This is the case even where policy makers want or encourage them to, and where customers themselves know the benefits to doing so. They do not switch because they are not dissatisfied enough with their existing provider, and feel that the perceived costs of switching are too great: whether the loss of a valued relationship, hassle of the process or the fear of things going wrong. Instead, in the case of bank account switching at least, there is a desire among customers for regulators to tackle the culture and practices of providers rather than expect them to switch.<sup>1</sup>

In other words, accepting that people do not switch might need to be the new starting point for policy and practice.

# Whose responsibility is it anyway?

**The poverty premium, like poverty itself, is largely a structural problem which requires structural solutions. So is radical reform required to eradicate the poverty premium in all its forms? Is there a need for complete system and structural change, for example? Current innovations risk increasing the structural disadvantage that already exists. For example, only the middle classes are able to take control of energy production (particularly in the context of high entry prices and regulated provision, such as solar panels). And focusing primarily on switching only serves to disadvantage further the less engaged customer.**

The immediate reality at least is to bring about change by working within the constraints of current systems and structures, while continuing to influence the debate about how financially vulnerable customers should be treated in the longer term. The solutions must address issues around both the control of production and supply, and the empowerment of the consumer (empowering by enabling, rather than by informing for example). And they can distinguish where markets already have provision (but do not have adequate reach) and where provision is missing altogether. These might derive from policy and regulatory intervention or from business innovation.

This has certainly been the case where the poverty premium has already been reduced or eliminated (see p.8). New business and social enterprise can productively exploit opportunities for positive change: to provide alternative products and services, and methods of service delivery which do meet the needs of low-income consumers. This is exactly the purpose of **Fair by Design**,<sup>12</sup> a new Poverty Premium fund launched by Big Society

Capital and Joseph Rowntree Foundation, in conjunction with Finance Birmingham and Ascension Ventures. There are examples where individual market-leading companies have intervened to eradicate poverty premiums and promote corporate social responsibility.

There are also examples where government has intervened to regulate, and industry bodies have implemented good practice guidelines. There is an increasing understanding among regulated industries (such as Ofwat, the FCA and the UK Regulators Network) about the differential impact of fair treatment policies depending on customers' vulnerabilities (including financial vulnerability), and a recognition of the importance of researching and testing different solutions for customers with a wide spectrum of vulnerabilities.





# Whose responsibility is it anyway?

## The role of business

From commercial business to social enterprise, there is scope to address supply chains and improve customer services, grow partnerships and develop novel products and delivery to disrupt existing markets.

The mobile phone market is one that has changed markedly in the last few years with one major no-frills new-entrant to the market, such that pay-as-you-go is no longer more expensive than like-for-like contract plans.

Social investment in alternatives to high-cost credit offers the potential to challenge existing high-cost provision.

Smart meters and new community-interest companies promise a new era of fair pricing in the energy sector.

## The role of policy and regulation

From the social responsibility policies of lead players, to industry-wide guidelines and the intervention of central Government, there is scope to redress existing imbalance and promote parity in market provision.

While water bills have previously contributed to the poverty premium this is no longer the case.

In particular, water companies do not charge for paper billing; they provide capped or social tariffs for qualifying households; and water meters (which cut the costs for low users) are increasingly commonplace.

The UK model for water provision (of regional monopolies) implements external regulation by Ofwat, which includes furthering customer interests.<sup>xiii</sup>

To reflect the complex causes of the poverty premium, opportunities for intervention should similarly consider the following combination of factors:

- How low-income consumers engage with goods and services, including:
  - Their **structural circumstances and needs**, recognising that tackling the poverty premium is not simply about saving households money but helping them avoid premiums arising from the inability to always meet basic costs; and
  - **Behavioural factors**, including consumers' awareness of the goods and services available, trust in other providers and how their wider values affect their choices;
- **Industry practices** in the provision of products and services, including the application of credit scoring and cross-subsidy, and the design of products; and
- Additional factors which **bridge the gap between demand and supply**, including through Fintech (financial technology) and policy and regulatory intervention.

The collective and multiple endeavour of the different players – whether mainstream business, social enterprise (and their investors), policy makers or regulators – and their effective coordination in addressing these factors is critical. In consultation with a range of experts, we have identified several key ways in which business and policy and regulation can help reduce the poverty premium.

# What can businesses do?

**Business - whether large or small, commercial or social, established or new - provides key opportunities to reduce low-income households' exposure to the poverty premium. This means re-thinking and tailoring product and service design and delivery.**

## Make payments work for low-income customers

By accepting that low-income households, by definition, lack affordability, we can start to understand their particular needs around payment methods, frequency and timing. Low and unstable incomes create a particular need for close budgeting control. Payment schedules which reflect households budgeting cycles (e.g. weekly or fortnightly) are likely to be beneficial. And some customers – including the most vulnerable – may be forced to default on instalments or repayments from time to time. Equally, others may want to overpay when they can. These considerations might be addressed explicitly within business models *and* offerings.

Offering flexible payment methods is an essential part of providing a service that fits the needs of low-income households. Direct debit discounts are an obvious way to create a poverty premium. Ideally, customers would be able to pay using the methods that suit their particular needs, without penalty. Consider that many may be operating entirely within a cash economy or a cash-equivalent economy (for example, using pre-payment meters or pre-paid cards). Online payments and direct debits are likely to be out of their reach. Others, including younger customers, may be more comfortable using online and smartphone payments.

## Improve credit risk assessment

The costs of serving riskier customers can contribute significantly to the poverty premium. Credit risk assessment and credit scoring impacts people's access not only to consumer credit but also insurance and energy deals, and it is not clear that the current system works effectively to judge individual risk. Currently, credit scoring is based on opaque criteria and it can be difficult to build a good credit history if you do not use the 'right' services (typically secured and unsecured credit). People are left with a 'thin' credit file, which may be compounded by errors in creditor reporting.<sup>14</sup> In turn, fears about impairing their credit record can deter people from seeking advice and contacting creditors when they are in financial difficulty.

The development of effective but fair credit scoring models should help reduce costs to providers and potentially reduce the poverty premium for some individuals and households. The Big Issue Invest<sup>15</sup> and Experian<sup>16</sup> have worked together to set up the Rental Exchange Initiative, which encourages social housing providers to provide rent payment data for inclusion in tenants' credit files. Credit Ladder<sup>17</sup>, a bill-payment service, aims to do something similar, by asking tenants who sign up to it to route rent payments through them. While these are promising developments, there are concerns that some people's credit ratings may deteriorate rather than improve as a result of including this data (including for reasons beyond their control such as late payment of housing benefit), and it is not yet clear how lenders will receive or use rent information. Rent payments routed through bill-payment services are not protected under the Financial Services Compensation Scheme, so are at risk if the intermediary company fails.

# What can businesses do?

Alternative models such as Credit Kudos<sup>18</sup>, FriendlyScore<sup>19</sup> and Aire<sup>20</sup> allow a wider range of data (including social media data in some cases) to be included in credit scoring to help determine creditworthiness. Pariti enables customers to connect all of their accounts to create a full picture of their financial situation and acts as a broker to help the financially excluded access credit when they need it.

Data sharing between organisations can also play a role in reducing the poverty premium, by increasing the capacity to build a more nuanced understanding of an individual's realistic credit risk.<sup>21</sup> It can also ensure that help reaches those who are entitled to it: data shared with energy providers by HMRC is currently used to make sure that the Warm Homes Discount reaches eligible households. Data sharing via open banking and platform banking allows credit scores to be developed from broader financial capability measures than just transaction and borrowing history, and may allow access to products from which customers have previously been excluded. However, data sharing is not without its concerns, such as potential data protection lapses and recording errors, the effects of which can amplify when data is shared between organisations.<sup>22</sup> And, again, with increasing data use there is a growing need to protect low-income households from the negative impacts of disruption beyond their control, such as delays in receiving Universal Credit and the effect of Council Tax and Housing Benefit rule changes on payments.

Outside of credit scoring, there are further ways in which businesses can deal with customer risk. With the government-backed 'Flood Re', it has been possible to mitigate some of the cost associated with individual flood risk, to ensure that even those already affected by floods will be able to

access affordable building and home contents insurance premiums and excesses.<sup>23</sup> Could there be scope to expand these principles to other forms of insurance?

**Key point:** Credit scoring could be implemented more effectively with the help of alternative credit scoring models and effective data sharing. For low-income households, it should be used to assess a fair price (and level of credit) and should not be used to unnecessarily further exclude vulnerable customers. Thought needs to be given to understand what criteria would actually represent a fair judge of creditworthiness, and to build these into a model.

## Diversify provision for affordable credit

In a context of inadequate household incomes and ongoing welfare reform, increasing access to affordable credit represents a key pillar for poverty premium reduction. More than any other aspect of the poverty premium, this demonstrates how providing a low-cost service conflicts with the higher costs of serving the poorest (and riskiest) of customers.

A number of non-mainstream affordable credit options already exist. Credit unions offer loans capped at 36% APR. Fair for You<sup>24</sup> offer an alternative to BrightHouse, selling furniture and white goods as well as offering loans at around 42.6% APR. Other social enterprises, such as Fair Finance<sup>25</sup> and Moneyline<sup>26</sup>, charge higher typical APRs, often ranging from 100 to 200%. While this seems high compared to mainstream lending, it is still lower than many sub-prime alternatives, and it appears to reflect the costs of providing short-term credit that suits the particular needs of low-income consumers.

# What can businesses do?

More can be done, however, with opportunities to increase access to affordable credit through:

- The potential for Fintech to deliver new models of banking and credit provision; and
- Greater investment in and promotion of existing affordable credit provision.

The need for affordable credit also crosses into the field of insurance, where the cost of a credit agreement to pay monthly for home or car insurance can be high, as we have seen. The Financial Inclusion Commission and the FCA are looking at ways in which access to insurance industry can be improved. Minimising the cost to consumers could be an area of inquiry for business and government.

**Key point:** Be aware that the affordability of (re)payments can be more important than the total cost a low-income customer pays for goods and services. This does not justify charging higher total costs than necessary, but should instead shape how repayments are structured and presented.

## Inclusive technology and innovation

New payment technology in energy meters, for example, has removed much of the cost differential that justified higher pre-payment meter tariffs. Further development of smart meters offers the opportunity to aid low-income households in budgeting and making payments. Fintech similarly offers the potential for cost-effective solutions to serving the previously financially excluded. Fintech entrant Monzo<sup>27</sup> presents a new way of

smartphone-based 'banking' with fee free, transactional capability, and tools to improve budgeting. While currently out of the reach of the poorest households (requiring a £100 deposit), Monzo demonstrate ways in which technology can disrupt traditional financial services. Revolut<sup>28</sup>, meanwhile, is introducing cheaper mobile phone insurance to the UK.

While innovation and Fintech are attractive for some, they will not be appropriate for all low-income customers, especially the most excluded and vulnerable. To feel properly valued and supported, customers may want to interact in other ways, including face-to-face. Investing in some more personal assessment (of credit risk, for example), and relying less on automation as a default, will deliver a business model that better serves low-income customers.

Fintech could also work to reduce the poverty premium through innovation for people without bank accounts. The ability to make routine transactions without a bank account may allow some low-income households to benefit from services or tariffs from which they were previously excluded. Smartphone technology can be used to good purpose in this area. Low-income consumers often value the immediate, real-time feedback they receive on their incomes and spending. PayPal is also often more relevant as a payment method than either credit or debit cards.

**Key point:** Consider that technology presents both a potential opportunity and a potential threat to reducing the poverty premium. Fintech solutions should be proceeded with cautiously, taking appropriate account of the target customer base and their likely appetite for Fintech innovations.

# What can businesses do?

## Think sustainably

Operational sustainability presents a challenge to businesses who are trying to provide better-value services to low-income households – if treated fairly, they are unlikely to be the most profitable customers. Reflecting this, the affordable credit sector has been supported by grants and initiatives such as the DWP Growth Fund. In the long run, grants or subsidies may not necessarily be the best way to reduce the poverty premium, but there is currently a lack of capital investment for social enterprises in the UK. At the same time, business plans need to reflect a realistic timeframe and cost structure to achieve operational sustainability.

Consideration also needs to be given to the extent to which a business model relies on cross subsidy, and – if so – who is subsidising whom. Perpetuating a market in which the more savvy customers are being subsidised by those more financially vulnerable will only reinforce the poverty premium.

A major hurdle for social enterprise, in particular, is illustrated by the large marketing budgets commercial businesses can invest to attract customers; budgets which social enterprise cannot hope to compete against, given their inevitably tight margins.<sup>29</sup> Customer acquisition and retention requires some investment in marketing, and social enterprise business models have to take this into account.

Key point: Having a clear target market is crucial. Social housing providers are often an effective route to reaching low-income households<sup>30</sup>. Nonetheless, there are far more low-income households living in the private rental sector, and it is vital to find ways to engage with these tenants as well

as social housing tenants. Community-based hubs may be another trusted way into this sector.

## Extend the reach and impact of business

There are already commercial products and services designed to reduce the poverty premium faced by low-income households. However, take-up is often low: the ‘build it and they will come’ model is unlikely to succeed even with well-designed and good value products. Even seemingly perfect product design cannot guarantee success. At its most basic, financially vulnerable households often lack the capacity to shop around for or ‘find’ a product or service. We have seen that effective marketing is one part of the puzzle, but how a venture is received and perceived by a customer base is also key.

One known effect of poverty is to reduce people’s cognitive capacity; and it does so directly. In other words, the experience of poverty is not just a shortage of money but also of available cognitive resources. Financial worries are tiring and stressful and there is little opportunity for people struggling on low incomes to rest or restore their energies. This depletes capacity for behavioural control, for example in spending control and in making economic trade-offs, and this might help explain why even well-intentioned interventions can fail.

From social psychology and behavioural economics we know there are many biases to which we all default (such as status quo bias, future discounting, loss aversion), in order to reduce cognitive load in decision-making. Overcoming these – through effective product/service design and promotion – should help businesses support their customers and improve the chances of business success.

# What can policy and regulation do?

**Policy makers and regulators have the power to reduce the poverty premium. Government policy drives regulation, and it is evident that concerns for financially vulnerable customers are feeding into policy, and subsequent regulatory recommendations. The introduction of a price cap on high-cost short-term credit, in January 2015, and the Pre-payment Charge Restriction for energy customers on domestic pre-payment meters introduced in April 2017 are examples of regulation that aim to reduce the poverty premium, and the early evidence of the effect of these regulation is broadly positive. The new Payments Systems Regulator should help ensure that Fintech works for the benefit of low-income households.**

Our consultations with experts speak clearly to the belief that policy and regulation have not yet gone far enough in tackling the poverty premium; nor is there enough support for the businesses and business practices tackling the problem. Progressive policy-making and regulation is needed.

## Address the obstacles to data sharing

There is a crucial role for policy and regulation in credit risk assessment and credit scoring. Greater sharing of data may allow for better treatment of customers but also risks misuse and exploitation by unscrupulous firms. This is a complex area of policy and practice because it spans financial services regulation (which mainly sits with the Financial Conduct Authority) and data protection (which is regulated by the Information Commissioner's Office). The implementation of the General Data Protection Regulation (GDPR) in 2018 could help or hinder the role of data sharing in tackling the poverty premium. Mandatory lending data disclosure could also be a way of

identifying consumer credit 'deserts' that are under-served by mainstream lenders and so help target provision and investment where affordable credit is most needed.

## Account for unintended consequences

Interventions have to be properly evaluated to fully understand the effects of policy and regulation on low-income individuals and households. Regulatory bodies including the CMA, Ofgem and the FCA<sup>31</sup> have already acknowledged the tensions that can exist between the needs of low-income customers and those of mainstream consumers. Policy and regulation can also have counterproductive unintended consequences, and may conflict with one another in a complex area such as the poverty premium. For example, the current regulation for credit unions constricts their ability to charge a rate of interest that can support more lending to higher-risk, low income borrowers. Similarly, the necessarily stringent regulation governing the sale of financial products may inadvertently prevent the use of unqualified intermediaries from actively encouraging take-up of products or other interventions such as 'auto enrolment' in pensions – in other words, activities that can help increase awareness and engagement but fall short of actually sales. Price caps can distort markets in ways that are not necessarily beneficial to low-income consumers; there may be merit in exploring other types of price control such as capping the difference between the highest and lowest tariff a firm can charge.

## Be bolder in the provision of funding

To serve low-income customers effectively, social business needs funding and other support. There is a particular and pressing need for capital investment. Currently charitable funding and grants are made to social businesses and charities to cover some of the extra costs of providing a service for vulnerable and/ or low-income customers, but there is little help

# What can policy and regulation do?

for these organisations to become operationally sustainable in the longer term, which severely limits their capacity to help everyone who needs it. The **Fair by Design** investment fund is a positive step in the right direction. But a problem on the scale of the poverty premium needs government support and funding. There are already calls for a government scheme to underwrite low or no interest loans.<sup>32</sup> given the current size of the high-cost short-term credit market.

## Stress-test the impacts of business

The Fairbanking Foundation already produces a Fairbanking Mark which identifies financial services products designed to improve the financial wellbeing of their customers. The influence of kite-marks on consumer decisions – particularly among consumers from low-income households – is poorly understood. But the idea of stress-testing products and services for their likely impacts on reducing the poverty premium is intuitive and could be applied across the energy, consumer credit and insurance sectors. Again, this would call upon the coordinated effort of business and policy and require some means of regulation and enforcement. Criteria to assess whether or not a business puts low-income customers first and is committed to reducing the poverty premium might include demonstrating that their service (where appropriate):

- Has considered the effect of the payment methods they offer.
- Offers tariffs/ prices that do not rely heavily on cross-subsidisation of stronger customers by those more financially vulnerable, and that are available to all.
- Has a system of dealing with arrears that is not punitive<sup>33</sup>
- Provides other positive social impacts, such as improved financial capability, better financial resilience by building up savings, or energy-saving improvements

## Close the gaps between individual policies and regulation

The poverty premium debate should not be left to individual regulators, or even just between regulatory bodies. To effectively tackle the poverty premium, across the sectors in which it arises, requires greater coordination of action between regulators as well as between policy, regulators and industry. In particular, the poverty premium could be part of a wider discourse around the treatment of low-income households in the current economic climate.

For example, the water industry recognises that low-income customers can struggle to manage their bills; so it provides lower tariffs to these customers. The water industry operates within a tougher regulatory environment, so now might be time for a debate about whether this approach could or should be extended to other sectors. While there are many concerns over the implementation of Universal Credit, and the focus on the consolidation of benefits, having all households data in one point does offer an opportunity to be able to identify and target households on lower incomes with greater ease when needed. Sectors that are not directly responsible for charging a poverty premium also need to be involved in the solutions: the higher energy cost of heating poor-quality housing stock, with scant insulation, in rental properties tenants have little control over potentially cost low-income households more than the premium on energy tariffs.

Whatever the solutions, it is clear that – at a conservatively estimated, average lived cost of £490 per household per year – the structural disadvantage the poverty premium describes demands action now to reduce the premium itself and acknowledge the wider problem that poverty itself presents

# Further information

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The guide was developed in consultation with representatives from organisations including Ascension Ventures, Association of British Insurers, Banking Standards Board, Big Society Capital, Carnegie Trust, Children's Society, Christians against Poverty, Citizens Advice, Competitions and Markets Authority, Financial Conduct Authority, Financial Inclusion Commission, Friends Provident Foundation, Moneyline, OFCOM, OFGEM, Our Power, Plot London, Social Market Foundation, StepChange Debt Charity, and UK Regulators Network. Any views expressed remain the authors own.

## Endnotes

<sup>1</sup> Which we have defined as households below 70% of median income.

Households Below Average Income for 2015/16; uses figures after housing costs. Table 3\_3tr,

<sup>2</sup> Across the income spectrum ONS 2011-03-21 average-household-size. In fact larger households are more likely to be poor, which would serve to reduce this estimate: Households Below Average Income for 2015/16 Table 3.3db, 3\_population\_composition.ods.

<sup>3</sup> Based on Children in Poverty data 2015, and UK census data 2011

<sup>4</sup> Kempson, E, Ellison, A, Whyley, C, Jones, PA (2009) Is a not-for-profit home credit business feasible? York: Joseph Rowntree Foundation

<sup>5</sup> Pre-payment meter price cap (2017) Ofgem

<sup>6</sup> FCA HCSTC review (2017) FS17/2 technical appendix table 4 exc. retail finance

<sup>7</sup> Responsible Finance (2017) The industry in 2016

<sup>8</sup> <http://cfa-uk.co.uk/wp-content/uploads/2016/11/SMF-Report-AKT10796.pdf>

<sup>9</sup> Payday loans after the cap: Are consumers getting a better deal? Citizens Advice 2016

<sup>10</sup> <http://cfa-uk.co.uk/wp-content/uploads/2016/11/SMF-Report-AKT10796.pdf>

<sup>11</sup> Comptroller and Auditor General (2017) Vulnerable consumers in regulated industries. London: National Audit Office

<sup>12</sup> <http://www.fairbydesignfund.com/>

<sup>13</sup> Hartfree, Y, Evans, J, Kempson, E and Finney, A (2016) Personal current account switching: Why don't more people switch and what could encourage them to do so? Bristol: University of Bristol

<sup>14</sup> Centre for responsible credit (2017) Social impact of Fair for You Third report

<sup>15</sup> <https://bigissueinvest.com/>

<sup>16</sup> <https://www.experian.co.uk/>

<sup>17</sup> <https://www.creditladder.co.uk/>

<sup>18</sup> <https://creditkudos.com/>

<sup>19</sup> <https://friendlyscore.com/>

<sup>20</sup> <http://aire.io/about-aire/>

<sup>21</sup> <http://policyinpractice.co.uk/credit-where-its-due-using-data-to-overcome-barriers-to-credit/>

<sup>22</sup> <https://www.moneyandmentalhealth.org/customer-data-sharing-caring/>

<sup>23</sup> <https://www.floodre.co.uk/homeowner/about-us/>

<sup>24</sup> <https://www.fairforyou.co.uk/>

<sup>25</sup> <https://www.fairfinance.org.uk/>

<sup>26</sup> <http://www.moneyline-uk.com/>

<sup>27</sup> <https://monzo.com/>

<sup>28</sup> <https://www.revolut.com/device-insurance>

<sup>29</sup> CSFI (2017) Reaching the Poor: the intractable nature of financial inclusion in the UK

<sup>30</sup> Both Aviva, with the tenant insurance product and Our Power, a not-for-profit energy supplier use social housing providers as means of distribution of their product

<sup>31</sup> See CMA (2016) energy market review, Ofgem (2016) Response to CMA review (2016), FCA (2015) Consumer vulnerability

<sup>32</sup> <https://www.stepchange.org/Portals/0/documents/Reports/stepchange-affordable-credit-discussion-paper-july2017.pdf>

<sup>33</sup> Subject to FCA regulatory requirements on treatment of customers in default or arrears.