BEYOND BANK ACCOUNTS:
FULL FINANCIAL INCLUSION

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Foreword

Too many people still lack the basic tools and skills to enable them to manage their finances effectively. They lack access both to suitable products and to the appropriate support and advice to make decisions about the future. The government, the banking industry and the Post Office should be commended for the progress they have made in establishing Universal Banking Services. The ambition to enable all people to own the most basic of financial services – a bank account – is one we share. But it is not enough.

This innovative collaboration between Citizens Advice and the Institute for Public Policy Research sets out a vision for what full financial inclusion might look like, and what the key challenges are to achieving it. Rooted in the experience of Citizens Advice clients, the publication illustrates the very real hardship that is often associated with financial exclusion.

There is no single solution. Central to any strategy is the need to encourage a mix of private, public and voluntary activity to help people access and use financial services. And alongside the development of new products which work for people on low incomes, we must improve both levels of financial literacy and the availability of financial advice. The Government should also bite the bullet and stop prevaricating on reform of the Social Fund.

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Executive summary

Understanding financial exclusion

Many people's opportunities are limited and their poverty deepened through their experience of financial exclusion. Allowed to continue unchecked, current levels of financial exclusion will inhibit the delivery of other social and welfare priorities. This publication aims to refresh the financial exclusion agenda and to suggest a second generation of financial inclusion policies for the government and other stakeholders to pursue.

The key to understanding and achieving financial inclusion is recognising its breadth and depth.

- *Breadth of needs:* People need access, when appropriate, to a range of products and services. This includes a bank account but also affordable and suitable credit, savings and insurance facilities. People will then be empowered to cope with fluctuations of income, to manage extra costs and to plan for the future.
- *Depth of engagement:* People also need the opportunity and ability to use a range of financial products and services. They need the capacity to make informed and appropriate choices, which reflect individual circumstances and which allow them to access their rights and fulfil their responsibilities. People need to be financially literate and capable, and have suitable advice and support to make the right financial decisions.

Why tackling financial exclusion matters

Financial exclusion inhibits:

- *Social inclusion and neighbourhood renewal strategies:* becoming financially included is a step towards full social inclusion. Neighbourhoods and communities need accessible financial services if they are to be sustainable.
- *The eradication of child poverty:* families may incur extra costs through not using mainstream financial products; financial

exclusion makes poor people poorer. Through poor financial understanding, families may also not claim the tax credits and benefits to which they are entitled

- *The ability to tackle pensioner poverty:* people may not be saving for retirement because pension products are too complex and advice is not available. Pensioners may not be claiming the Minimum Income Guarantee or the Pension Credit for reasons linked to financial exclusion, and because of the complexity of navigating the relationship between state and private provision.
- *The prevention of poverty:* being financially excluded can reduce the ability to cope in times of change: when income falls households may have no savings or insurance, or affordable credit may not be available. If we can make headway into achieving greater financial inclusion, this may help people cope in difficult times and prevent some people falling into poverty.
- *Delivery of the Government's welfare strategy overall:* where individuals are responsible for their own provision, they may not be able to access and use suitable private products, and where state support is available, benefits and tax-credits may go unclaimed.

Meeting the remaining challenges

This report assesses progress to date and identifies four key challenges for progressing financial inclusion. These are:

- improving financial literacy;
- filling the advice gap;
- the availability of affordable credit; and
- developing effective delivery mechanisms.

Improving financial literacy

It is impossible to achieve any *depth* of financial inclusion without improving financial literacy. The need to invest in and prioritise financial literacy is widely recognised to be a necessary element of financial inclusion. This is essential given the society we live in and the bewildering array of financial decisions people now need to make just to live their daily lives.

- *Starting young:* Looking to the future, we should have an ambition that all young adults leave education with the necessary financial skills to be able to make informed decisions about their futures. The role of schools is critical here. Personal finance is currently part of the non-compulsory element of citizenship education and many teachers still feel ill-equipped to teach the subject. If we do think being financial literate is an essential requirement for being an empowered citizen, then financial education should become a compulsory part of the curriculum.
- *More than basic skills:* Much of the activity on financial education is linked to the basic skills agenda. It is certainly a concern that many people do not have the basic levels of numeracy and literacy needed to engage in financial decisions and with financial services. Our definition of financial inclusion illuminates the need for quite sophisticated skills to be fully financially included. The level of literacy and understanding needed has increased because of innovation in the financial services industry and because of changes to public policy resulting in people having greater individual responsibility. Both of these factors will continue to change which means that the level of financial literacy people need today will be different in the future. This highlights the need for investment in 'life-long financial learning'.
- *Co-ordination and good practice:* There is a myriad of initiatives for financial education run by a wide range of organisations. The impact overall is unclear. There is a lack of co-ordination and overarching strategy, which means that the different initiatives can duplicate and in totality leave big gaps in provision.

Citizens Advice have previously called for a national strategy that joins up and co-ordinates initiatives to improve financial literacy. In October 2003 the Financial Services Authority announced a Financial Capability Steering Group which is to develop and implement a national strategy for financial capability. As part of this strategy, 'financial literacy proofing' of all policy relating to consumer and financial services, welfare benefits and tax credits, and administration of personal finance should be initiated. If the proofing shows that, even with a high level of financial literacy and with advice, individuals still find it very difficult to make good decisions, then the policy itself should be revisited. The current pensions framework and the interaction of state and private provision might be a good example of this, where what is really needed is a much more simplified system.

Many companies do not recognise the business case of having more financially literate employees and consumers. Government also has not acknowledged that current levels of financial illiteracy contribute to the national skills gap. This is not just a welfare issue but also a productivity issue.

Filling the advice gap

Even with good financial literacy skills, individuals will still require advice to help them make the right decisions. Given the unpredictability of certain life events, investment returns and inflation and their impact of households' financial futures, getting good advice is by no means a guarantee of best outcomes. Financial advice that genuinely represents best advice at the time of delivery will often turn out not be the most appropriate advice, because the assumptions made regarding life events prove to be wrong. People need to understand this reality of financial advice and be protected as far as possible against advice that does not reflect their needs and attitudes to risk at the time of sale. Support is then needed to help them manage the responsibility they have taken on, such as through low-cost financial reviews. The key question here is who pays for both generic and product-specific advice.

- *Generic advice:* Generic advice can be provided through a combination of interactive methods including talks, CD-ROMS, websites, questionnaires and others. A broad church of both resources and outlets is required. A lead agency with a budget and authority is also needed; the Financial Services Authority (FSA) would be the most obvious choice. There is also scope for employers to provide or facilitate the provision of advice and information on financial issues. Employer organisations and trade unions could support and promote this role. Further thought could also be given to resourcing a 'Citizens Direct' to complement the Department of Trade and Industry's 'Consumer Direct.' This would be a national advice-line that aimed to meet people's needs as citizens as well as consumers. In relation to financial advice, it would offer generic advice on the different facets of financial inclusion.

- *Product-specific advice:* The financial services industry is most appropriately placed to offer product-specific advice, but the needs of low/moderate income households are not being met by the market. There is scope for financial advisers to work with trusted intermediaries to access people, or for the workplace to act as a site for the provision of financial advice. The key problem seems to be that people on low/moderate incomes simply cannot afford personalised financial advice. Can government work in partnership with others to fund all or part of this cost? Is there more that the financial services sector might be able to do, perhaps through offering consumers the option of paying an hourly fee rather than commission and providing low-cost fixed fee financial health checks?

The availability of affordable credit

Access to affordable credit is an essential element of financial inclusion, one that is currently denied for many people. There is a clear market failure resulting in a lack of affordable credit for many people on low incomes. People often turn to extortionate credit and can become over-indebted with significant effects on quality of life.

- *Social Fund reform:* There has been some welcome additional resources committed to the Social Fund, but of the welfare architecture inherited by this government it stands out as being virtually unreformed. This is in the face of an overwhelming consensus on the need for reform.

  It is our view that, particularly given limited government resources, any reform should continue to use a *mix* of grants and loans. Further work is needed in this area but we suggest how the loan element of the Social Fund could be transformed into a 'social lender.' The key elements of this model might be:

- Expansion of access and eligibility of loans: making the fund available to other people on low incomes in addition to those in receipt of Job Seekers Allowance and Income Support and ending its cash-limited nature so that anyone in need would get access.

- Delivery through a public interest company which administers the fund and which has a pivotal role within a network of local trusted intermediaries who raise awareness within their communities and deliver complementary services such as money and budgeting advice.

This revamping of the Social Fund as a more extensive social lender does not remove the need for grants, particularly for very low-income households reliant on benefits who would struggle to repay loans. The strategic use of benefit grants should be considered further.

The first step has to be for the Government to engage in this debate which, after an initial effort in 1999, they have to date been reluctant to do. Can continuing to do nothing, in the face of overwhelming support for reform, really be an option?

- *Reforming the market:* There is a broader debate about over-indebtedness and problem debt which extends far beyond both the Social Fund and the availability of affordable credit. Two things that market could do better is to provide more affordable products and lend responsibly to help avoid over-indebtedness.

  Universal Banking Services delivers basic bank accounts but does not extend to the other products needed to be fully financially included. A suite of products could be developed which might also include a savings account and appropriate credit and insurance products. These products would complement Sandler ‘stakeholder’ products, which are unlikely to work for people currently financially excluded. On opening a basic bank account, people could receive information on other standard products. The suite could be branded ‘universal banking products’ or ‘citizens banking products’.

  In relation to the bigger picture of over-indebtedness a cross-cutting government review and a strategy on over-indebtedness are needed. As a starting point, Citizens Advice have called on codes of practice for banks and other credit lenders to include commitments to assess the borrower's ability to repay before lending. The Office of Fair Trading (OFT) should provide clear guidance until this becomes a legal duty.

Developing effective delivery mechanisms

The ambition of full financial inclusion will only be realised through a variety of stakeholders 'upping their game'. The role of government and the public, private and voluntary sectors needs to be revisited.

- *Trusted intermediaries:* A lack of trust in banks is a major obstacle in their capacity to engage with people who are financially excluded. Branches may also not exist in certain areas presenting an additional outreach obstacle. Community-based organisations and voluntary sector organisations are good at filling this gap. It is not clear how comprehensive the coverage of community-based organisations is in its ability to reach people who are financially excluded. It would be helpful for a comprehensive analysis of existing coverage to be carried out and thereby be able to identify areas where there are gaps. Where organisations do exist there is also a need to ensure they have the capacity to play a role in financial inclusion.
- *Commitment from the private sector:* The relationship between government and the financial services sector has changed over time. The development of Universal Banking Services has led to greater dialogue and co-operation but has this set the stage for greater involvement of the banking sector in tackling financial exclusion, or have they had enough?

  There has been little work in assessing the overall business case for banks doing more to tackle financial exclusion. An intelligent view of the business case is needed which recognises that all banks benefits from a more financially literate population and see their responsibility in bringing this about, and which recognises that people on low incomes can provide a market for their products and services. Some banks already play a role or lead financial inclusion initiatives and we need to learn more about their reasons for doing this and spread this practice to other banks. The challenge of incentivising the private sector to participate more fully in financial inclusion remains, and is significant.

- *Financial Inclusion Agencies:* The appropriate development of Universal Banking Services could provide the bedrock of new types of partnership at a local level to encourage and enable people to use financial services effectively. Ultimately, the key challenge is to encourage a mix of private, public and voluntary sector partners to work together. We think there is scope to learn from existing local initiatives to develop a good practice model which could evolve into the concept of financial inclusion agencies. These would rely on a partnership approach which utilises the comparative advantages of each partner.

  Financial Inclusion Agencies could become a network of partnership bodies with central government providing funds to initiate and secure ongoing commitment. Each Financial Inclusion Agency would look at local solutions to delivering complementary set of choices and services to people who are financially excluded. They would endeavour to join-up financial inclusion services at a local level. Savings from Direct Payment could be put into a financial inclusion fund to support their development.

Making full financial inclusion happen

Tackling financial exclusion should be a priority for the Government. Without access to and understanding of financial services, individuals cannot operate fully in today's society. Financial Exclusion is hindering the achievement of other government objectives in welfare reform and poverty alleviation. If there is to be a concerted drive to tackle financial exclusion, two key central elements of a new strategy are needed:

- *Joined–up government:* Better coherence across government might be achieved by a central unit such as the SEU revisiting PAT14 with the engagement of all relevant departments. Joint targets on financial inclusion might galvanise departments to work together and a regular cross-departmental meeting or sub-cabinet committee could monitor and promote the issue.

- *A political champion:* Experience has shown that issues that get the buy-in across government often have a political champion who makes the links with other political priorities. There is a strong political argument which links financial inclusion to many of the key themes running through government thinking. The problem of financial exclusion is embedded in debates on poverty and social exclusion, and the solution is to be found in debates about positive and innovative partnerships between the state, private sector and voluntary non-profit sector. A political champion is needed to make this case both within and outside government.

1. Introduction: Changing the debate

In the period following the 1997 election, tackling financial exclusion was seen as one of the elements of achieving broader social inclusion. Since then, some important progress has been made but there is a sense that the debate has lost steam. This publication aims to refresh this agenda and to suggest a second generation of financial inclusion policies for the government and other stakeholders to pursue.

The concept of 'financial exclusion' is complex and poorly understood. There is no single definition, and no single solution. The most common interpretation of the problem is that people lack basic financial services. The policy response has been particularly focused on people without bank accounts. In this pamphlet, this focus is questioned. We describe a more comprehensive view of the problem, and this assessment leads to new policy priorities.

Tackling financial exclusion is not currently a political priority. But it needs to be. By making the links between financial exclusion, poverty and welfare reform, we challenge this neglect. Many people's opportunities are limited and their poverty deepened through their experience of financial exclusion. Crucially, if allowed to continue unchecked, current levels of financial exclusion will inhibit the delivery of other social and welfare priorities.

In many ways, the Government's policy agenda has been flawed from its early days. A concern with financial exclusion did emanate from the early work of the Social Exclusion Unit (SEU 1998), and Policy Action Team 14 (HM Treasury 1999) did assess a range of supply and demand side measures for creating greater financial inclusion. However, since then, policy has largely been driven by the political and cost imperative of ensuring welfare benefits can be delivered electronically straight to bank accounts. Whilst this delivers public interest benefits in terms of savings to the public purse, this approach will only achieve a limited and flawed concept of financial inclusion. It is an important advance, but it fails to address the full *breadth* and *depth* of the experience of financial inclusion: it is not just about access to products but also the quality of engagement with those products and the need for individuals to develop skills and confidence to make informed decisions.

Where to go next after the rolling out of Universal Banking Services is uncertain. It is our diagnosis that we are struggling now with moving forward because of a failure to recognise the entirety of the experience of financial exclusion. Progress has also stalled because the necessary public and private sector commitment to making a reality of financial inclusion has not been secured. This publication aims to start this debate afresh by developing a clearer definition of *what it means to be financially included* and by fully explaining *why financial inclusion matters*. From here, we develop the key priorities for achieving *full financial inclusion*. We address a number of key questions:

- What is financial inclusion and what is its relationship to poverty and social exclusion?
- How far does current policy and practise go to achieving financial inclusion? What progress has been made?
- What are the remaining challenges to financial inclusion?
- Are there solutions that will help meet these challenges and what are the priorities for policy action?

2. A new definition of financial inclusion

An evolving definition

Although financial exclusion has been experienced by individuals and families since financial services came into being, it has only been an issue on policy makers' radars since the Labour government came into office in 1997. The debate was at its height when Policy Action Team 14 (PAT 14) reported in 1999. Policy Action Teams, initiated by the Social Exclusion Unit, were an innovative form of policy development bringing together individuals with a wide range of expertise and experience. PAT 14 recommended a series of reforms to develop credit unions, to make insurance services more available in deprived communities and to expand access to banking services.

Since then, a number of other policy debates have explored different aspects of financial exclusion ranging from improving financial literacy to the piloting of a new savings vehicle for those on low incomes: the Saving Gateway. These will be discussed in more detail below when we assess progress to date. First, we need to be clear about what we mean by financial exclusion, and how will we know when we have achieved the goal of full financial *in*clusion?

PAT 14 did not define financial exclusion but interpreted it as 'lacking access to financial services' (HM Treasury 1999). Since then, the Government's agenda has been dominated by facilitating the development of Universal Banking Services, of which basic bank accounts and the post office card account (POCA) are the main components. This agenda has been subsumed into achieving the Government's own target of delivering benefits direct to bank accounts. The initial driver seemed to be reducing the cost of benefit delivery rather than explicitly ensuring people could be financially engaged citizens.

This focus on developing appropriate products is important but it is incomplete. In 2000, the then Secretary of State for Education and Employment, David Blunkett, set up the Adult Financial Literacy Advisory Group (AdFLAG) with the remit to make recommendations on ways to improve the financial literacy of the adult population with a specific emphasis on those who are disadvantaged. AdFLAG clearly identified that use of and access to financial services raises questions both of *supply* and *demand*. While they acknowledge that much work had begun to address the supply of appropriate products, the demand side had been neglected. They recognised that,

> people need to be equipped with the skills, knowledge and confidence to ensure they make informed judgements and take effective decisions regarding their own financial circumstances (DfEE 2000).

Their recommendations were based on the premise that pure *information* was insufficient and that people needed the ability to *understand* this information. This means stressing the importance of raising levels of financial literacy and on the role of appropriate advice.

Breadth and depth

This latter emphasis helps us develop what being 'fully financially included' might look like. Our approach takes into account a concern for both the supply and demand side of tackling financial exclusion. The key to understanding and achieving financial inclusion is recognising its *breadth* and *depth*. By this we mean the following:

- *Breadth of needs:* People need access, when appropriate, to a range of products and services. This includes a bank account but also affordable and suitable credit, savings and insurance facilities. People will then be empowered to cope with fluctuations of income, to manage extra costs and to plan for the future. Having a bank account is only a step on the ladder.
- *Depth of engagement:* People also need the opportunity and ability to use a range of financial products and services. They need the capacity to make informed and appropriate choices, which reflect individual circumstances and which allow them to access their rights and fulfil their responsibilities. Product availability is insufficient on its own. People must also be financially literate and capable, and have suitable advice to make the right financial decisions.

People can lack access to the range of financial products and services for a variety of reasons. PAT 14 highlighted the main causes as:

> a mismatch between potential customers' needs and the products on offer. Product diversity is clearly part of the answer for under-served markets. People in poor neighbourhoods may make little use of financial services for reasons that are related to the area itself. Where crime rates are high, property insurance both household and business may be unaffordable. Remoteness from major commercial centres, and withdrawal of financial service outlets from poor communities may be factors in low-income households' use non-use of mainstream institutions. (HM Treasury 1999)

Whilst the breadth of financial exclusion (availability of appropriate products and services) seems largely to affect people on low incomes living in disadvantaged communities, the depth aspect of financial exclusion (lacking the ability to engage and the financial skills to make informed choices) can affect many more people.

> It is a mistake to believe that only those on low incomes or in disadvantaged areas need financial literacy. These groups have specific needs and challenges due to their particular circumstances. However, the changing world is having an impact on the wider population and most people recognise they would benefit from some form of additional financial skills and understanding. The nature and delivery of financial services have changed dramatically over past years with new technology and the introduction of numerous more products. If adult financial literacy is to be resolved in a real attempt to empower the individual and allow them to become truly self-reliant, then financial skills and understanding need to be improved across most of the population. (DfEE 2000)

A concern with the breadth and depth of financial inclusion also illustrates the *different degrees* of financial exclusion. Opening a bank account, whilst a positive step, does not move someone from being excluded to included. There is a spectrum of financial inclusion. Some people have no financial products and no contact with financial services. Others may have a bank account and home insurance, but be forced to use expensive credit. Others still may have a range of financial products but not have enough rainy-day savings. Crucially it is the relationship between breadth and depth of inclusion that matters most: they go hand in hand. Little progress is made if products are made available but people are unable to use them effectively. Recent research (Jones 2003) has shown that supportive services like financial advice, bill payment and budgeting advice all need to go along side take up and effective use of products. People will only move along the spectrum of financial inclusion if they:

- open a bank account and understand how to use it to manage their finances;
- have access to credit facilities and choose the product which suit their needs;
- use savings products which balances their need for rainy day cover and longer-term security.

Financial exclusion is also a dynamic concept. People move in and out of using financial products because of individual and household changes of circumstances, but developments in the nature of financial services and changes in public policy also influence the level of financial inclusion. First, the evolution of the financial services industry, whilst leaving many people on low incomes with little choice and a lack of simple and affordable products, has led to too much choice for others as products proliferate. There is an increasingly bewildering array of products now on offer. Secondly, changes in public policy have required individuals to take greater responsibility for their welfare and to be able to navigate effectively the interface between public and private provision. This point has been made by the Financial Services Authority (FSA):

> In the longer term, the importance of understanding financial concepts and risks is increased as consumers take greater responsibility for their financial affairs. At present, many consumers (for example) are not saving enough to provide for a comfortable retirement. (FSA 2003)

These, and other reasons, mean individuals often do not have the necessary private provision and neither do they claim their rights as illustrated by low take-up of some benefits and tax credits. We return to these points in more detail below.

These trends – increased complexity and a shift from public to private responsibility – look set to continue. This not only illustrates the shifting nature of financial exclusion, but it also underscores the importance policy makers and the private sector need to attach to financial inclusion understood using the *broad* and *deep* formulation adopted in this pamphlet.

Whilst it needs to be recognised that taking a broad and deep conceptualisation of financial inclusion brings in the needs of a wide spectrum of society, from a public policy perspective, the priority should be the most financially excluded. It is often the most disadvantaged – lone parents, ethnic minorities, disabled people – who are most at risk of being financially excluded. Getting people onto the ladder of financial inclusion is vital and Universal Banking Services should be heralded in this regard. But we cannot stop there. If we genuinely want these priority groups to become empowered citizens able to make their own financial decisions, we must address the range of needs that prevent them being fully financially included.

Life being financially excluded

A homeless woman sought advice from a CAB in County Durham about opening a bank account. She received cheques regularly under a magistrates court compensation order, but could not cash them as she did not have a bank account. The woman had tried to open an account, but had been turned down by many banks as she did not have documentary proof of her address. The woman was also unable to cash the cheques at cheque-cashing companies as the fees were too high – £30 per cheque.

A client of a CAB in East Yorkshire needed to open a bank account of her own when she took on a second part-time job, as the employer insisted that they would only pay her wages into her own named account. The client approached a bank who were not happy with the proof of identity and address she supplied and asked for her national insurance card. The client applied for one from the Inland Revenue, but was told that this might take up to six weeks. The client sought advice when she had worked five weeks without pay and was considering whether to give up her job.

A CAB in South Yorkshire reported that a client whose first language was not English needed to buy a car. He went to a garage whose advert promised that they would arrange finance and let buyers drive away within an hour. The client told the salesperson that he wanted to pay no more than £240 per month in hire purchase payments, but he was persuaded that he could afford £260 per month. The salesperson also insisted on including extra insurances with the payment, which increased the monthly payment the client would have to make to £335 per month. The client was kept at the garage for a total of seven hours. He felt he had no other choice but to accept the deal as the salesperson told him that he could not get finance elsewhere due to his lack of credit history.

What full financial inclusion looks like

This approach, which stresses the importance of both the breadth and depth of the concept of financial exclusion, leads to a clear working definition of financial inclusion. It brings together access to a range of appropriate products and the concern with having the skills and confidence to make informed decisions. Our definition is as follows:

> Financial inclusion is when citizens have access to appropriate financial products and services *and* the opportunity, ability and confidence (and appropriate support and advice) to make informed decisions about their financial circumstances, as would be regarded as a minimum to organise their finances in society effectively.

Full financial inclusion is when all citizens have this opportunity.

3. Why tackling financial exclusion matters

One of the key reasons that little political and policy energy has been devoted to financial exclusion is arguably that its implications and consequences have not been fully and widely understood. Reducing financial exclusion is a desirable end in itself. However, it is also something that is important in achieving wider and more high-profile social objectives. Without tackling the issue, some key objectives and aspirations will be harder to achieve.

A subset of social exclusion

The development of the concept of social exclusion stresses the multi-dimensional and dynamic nature of poverty and deprivation. Tackling social exclusion was an early priority of the incoming Labour Government with the setting up of the Social Exclusion Unit, the establishment of a number of Policy Action Teams (exploring different aspects of social exclusion and one of which, on financial exclusion, we have referred to above) and the development of the National Strategy for Neighbourhood Renewal. Tackling social exclusion involves looking to the many different reasons that stop people being fully active citizens from a scarcity of jobs and educational opportunities, to poor housing conditions, to lack of access to financial services. In this sense, financial exclusion should be seen as a subset of social exclusion, and tackling social exclusion comprehensively must involve tackling financial exclusion.

Financial exclusion is often a problem layered on top of other forms of exclusion. That is, there is a close correlation between being socially and being financially excluded. For those people who use no financial services, many (though by no means all) are not in employment, living on benefit, social housing tenants and live in deprived neighbourhoods (HM Treasury 1999).

Perhaps surprisingly, the debate on financial exclusion is rarely looked at in the wider context of social exclusion. Witness the lack of reference to financial exclusion in the Government's ongoing strategy to tackle social exclusion (DWP 2003). This could be because of the focus on product development, which has engaged the financial services industry and regulator, but has not excited mainstream poverty experts and practitioners nor local or regional government. This is a damaging oversight. If the goal of social inclusion is to be achieved, and people are to be empowered and given the opportunity to participate fully in society, then financial inclusion, in all its depth and breadth needs to be tackled.

Poverty and the cost of financial exclusion

If at a general level financial exclusion is seen as a subset of the wider social exclusion agenda, then more specifically it needs to be set in the context of the Government's priorities to tackle child and pensioner poverty. As doubts grow about the extent of the efficacy of current anti-poverty strategies, the Government needs to consider a wider strategy than simply increasing employment rates, some benefits and tax credits. Financial exclusion and poverty are related in three ways:

- financial exclusion results in money seeping out of household budgets;
- greater financial awareness could increase the likelihood that people will take up means tested benefits;
- access to a suitable range of products can both help prevent people falling into and help people get out of poverty.

Financial exclusion sucks money out of low-income households

Current anti-poverty policies have focused almost entirely on getting more money into poor households. This should not be the sole focus of government policy. Government should also help ensure that low-income families do not incur extra costs because of their poverty.

Financial exclusion is crucial in this context. It can be the root cause of money seeping out of household budgets and low-income communities. Instead of being used to pay for food or heating, money is lost through the costs inherent in lacking suitable products or through people (through no fault of their own) making poor financial decisions. In short, financial exclusion makes poor people poorer. The cost of being financially excluded has never been officially assessed and it would be difficult to do so. But the overall figure for the amount of money that is pouring straight through households with no benefit is likely to be considerable. These costs are various and result from different behaviours, such as using expensive sources of credit or not using direct debits.

Perhaps the most significant cost arises from a lack of access to affordable credit. We discuss below how many people resort to the use of expensive credit and illegal moneylenders. When the additional costs associated with pay-day loans, cheque cashing and the need to pay bills in cash or on prepayment meters, the impact on attempts to reduce poverty could be considerable.

New risks are also becoming apparent. An example is charges for the use of convenience cash machines, which can be one source of extra cost with particular impact on low-income households. Such charges are most unfair for those people who only want to withdraw a small amount of money. For instance, a £1 charge on a £10 withdrawal means you are paying ten per cent to the bank or whoever runs the machine. The network of convenience cash machines is growing and the introduction of directly paid benefits to claimants means that there are more people who will be using Automatic Teller Machines (ATM) to draw out their benefits.

> For instance, a family with two children receives approximately £107 per month in child benefit. If they were to withdraw £20 per week from a convenience ATM, charging £1.50, this would mean that 7.5 per cent of the weekly allowance would be paid straight to the bank or ATM owner (BSA 2003).

The Building Society Association has recently called for greater transparency on cash machine charges. Upfront notification of charges would be a positive step so that people at least know that they are being charged.

It would be wrong to infer individuals' are incurring costs because they are just making the wrong choices. Sometimes not choosing the most cost-effective short term option is the right choice because, for example, people find it easier to manage their finances in cash or because it is more convenient. But often people have no choice. For example, the behaviour of firms can embed financial exclusion. Fuel companies when they require large deposits of new customers are a case in point. People who cannot pay the deposit have to accept a pre-payment meter – the most expensive means of paying for fuel. Two million households have gas pre-payment meters and 3.7 million have electricity pre-payment meters (OFGEM 2003).

Financial exclusion and benefit take-up

Being able to make better financial decisions or use mainstream financial services can help people minimise their costs, but also maximise their incomes. The Government's welfare and poverty-reduction strategy relies heavily on individuals applying for means-tested provision. It relies largely on people becoming aware of their entitlements and making a claim. However, it has proved difficult to ensure high take-up. Greater financial awareness and understanding might help people recognise the support that they are entitled to, and ultimately lead to a reduction of poverty. Take-up of the Minimum Income Guarantee was between 68 and 76 per cent (by caseload) in 2000/2001, and take up of Working Families Tax Credit was between 62 and 65 per cent (DWP/IR 2002).

Financial exclusion and the dynamics of poverty

We know that poverty is not a static phenomenon. Though some households and individuals experience prolonged periods of poverty many others move in and out of it. Accordingly there has been interest in recent years in the pathways that people take into and out of poverty. What is it that means that some people slip into poverty while others can steer clear of it? This is a highly complex question to answer and the public policy response to these pathways into poverty is necessarily multi-faceted. Changes in circumstances such as losing a job, divorce or separation, and starting a family are all factors which can trigger a fall into poverty. Being financially excluded can reduce the ability to cope in times of change: when income falls households may have no savings or insurance, or affordable credit may not be available. If we can make headway into achieving greater financial inclusion, this may help people cope in difficult times and prevent some people falling into poverty.

Welfare reform and facilitating empowerment and choice

Low levels of financial inclusion are also limiting the success of the Government's wider welfare reform strategy, the direction of which over the last few decades has been to shift responsibility more towards the individual. We have witnessed the reduction in the state pension and the expansion in private provision; the reduction in student grants and the expansion of loans; the reduction of state mortgage support and the (limited) expansion of private mortgage insurance. This approach has continued under Labour and means that today individuals are expected to be more self-reliant than in the past. As a result financial inclusion is more important than it was in the past, as people need to use private products to make their own provision and have the necessary skills to make complex choices.

> There is a growing expectation that the individual will need to become more self-reliant in the future. Increased competition and more complex products in the financial services industry leave many people ill equipped to cope with the sophisticated choices they may need to make (DfEE 2000).

The pensions reforms of 2002 are a good example. This is an issue usually not considered under the auspices of financial exclusion. Increasingly it should be. For many, including those on moderate incomes, a private pension and certainly informed decision making about planning for their retirement is becoming a necessity.

Recognising that people on low to moderate incomes did not have appropriate products available to them, the Government introduced Stakeholder Pensions which were low-cost, flexible private pensions. Their success has however been limited for a number of reasons. One reason is that the Government failed to put in place the necessary advice and information framework to help people make the decision to save for retirement, and the provision of advice by private providers reduced as the costs they were allowed to charge were capped. The increasing complexity of the pensions system overall is a severe obstacle.

> Planning is very difficult for individuals. The pensions environment has become much more complicated since 1997,

> and the new policy instruments both increase the need for good quality advice and make such advice more difficult to provide (IPPR 2002).

Engaging with the welfare state also requires a level of financial understanding that few hold. People frequently need advice and advocacy to get the support to which they are entitled. The interaction between state and, in this example, private pensions and the eligibility criteria for tax credit entitlement are highly complex. Simplicity should be a first order priority for welfare reform, but this needs to go hand in hand with raising levels of financial literacy through education. The level of complexity also makes the role of advice very important, which is often missing. This is also not a minority issue. The majority of pensioners will be means-tested in the future and the majority of families with children are entitled to tax credits. Financial literacy and provision of advice are key challenges to financial inclusion and are discussed in more depth below.

Making financial inclusion a political priority

Financial exclusion does not currently have a high political profile. Whilst ministers and civil servants pay lip service to it, it attracts little policy attention and few public resources. Financial exclusion however will limit the effectiveness of strategies for what *are* government priorities.

Financial exclusion inhibits:

- Social inclusion and neighbourhood renewal strategies: communities need access to financial services locally and individuals being able to use a range of financial services is a step towards full social inclusion.
- The eradication of child poverty: families may incur extra costs through not using mainstream financial products and, through poor financial understanding, may not claim the tax credits and benefits to which they are entitled.
- The ability to tackle pensioner poverty: people may not be saving for retirement because pension products are too complex and advice is not available. Pensioners may not be claiming the Minimum Income Guarantee or the Pension Credit for reasons linked to financial exclusion.

- Delivery of the Government's overall welfare strategy: where individuals are responsible for their own provision, they may not be able to access and use suitable private products, and where state support is available, benefits and tax-credits may go unclaimed.

4. Progress on tackling financial exclusion

Revisiting PAT 14

The report of the Policy Action Team 14 (HM Treasury 1999) set out over 40 recommendations for tackling financial exclusion. An audit of the recommendations has not been undertaken but there have been some notable successes and failures. In the foreword to the PAT 14 report, Melanie Johnson, the then Economic Secretary to the Treasury, highlighted three key areas for immediate action: the setting up of a central services organisation to develop credit unions; the development of Insurance with Rent schemes; and reform of the Social Fund to extend its reach. Progress on these priorities could be described as 'fair to middling':

- It is now very unlikely that a Central Services Organisation for credit unions will be established. The Association of British Credit Unions (ABCUL) is taking forward some elements of what was intended but a new organisation is not being formed. In other areas of credit union reform, better progress has been made. Deregulation measures to promote credit union growth have continued and the Financial Services Authority (FSA) have introduced a new regulatory regime which it is felt is appropriate for the risks faced by credit unions.
- Insurance with Rent schemes have been promoted by the Housing Corporation and the Association of British Insurers (ABI), who have both published detailed guidance. Tenants in five of the New Deal for Communities areas have access to an Insurance with Rent scheme, but there is no data available on the take-up of schemes overall. PAT 14 also recommended that consideration should be given to undertaking pilot studies for extending Insurance with Rent beyond contents insurance, yet there are no plans for these pilots to go ahead. More generally in relation to insurance, there has been some increased availability of insurance through using the Post Office to collect premiums but the anticipated extension of insurance services through credit unions has not yet occurred.

- Reform of the Social Fund continues to be elusive despite multilateral support for urgent change. Budget 2003 did increase the resources for the Social Fund, and this is very welcome, but it is still the case that the Social Fund is the embarrassment of the welfare system. We discuss reform of the Social Fund in more detail in the next section.

With regards to other aspects of PAT 14, there have been some other advances. The FSA is now required to complete a cost-benefit analysis for rule changes which considers the impact on different types of consumers, including those who are currently excluded from mainstream financial services. The FSA's research and education work programme also now includes a focus on the specific needs of low-income groups. There has also been progress on financial education and literacy, which we return to in the next section, but the area of most activity and most progress following PAT 14 is banking.

Basic Bank Accounts and Universal Banking Services

As discussed already, the Government, the Post Office and the high street banks have all signed a five-year agreement to provide what have become known as Universal Banking Services: through basic bank accounts and the Post Office Card Account. Basic bank accounts are a 'no frills' account which provide money management functions but do not offer a chequebook or overdraft facility. All high-street banks offer them, though not necessarily under the name 'basic bank account'. The Post Office Card Account is even simpler with the single purpose of collecting benefit income after direct credit from the government. Its only functionality is a plastic swipe card and pin number to enable claimants to make withdrawals at a Post Office counter.

The establishment of Universal Banking Services has been a considerable achievement for the Government and the banking industry. It will affect the 13 million people who currently collect benefits over the counter and is being phased in between April 2003 and April 2005. The impetus for the initiative from the Government's perspective is to facilitate the direct payment of benefits and tax credits into bank accounts, with the aim of making administrative savings and reducing fraud. If successful, it will also be a significant advance in tackling basic financial exclusion.

In relation to Universal Banking Services, we ask two questions. First, drawing on the real life experience recorded by Citizens Advice Bureaux around the country, we ask whether Universal Banking Services will be a success when tested against their own, relatively narrow aims. Secondly, we ask how significant a contribution Universal Banking Services will make to reducing wider financial exclusion.

Will the Universal Banking Services achieve their stated objectives?

It is early days in assessing whether Universal Banking Services will be a success at achieving the stated objectives, that is ensuring the safe electronic delivery of benefits. From July 2002 onwards, Citizens Advice Bureaux were asked to find out how banks, building societies and the Post Office have been gearing up for Universal Banking Services. The evidence provides some useful insights into the challenges that are being.

It is certainly the case that the banks and the government have worked well together and achieved a lot in getting this far. Most banks and branches seem to be aware of and have been informing their front line delivery staff. However, there is a number of risk areas.

Proof of identity

Proof of identity continues to be a problem, despite some progress. The FSA has recently changed its guidance so that: 'if a financial institution has reasonable grounds to conclude that an individual cannot produce detailed evidence of his or her identity, it may accept a letter or statement from a person in a position of responsibility who knows and can confirm his or her identify.' This has yet to translate itself into consistent practice and different banks require different documentation. Some banks do accept a reference from a 'responsible' person; others do not. Some banks accept benefit books; others do not. It would seem that identification for marginalised groups is a particular problem, including homeless people, asylum seekers and people recently released from prison. The evidence shows that these groups often have difficulty proving their address and often experience insensitivity from bank staff.

The heart of the issue is that bank staff are having to operate under two contradictory sets of guidelines: one to be more inclusive and open up their services to new groups; the other to limit access as an appropriate response to money-laundering concerns post-September 11th. Bank staff are individually liable and so often err on the side of caution.

Proof of identity

A UK citizen who had escaped from the current unrest in Zimbabwe sought advice from a CAB in Essex, because he could not open a bank account. At the time he was living with his stepdaughter and so his name was not on any household bills. The client desperately needed an account as he had recently been sent a crossed girocheque for £1,000 arrears of benefit following a successful appeal.

A client of a West Midlands CAB, an Iraqi refugee with exceptional leave to remain in the UK, needed to open a bank account so that he could work. Although the client had a number of documents proving his identity and address, none of the banks would accept them. One bank erroneously told him that Iraqi nationals were not allowed to open bank accounts.

A previously homeless client of a Nottinghamshire CAB needed to open a bank account when he found work to pay his wages into and to pay rent by direct debit. The client had visited many banks, but none of them were prepared to let him open an account without proof of his address. As the client had been homeless, he could not provide this.

A CAB in Northamptonshire reported that an 89-year old woman was unable to open a bank account for payment of her pension. She needed to open a bank account, as the post office at which she currently cashed her pension was due to close. The banks would only accept a driving licence or passport as proof of her identity, neither of which the client had.

Staff awareness

Staff awareness of the changes is patchy but in general good. Most banks have received briefing on how direct payments works, although some are unaware that a Basic Bank Account is also available at the Post Office. Interestingly, awareness does not seem to differ systematically between different banks, that is Barclays is not systematically better than HSBC, but it does appear to differ randomly between different branches.

Staff awareness

A CAB in Hampshire advised a lone parent client in July 2003 to open a new basic bank account, as her income support was being swallowed up by the overdraft and other debts to her bank. The CAB gave the client an FSA booklet containing details of all the banks and building societies who provide basic bank accounts to help her choose the most appropriate account. When the client asked one bank if she could open their basic account, the bank staff refused, commenting that their name should be taken out of the FSA leaflet. The bank in question is a signatory to the Memorandum of Understanding on universal banking services. As a result, the client could not access her benefit which was still being paid into her overdrawn current account.

Information and advertising

Information and advertising of basic bank accounts is very limited. The Citizens Advice evidence is consistent with the findings of the FSA consumer panel and Treasury Select Committee, among others, that banks do little to sell basic bank accounts. At present there is little reason for banks to promote basic bank accounts; they are not regarded as making much, if any, money and there is no requirement for the accounts to be advertised. People's circumstances change and this could be regarded as a rather short term view by the banks.

Information and advertising

A CAB in Yorkshire had surveyed local bank branches' knowledge of basic bank accounts in March 2003 in order to draw up a leaflet for their clients. They found that on the whole knowledge was good, but several banks did not have any information about basic bank accounts at all. Two branches of one bank told the CAB they were not keen for their details to be included in the CAB's leaflet.

A CAB in Sussex found that only one bank out of the eleven they visited in January 2003 knew about their basic account, and had on display the leaflet about the basic account in the branch. The receptionist also told the CAB adviser that their basic account was one of their most popular accounts. In complete contrast another bank told the CAB adviser that it was the bank's policy not to display leaflets promoting the basic bank account.

A woman with poor literacy skills sought help from a CAB in Hertfordshire in August 2003 to complete an application form for a basic bank account, which she needed for payment of her benefits. The CAB adviser was concerned to discover that the leaflet which accompanied the application form for the basic account appeared to be a standard banking leaflet with few adaptations other than the title.

Culture change

A culture change amongst bank staff will be needed if Universal Banking Services are to be truly effective. Bank staff are often unused to dealing with people who have little or no experience of a relationship with any financial institution. These people will often lack confidence in dealing with the banks and may require additional help and support.

Culture change

A Devon woman with health problems and special needs needed to open a bank account to pay a £50 cheque in. The bank she went to refused to open an account for her, as she did not have any utility bills proving her address. As the client's fuel supply was paid by meter, she had none. The woman came back with a letter from the CAB confirming her identity and explaining the details of her fuel payments. But the bank still refused to open an account for her and the woman became very upset. The CAB felt that the bank just could not be bothered to open a bank account for their client due to her behavioural problems and special needs. In the end, the CAB manager had to go with their client to another bank to get an account opened for her.

Credit scoring

Credit scoring is being undertaken in some cases prior to opening bank accounts despite there being no credit facility with a basic bank account. The evidence reveals a number of examples where people are unable to open accounts because of poor credit scoring.

Credit scoring

A client of a CAB in Wiltshire needed to open a new basic bank account because it was impossible to negotiate reduced payments to her debts whilst her wages were paid into the overdrawn current account. The client was turned down by one bank on the basis of her poor credit rating.

A CAB in Cumbria had advised debt clients to open a basic bank account. The clients had been given the FSA leaflet, in order to help them choose one. The clients chose the bank because it had a local branch. When the clients had completed the application form, the bank staff told the clients they could not have the basic account, but could have a full current account instead. When the clients told the bank that they had been advised by the CAB to open a basic account and produced the FSA leaflet, the bank grudgingly agreed to open one.

Fraud

Despite the claim that Universal Banking Services will reduce fraud, there is a good chance it will remain an issue. Most of the concerns centre on the use of Personal Identification Numbers (PINs) that accompanies direct payments. At present most order books or Giros are cashed at specific post offices and often the Post Office knows the claimant. With a PIN, money can be taken out anonymously at any location. Older people in particular have concerns about using PIN numbers and having to write them down and carry them around with them. Indeed the possible gains from reduced fraud have probably been exaggerated. A Trade and Industry Select Committee report highlighted that the projected £80 million savings in fraud reduction was small when set aside the overall estimate of benefit fraud of £2 billion (REF insert).

These concerns need to be addressed if Universal Banking Services are to work. Some are straightforward and could be resolved through staff training. Others, such as potential new fraud and culture change will be more difficult to tackle. Even if these problems are merely teething problems, the more fundamental question of how much Universal Banking will achieve in tackling broader financial exclusion remains.

How far will Universal Banking Services go to tackle financial exclusion?

It will be an important achievement to have enabled all citizens to hold a bank account and to join the financial mainstream. But bearing in mind the breadth and depth of our definition of financial exclusion, simply having an account is emphatically not financial inclusion. So how should we assess the possible impact of Universal Banking on wider financial exclusion. Broadly speaking, there are two scenarios:

- Under the first, it will act as a route towards full financial inclusion. People will learn by doing and gain more confidence with financial products and so will become more included and engaged with financial products.
- Under the second, the provision of basic bank accounts and Post Office Card Accounts will not lead to wider engagement. Simply

having these products does not achieve and will not lead to full financial inclusion.

The true impact is likely to depend on the individual. For some people, having an account for the first time may increase their confidence and lead to wider use of other products and improved financial capability. For others, it will not lead to significant changes in their behaviour. It is our view that Universal Banking Services alone will be insufficient to lead to the wider inclusion we are aiming for. They will achieve neither the depth nor breadth of financial inclusion required.

Universal Banking Services, although only about basic bank accounts, could however raise awareness about the need for other products, which may not be available. The Government has been busy devising a set of Sandler Suite products. It is unlikely that these will meet the needs of those who currently lack basic financial products but a set of products could be developed for this target group. The features could include a bank account, a savings account and appropriate credit and insurance products. On opening a basic bank account, people could receive information on the other standard products. The suite could be branded 'universal banking products' or 'citizens banking products'. The products could have CAT standards and there may be a need for incentives to encourage the market to offer them. This is an area worthy of further development.

Universal Banking Services show that government and the banking industry can work together at a high level to meet certain public policy goals. Action is required to make sure that misunderstanding of ID requirements or the lack of awareness of staff does not limit its potential. Whilst good progress has been made on delivering basic bank accounts, other issues need greater focus if we are to make progress on the full breadth and depth of financial inclusion. In the next section, we discuss what we see as the critical priorities and next steps for achieving full financial inclusion.

Asset-based welfare and the Saving Gateway

The other area where significant progress has been made is in the context of asset-based welfare and the Saving Gateway. Asset-based welfare is a new approach which helps people on low incomes accumulate assets and which recognises the welfare effects of asset-holding such as coping in times of change and being able to take opportunities which would otherwise be denied (Sherraden 1991). Savings are important because, as with access to affordable credit, they help people not to fall into poverty or over-indebtedness.

The Saving Gateway is a savings account for low-income adults. The innovative feature is that the savings of individuals are matched pound-for-pound by the Government to give strong incentive to save. Pilots of the Saving Gateway started in the second half of 2002. They are being carried out in five different locations around the country; four of which are using a partnership model involving community-based organisation and one of which is just being delivered through a high street bank. The pilots using community-based organisations, such as Housing Associations, are working on the basis that this is a better way of reaching the target groups the policy is intended to benefit. Also for many people, opening a Saving Gateway account is a major decision which requires proper explanation, support and advice.

The initial findings from the pilots have been positive. The number of people opening accounts has been healthy and the levels of saving have been high. But it is too early to say whether the Saving Gateway leads to wider social and financial inclusion, in that it allows people to take opportunities which would otherwise not be open to them. It should be remembered that original ambition of the Saving Gateway was not just to be a savings product (although this clearly has value) but also to be an initiative with improves people's welfare and inclusion in a broader sense.

Ministers have said that, on completion of the pilots, the policy will be rolled out to a wider area. Indeed one option is to make it available throughout the country. Another would be to make it available only in deprived areas. Our view, without having seen the final evaluation, is that within the current pilots are two distinct approaches, which could be pursued in different ways. One is a targeted matched savings scheme which is delivered through community based organisations and draws on their expertise in providing tailored support and outreach. But this model is neither viable nor necessary in all areas of the country: not viable because the community-based infrastructure does not exist; not desirable because some communities have good access and are comfortable using mainstream financial services.

The second approach is to deliver the Saving Gateway as a government subsidised financial product. Rather than providing it through community-based organisations it should be available to people on certain incomes through high street banks. Ultimately this savings product could be seen as a basic savings account and might be marketed alongside basic bank accounts. It would be part of the basic brand we have talked about above. This would not be a policy specifically for those on very low incomes who might still need to access savings products through community-based intermediaries. Instead it might meet the needs of a larger group of people for whom the term 'saving gateway' might mean more, and who would use the account to feed into longer term savings such as pensions and ISAs.

From the evaluation of similar policies in other countries, in particular Individual Development Accounts in the US, we can learn some important lessons. A number of issues stand out:

- the importance of financial literacy to enable people to use their accounts effectively;
- the importance of trusted intermediaries – usually community-based organisations – to provide outreach, education and advice;
- the importance of savings goals to motivate people to change consumption patterns.

The Saving Gateway is being piloted in some locations alongside the Community Finance and Learning Initiative (CFLI). The CFLI aims to use local community based organisations to draw together a range of different programmes and policies at a local level. It has a number of aims one of which is to build financial literacy skills through the provision of appropriate training, education and support. Its other aims are to increase awareness of and access to education and training, to increase access to financial services and to provide a vehicle for micro-finance. The CFLI recognises the multi-faceted nature of financial exclusion and its links with broader welfare agendas.

As well as the Saving Gateway, the government is also introducing a second asset-based welfare policy – the Child Trust Fund – which it is hoped will have dramatic implications for the long-term eradication of financial exclusion. From 2005, a Child Trust Fund will be opened for every new-born child. Each child will receive a government endowment into their trust fund with top-ups made at key life stages. Additional contributions can be made and it is hoped that parents and others will make regular contributions. A programme of school-taught financial literacy will accompany the trust fund. At 18, individuals will be able to access the funds in their trust fund. In 20 years time, all children will be reaching 18 with an account, with some funds, and having undergone a programme of financial learning linked to their fund. This bodes well for achieving full financial inclusion for future generations.

Financial inclusion outcomes

There has been a lot of activity then on tackling financial exclusion, but what impact has it had? It clearly takes time for policy changes to have an effect and it is perhaps too early to assess outcomes. Both the Universal Banking Services and the Saving Gateway have not had much impact to date but do have the potential to have significant effects in the medium to longer term.

Since PAT 14 was published, there has been some progress. Whilst usage of basic bank accounts should not be used as a proxy for financial inclusion, they do illustrate whether people are taking the first step on to the inclusion ladder. The financial services industry report that over 5.4 million basic bank accounts have been opened but it is not clear how many of these have been taken up by those that were previously 'excluded'. The Family Resources Survey indicates that changes in the adult population without a bank account have been fairly static. There has been strong growth in credit union membership (more than 100 per cent over the last five years) but the coverage is still less than one per cent of the population. The coverage of households with contents insurance has been rising but from a low base (HM Treasury 2003).

The extent of financial exclusion does not seem to have changed much and is still of great concern. The key problem in monitoring financial exclusion is the lack of data with no one monitoring the different aspects over time. Drawing on the latest evidence available we know that:

- 12 per cent did not have a current account and 7 per cent had no type of account (FRS 2001-2);
- half of all households had less than £1500 or no savings (FRS 2001-2);

- in 2000, five per cent of households did not have home contents insurance because they did not want it; eight per cent did not have it because they could not afford it (Gordon *et al* 2000);
- only 45 per cent of people were financially literate in 2000 (FSCP 2000).

Whilst progress on the Universal Banking Services has been good, we have highlighted some risks and the current limitations to their potential. The Saving Gateway is innovative and meets a clearly identified need. There is also a number of local initiatives which illustrate what can be achieved, and we discuss these below. But our overall conclusion is that current policy fails to address the breadth and depth of full financial inclusion. In the following section, we focus on four key areas where some progress has been made but which we think are the key challenges to financial inclusion and which require much greater development and priority. These are:

- improving financial literacy;
- filling the advice gap;
- the availability of affordable credit; and
- developing effective delivery mechanisms.

5. Meeting the remaining challenges

Improving financial literacy

It is impossible to achieve any depth of financial inclusion without improving financial literacy. To have the ability and confidence to make informed decisions requires a certain level of financial capability. The need to invest in and prioritise financial literacy is widely recognised to be a necessary element of financial inclusion. This is essential given the society we live in and the bewildering array of financial decisions people now need to make just to live their daily lives. As Citizens Advice have highlighted, 'Financial literacy is no longer a desirable trait that consumers should be encouraged in. It is an essential requirement to play an informed role as a consumer in today's 21st Century market' (Citizens Advice 2002).

The Government has devoted a lot of energy to financial education policy development and there is now in place a wide range of initiatives. Many of these – such as Skills for Life which emphasises basic numeracy and literacy skills – are led by the Department for Education and Skills. The introduction of financial education into the National Curriculum was an important step forward but it is not yet clear how comprehensive personal finance learning is in schools. The work of the personal financial and education groups (pfeg) has been important in this regard. It brings together teachers, the FSA, government, consumer bodies and industry representatives and promotes and facilitates personal finance education in schools. The FSA has led on its own programme to improve financial literacy given its remit to protect and inform consumers. In October 2003, the FSA launched a Financial Capability Steering Group which is to develop and implement a national strategy for financial capability. Many CAB offices and a range of voluntary organisations are also now promoting financial literacy and involved in specific local financial literacy initiatives. The Department of Trade and Industry also plays a role through its 'confident consumer' initiatives.

In February 2000, the then Secretary of State for Education and Employment set up the Adult Financial Literacy Advisory Group (AdFLAG) to make recommendations on ways to improve the financial literacy of the adult population. Some of these recommendations have been progressed but others did not gather momentum. Despite the level of activity, financial literacy remains a major challenge to financial inclusion. High levels of 'financial phobia' within the general population are possibly a symptom of a lack of financial confidence and literacy.

The need for financial literacy

A single man sought advice from a CAB in Staffordshire as he could no longer afford the payments on a mortgage. The client told the bureau that he needed a loan, so when he got marketing about a mortgage lender through the post, he remembered seeing their TV advert which featured an endorsement of their products by a celebrity, and contacted them for further details. The client was attracted by the information quoting a low interest rate – only 1.170 per cent, so he agreed to a secured loan for just under £25,000 and accepted a one-off optional payment protection insurance which increased the loan to £29,000. The client was attracted by the insurance as they offered to pay the premium back if he made no claim in five years, as he had done this with an extended guarantee on electrical goods and thought it was reasonable. However, the client did not realise that the insurance premium was added to the loan and he would pay interest on it over the 25-year term of the loan. Nor did he appreciate that the interest rate he had seen was a monthly figure and the actual APR was nearer 15 per cent and that he would pay back over £100,000 to the company. The client cannot afford payments to this loan and his first mortgage, has arrears with his first mortgage and has only kept up payments by increasing his non-priority debts.

A CAB in North Yorkshire reported that a man had engaged a claims management company to pursue damages against his former employer for an industrial accident. The claims management company asked him to sign a loan agreement for £1,350. However the client had not read the policy document and did not realise what he had agreed to. The claim was settled at £1,350, but after settlement of the loan, the client will only receive £400.

A CAB in Warwickshire reported that a client who had bought a fitted kitchen with finance arranged by the salesperson was shocked to discover that he would be paying off the credit over a total of 10 years. At the time of seeking advice six years after buying the kitchen he had paid nearly double the cost of the kitchen already. The client told the CAB that he realised now he should have looked more carefully at the agreement, particularly at the length, before signing it.

A CAB in Cambridgeshire reported that when a client had home improvements carried out, he was persuaded to pay for them with a loan, rather than use cash, because he would receive a £1,000 discount as long as he repaid the loan within 14 months. After 13 months of payments, the client requested the early settlement figure. He was shocked to discover that the £1,000 discount made hardly a dent in the figure he had to repay due to the 25 per cent interest rate charged on the loan.

There is a strong need to prioritise action in this area. We explore three issues.

Starting young

All citizens need to be financially literate and different age groups require different types of financial education. Looking to the future, we should have an ambition that all young adults leave education with the necessary financial capabilities. The role of schools is critical here. Personal finance is currently part of the non-compulsory element of citizenship education and many teachers still feel ill-equipped to teach the subject. If we do think being financial literate is an essential requirement for being an empowered citizen, then financial education should become a compulsory part of the curriculum.

The Child Trust Fund will provide a tremendous opportunity to 'start young' in financial awareness and learning. All parents and teachers will have a tangible tool to talk to children about money issues. In the consultations on the Child Trust Fund and the Saving Gateway, the government recognised the critical role that financial literacy will play in making new asset-based welfare policies a success and in creating general financial inclusion.

More than basic skills

Much of the activity on financial education is linked to the basic skills agenda. It is certainly a concern that many people do not have the basic levels of numeracy and literacy needed to engage in financial decisions and with financial services. Our definition of financial inclusion illuminates the need for quite sophisticated skills to be fully financially included. Evidence (Citizens Advice 2001) shows that people need high levels of understanding of financial issues, together with information and impartial advice.

Many of the people making poor decisions have well-developed numeracy and literacy skills but remain unable to make the right financial decisions.

> Full financial literacy requires basic numeracy and literacy skills. It also requires the ability to understand payslips, to

> choose between different types of mortgage, to determine whether a stakeholder pension represents the best option for long-term savings, to choose between utility suppliers, to complete tax and benefit forms, and to determine whether borrowing is best undertaken through secured or unsecured facilities. It requires the ability to look ahead and take account of whether future interest rate savings or borrowing product a better option than a variable rate alternative. It requires those watching over their new born baby to think through the financial consequences of parental death, those starting work to think of retirement, and those reaching retirement to consider the time when they may no longer be able to care for themselves (Citizens Advice 2001).

We identified earlier that levels of literacy and understanding need to increase because of innovation in the financial services industry and because of changes to public policy resulting in people having greater individual responsibility. Both of these factors will continue to change which means that the level of financial literacy people need today will be different in the future. This highlights the need for 'life-long financial learning'.

Case Study: North Liverpool Citizens Advice Bureau

North Liverpool Citizens Advice Bureau provides a range of advice services, including specialist level money advice, to seven wards representing over 100,000 people. The bureau serves a high proportion of people who claim income support and many local communities experience multiple deprivation.

The bureau first developed their financial literacy programme for secondary schools in 2000 in response to a sharp increase in the number of young people coming to the bureau with debt problems.

> Many of the young people we were advising seemed to lack an awareness of key financial concepts and options, from effective budgeting skills to understanding credit. We therefore felt we could build on our money advice expertise by developing a training package suitable to use with young people aged 15 to 18. (Siw Jones, District Manager, North Liverpool Citizens Advice Bureaux)

At the time of writing the bureau has provided over 80 sessions to over 1,640 students, including students with special needs and learning disabilities. The sessions have been well received by young people who are often able to bring them to life with their personal experiences. The bureau has found that older students in particular may already know something about things like doorstep lending practices, bailiffs and catalogue shopping.

In 2002 the bureau organised a financial literacy conference in partnership with Croxteth Advice Centre and Speke Advice Services at which they launched a new financial literacy information pack aimed at young people aged 15-25. Young people themselves identified the topics for the pack, which include opening a bank account, credit scoring and saving and earning for the first time. Over 60 delegates, including teachers, youth workers and students attended the event which highlighted money issues through presentations by local agencies and young people and a play performed by a young persons' drama group called 'All Talk Productions'. Financial literacy workshops also took place where delegates discussed topics such as the 'real' costs of moving into your own home and life with a student loan.

More recently the bureau has extended its work to deliver a new three-year project that will improve the financial literacy skills of young unemployed adults through face-to-face workshops. The project focuses on the needs of particular groups of young adults such as lone parents, young men, ex-offenders and refugees, with the bureau working through partnerships with local agencies such as the probation service and a local Sure Start scheme.

Co-ordination and good practice

There is a myriad of initiatives for financial education run by a wide range of organisations. The impact overall is unclear. There is a lack of co-ordination and overarching strategy, which means that the different initiatives can duplicate and in totality leave big gaps in provision.

A national strategy that joins-up and co-ordinates initiatives to improve financial literacy is needed. The FSA have taken the lead in developing this strategy, which should aim to improve coverage of initiatives and courses and to widen the focus beyond basic skills. To complement the national strategy, 'financial literacy proofing' of all government policy relating to consumer and financial services, welfare benefits and tax credits, and administration of personal finance should be initiated (Citizens Advice 2001). This proofing should identify the financial literacy implications of all new policies action taken to ensure consumers have sufficient knowledge and skills to take best advantage of new products and services and responsibilities. If the financial literacy proofing reveals that advice is needed as well, then this too should be put in place. If the proofing shows that even with a high level of financial literacy and with advice, individuals still find it very difficult to make good decisions, then the policy itself should be revisited. The current pensions framework and the interaction of state and private provision might be a good example of this, where what is really needed is a much more simplified system.

Within this new strategy, different partners may need to enhance their roles. The FSA is taking a lead in ensuring the financial capability of citizens, and the resources to back this up. Other government agents, as well as the education system, also have a key role to play. The Department for Work and Pensions, and Job Centre Plus personal advisers could assess financial literacy needs and direct them to financial education opportunities in their local area. Many community-based organisations could also do more. Few housing associations take action to raise financial awareness and financial literacy although there are some notable exceptions. The Credit Unions Act 1979 gives credit unions a legal power to provide education and training to their members in the wise use of their money and in the management of their financial affairs. They are actively involved on a day-to-day basis in improving the financial literacy of their members, but this could be expanded.

The US evidence also suggests that employers can be very successful deliverers of financial education. The experience of 401ks (employer-delivered pensions), where there are strong incentives for employers to financially educate their employees, is instructive. When the Adult Financial Literacy Programme discusses low-income people in work, it emphasises the need to engage employers. Small businesses can be supported through the use of employer learning networks, working together with other small employers. The strategy also suggests that the Learning and Skills Council and the Basic Skills Agency support large, medium and small employers through creating more 'brokers' to facilitate a close and constructive relationship between employers and training providers.

Filling the advice gap

Even with good financial literacy skills, individuals still require advice to help them make the right decisions. Advice is needed not least to help people take a measured view of the short-term versus the long-term.

The need for good advice

An elderly woman sought advice from a CAB in Surrey about a loan she had taken out. She approached a high-street mortgage lender for a secured loan of £3,000. The lender advised her that the minimum they were prepared to lend was £25,000. The lender agreed to lend the client £25,000 as an interest only mortgage, but did not give her any advice on alternative sources of finance which might better match her requirements. As a result the client had £22,000 left over in her bank account. This meant she was no longer entitled to council tax benefit as she had capital over the limit for that benefit, and now had to pay full council tax. Whilst the client was pleased to have money left over, she really wanted a much smaller sum, and she was concerned that no one had explained the implications of taking out such a large amount to her.

A CAB in Merseyside reported that a lone parent on income support bought her council house after being told by a mortgage broker that he could arrange a mortgage on which the social security office would pay the whole mortgage payment as long as the amount did not exceed her then housing benefit entitlement. The client found out later that the social security office would not cover the capital. She sought advice when she could not afford the repayments.

A CAB in Yorkshire reported that a lone parent in receipt of income support with three dependent children sought advice from her bank in January 2003 as she could not afford the £48 per month repayments on a loan and the repayments on her credit card out of her weekly income of £166. The client was in a low emotional state at the time and was easily persuaded by the bank to take out a new loan of £9,000 with repayments of £209 per month. The client struggled for a few months to make the increased repayments, and then sought advice from the CAB in June 2003. The CAB commented that the bank should have referred the client for independent debt advice in January 2003 rather than make her debt problem worse.

An elderly man sought advice from a CAB in Wiltshire about his overdraft. It transpired that the bank had set up an ISA for the client to increase his savings paid by direct debit from his bank account. The client told the CAB that he had no recollection of agreeing to this and did not know what an ISA was. The client did not have sufficient income in his account each month to cover the direct debit, so the client incurred transaction charges of £72 per month, eventually making the account permanently overdrawn. When the client contacted the bank to sort the problems out, the bank suggested that he pay £35 per week from his retirement pension to reduce the overdraft. The bank did not discuss with the client the options of either stopping payments to his ISA or removing funds from his ISA to pay the debt.

The FSA has confirmed that the existence of a financial advice gap, stating there is ‘a mismatch between the needs of lower income consumers, who need good quality basic advice and an advice sector that in the main meets the needs of better-off consumers' (FSA 2002).

So how do we fill this gap? The Consumers Association (2002) has called for the establishment of a national Financial Advice network. These would involve three types of services: those in advice agencies including Citizens Advice Bureaux; those in the workplace or run by trade unions; and those in financial bodies such as banks and Independent Financial Adviser (IFA) firms. There are also some examples of good practice of which the Birmingham Settlement is one. Their 'Making Sense of Your Money' service offers information and advice on a wide range of issues from general money management to savings and investments. The aim was to experiment with a creative linkage of Money Advice and Financial Advice to test out cost effective ways to provide generic financial advice to the poorest households in Birmingham (Mayo 2003). They also offer several financial literacy projects, recognising that is it not sufficient to provide services to deal with debt crisis but that prevention and education are vital.

It is important to recognise that fulfilling the advice needs of low/middle income consumers will take financial advice in a new direction so far as the industry is concerned. Debt advice will far more crucial than is currently the case. This is not just relevant to the many people who have debt problems, whilst this is of course part of the story. Because of the growth in mortgage and unsecured debt and because of the way that the future developments are likely to offer even more potential to re-package debt, advice on debt and on overall financial management is likely to be a core component of any financial advice.

Given the unpredictability of many life events, investment returns and inflation and their impact of households' financial futures, getting good advice is by no means a guarantee of best outcomes. Financial advice that genuinely represents best advice at the time of delivery could often turn out to be sub-optimal because the assumptions made regarding life events etc prove to be wrong. Ultimately it is down to the individual to take a gamble on how long they will live or whether they stay married or how investment returns perform. We need to ensure that people understand this reality of financial advice and are protected as far as possible against advice that does not reflect their needs and attitudes to risk at the time of sale. Support is then needed to help them manage the responsibility they have taken on, such as through low-cost financial reviews.

There are three ways of providing advice to low and middle income groups:

- through the financial advice industry
- through trusted non-industry outlets using generic (non product-specific) advisers
- through financial industry advisers but provided through trusted non-industry outlets

Citizens Advice has undertaken research with the Financial Services Authority on the views of CAB advisers on the second option. The results, due in early 2004, will be valuable in assessing the feasibility and desirability of using generic advisers in trusted outlets such as Citizens Advice Bureaux. The problem with this approach is that generic advice takes the consumer so far but ducks out at the product choice stage. It is unlikely that a non-confident consumer will be able to make this choice unaided. We therefore think there are two inter-linked challenges: how do we ensure everyone can have access to generic advice and how do we fill the advice vacuum on affordable product-specific advice.

Preventative, generic advice

Providing generic advice can be done through a combination of interactive methods including talks, CD-ROMS, websites, questionnaires. A broad selection of both resources and outlets will be required. A lead agency with a budget and authority is also needed (the Financial Services Authority would be the most obvious choice).

It becomes more difficult and resource-intensive where that generic advice has to be followed up by tailored individual advice in a large proportion of cases and this inevitably leads to product-specific advice. There is a strong argument for product-specific advice remaining the domain of industry financial advisers. It is difficult to think of an alternative given that it would not be appropriate – nor would PI (Professional Indemnity) insurance allow – for example for CAB advisers to give product-specific advice.

There is also scope for employers to provide or facilitate the provision of advice and information on financial issues. Employer organisations and trade unions could support and promote this role. Perhaps there is also need for a 'Citizens Direct' to complement the Department of Trade and Industry's 'Consumer Direct.' This would be a national advice-line that aimed to meet people's needs as citizens as well as consumers. In relation to financial advice, it would offer generic advice on the different facets of financial inclusion.

Who delivers and who pays for product-specific advice

We have highlighted how the financial services industry is most appropriately placed to offer product-specific advice, but the needs of low/moderate income households are not being met. There is scope, as we have discussed above, for financial advisers to work with trusted intermediaries to access people, or for the workplace to act as a site for the provision of financial advice. A Citizens Advice pilot will facilitate financial advisers in providing limited advice within bureaux along the lines of pro-bono legal advice currently offered by solicitors. The key question is whether this model can be made widespread given it relies on financial advisers giving their time for free. It does not provide the answer to the central question of who is going to pay to fill the advice vacuum. The problem is that people on low/moderate incomes simply cannot afford personalised financial advice. Can government work in partnership with others to fund all or part of this cost? Is there more that the financial services sector might be able to do, perhaps through offering consumers the option of paying an hourly fee rather than commission and providing low-cost fixed fee financial health checks? But this is by no means the whole solution; further consideration needs to be given to this issue.

Availability of affordable credit

Access to affordable credit is an essential element of financial inclusion, one that is currently denied for many people. There is a clear market failure resulting in a lack of affordable credit for many people on low incomes. The Social Fund, the state safety net, fails to fill this gap. Access to affordable credit has to be looked at within the context of current trends in borrowing and of increases in problem debt or over-indebtedness.

Borrowing by consumers has grown rapidly in the UK over recent years. In the year to November 2002, residential mortgage borrowing increased by 13 per cent and consumer credit increased by 15.4 per cent (FSA 2003). Some people think we are experiencing the 'normalisation of debt'. It is the FSA's view and others that 'household indebtedness is growing at an unsustainable rate' (FSA 2003). Citizens Advice Bureaux have dealt with a 44 per cent increase in the number of new consumer credit debt enquiries over the last six years. They record over one million new debt enquiries per year of which the vast majority are consumer credit problems. Changes in personal circumstances are the most important trigger for getting into debt problems. For many, the level of commitments relative to their income is such that small changes in their circumstances turns what were previously manageable payments into debt problems.

Debt

A client of a CAB in Staffordshire contacted her mortgage lender when she got into difficulties paying the mortgage and an unsecured loan. The lender was unwilling to reduce payments on either the mortgage or the loan, and insisted that either the client take out additional loans to pay the arrears or go bankrupt. When the client explained that she had been unable to sort her problems out due to one of her children being admitted to hospital, the lender told her that the debt should be her number one priority not her sick child. The lender also sent the client a letter at her place of employment which was not marked confidential, so anyone could have opened it.

A lone parent on income support sought advice from a CAB in West London. He had got into debt when he became a lone parent, because he was unable to continue self-employment. The client, who owed £18,000 in total, told the CAB that he has kept in constant contact with his creditors but felt that the only realistic option for dealing with his debts was bankruptcy. The client had been trying to save up for the £250 bankruptcy deposit fee for eight months, but had found it impossible because emergencies kept cropping up, such as buying new shoes for his daughter.

A pensioner woman told a specialist CAB money advice service in Yorkshire that she felt so pressurised by phone calls from her creditors that she had unplugged her phone and put it in a drawer as the only way of coping with the pressure. Even after she had gone bankrupt, one creditor continued to phone her several times a day about the debt. The client, who had to cope with a severely disabled partner, found it impossible to manage with the additional pressure from her creditors.

A CAB in North Yorkshire had been helping a disabled man who was no longer able to work renegotiate payments on a bank loan. The bank had initially accepted reduced repayments and stopped interest, but subsequently threatened to recoup the debt at a higher rate by appropriating the client's disability living allowance which was paid into his bank account.

The DTI over-indebtedness task force has defined over-indebtedness as 'when income is insufficient to cover reasonable living expenses and meet financial commitments as they become due' but also incorporate 'consumers with commitments bordering on the unmanageable' (DTI 2001). Although over-indebtedness is a problem faced by all income groups, those on low-incomes are more at more risk.

The issue of reform of the loans component of the Social Fund needs to be placed in the context of preventing over-indebtedness and providing access to affordable credit. Many people on low incomes, who either do not approach or are turned down from the Social Fund are also denied access to mainstream financial providers. Instead they often rely on expensive alternative credit providers. This can range from door-to-door legal alternative credit providers through to Pawnbrokers and illegal moneylenders.

Perhaps the most discussed cost of financial exclusion is extortionate credit. The government has recognised this and recently consulted on making the extortionate credit provision within the Consumer Credit Act 1974 more effective. Not all door-to-door and sub prime lending is necessarily bad. Evidence of satisfaction among customers, albeit provided by the industry, is high. Independent research supports the view that alternative credit providers provide a service that people want. But the fact remains that some, maybe many people, do use expensive forms of credit because they do not have access to or feel uncomfortable using mainstream forms of credit. People on low incomes can be very vulnerable to unscrupulous practices such as praying on limited understanding and using high pressure sales techniques. The answer will not be found in capping the interest rates charged but by offering low income households more choices.

Extortionate credit

A CAB in Gloucestershire reported that a man with other debts borrowed £350 at 212% APR to buy Christmas presents for his children. The lender took the client's car log book and MOT certificate as security for the debt. The client found it very difficult to make the payments, but at the time of seeking advice was unaware of the interest charged on the loans and the implications for non-payment: loss of his car.

A man sought debt advice from a CAB in Staffordshire. He needed to buy a car for work, but could not get a bank loan due to a poor credit history. The client went to a garage which advertised it could help people buy cars even if they had a poor credit history. The client bought a car costing £9,200 with a hire purchase agreement at 42.9% APR. Insurance, including payment protection insurance and a warranty, was included in his payments of £399 per month. The total the client would pay under the agreement was a staggering £19,000. However the client began to experience problems with the car immediately. The car was delivered to his home dented and untaxed. Two months later the clutch broke, but the client was unable to claim on the warranty as it was excluded from the insurance. Six months later the client lost his contract and claimed on the payment protection insurance. However, as he had been self-employed, his claim was refused. Eventually the client returned the car to the hire purchase company.
A man sought advice from a CAB in Suffolk about settling a loan early. He had borrowed £500 at an APR of 96% due to a poor credit rating. When he approached the company about early settlement, they told him that they would charge nearly all of 12 months' interest.

A CAB in Lancashire reported that a single man in full time work borrowed £240 from a company that advertises in national newspapers to see him through to his next payday. The terms of the agreement were such that he had to pay the loan in full plus £60 interest the following month. The APR was quoted as 752.8%. The client was unable to keep to the terms of the agreement and was paying £60 interest per month. At the time the client sought advice he had been paying interest only for the last six months and could not afford to save enough from his wages to repay the principal.

A CAB in Hampshire reported that a couple on a low income contracted to have double-glazing installed on their house. The price agreed (£10,800) was twice that they needed to pay, but they were persuaded to enter a credit agreement to pay for it by a promise by the double glazing supplier to pay for the use of the property in advertising which would have reduced the amount to £4,800. However the supplier's payments ceased after the first £500, and the clients fell into arrears.

We focus on two key challenges if extortionate lending is to be foiled: reforming the Social Fund and reforming the market.

Social Fund reform

Of course the answer to increased levels of problem debt will be multifaceted, requiring regulation of providers, ameliorative measures and better financial education and advice. There is a real need to deliver an alternative to expensive credit providers. Reform of the Social Fund is part of providing this alternative. There is a powerful case for reforming the Social Fund. Anyone who has spent time analysing the policy, has concluded the Social Fund is failing; failing people on low incomes, failing the financially excluded and failing a centre left government. There has been some additional resources committed to the Social Fund, but of the welfare architecture inherited by this government it stands out as being virtually unreformed.

When the then Social Security Select Committee investigated the social fund, they concluded that: 'the scheme in its present format needs urgent overhaul and an injection of funds. Without such action, there is a strong possibility that the wider social policy objectives of the Government will be endangered.' (SSSC 2000)

Other recent reports, for example a recent Citizens' Advice study, have argued that the failings of the Social Fund was forcing people into the hands of expensive alternative credit providers (Citizens Advice 2002). The New Policy Institute and an alliance between the Child Poverty Action Group, the National Council for One Parent Families and the Family Welfare Association have also recently published proposed reforms (NPI 2002; CPAG, NCOPF & FWA 2002). All have broadly agreed on the nature of the fundamental problems.

- Cash limited budgets mean that many people who are in need do not receive help, and whether people receive funds can be a post code lottery.
- Over-reliance on loans can mean that benefit claimants have deductions made from already low benefit incomes, thereby increasing poverty.
- The system is inflexible and often information is lacking and people are not aware of their eligibility.
- Decision-making is difficult with high levels of discretion often resulting in wrong and unfair decisions being made; a high proportion of outcomes are overturned on appeal.

The Social Fund is designed to provide very low-income households with support at times when they have one-off 'lumpy costs'. It does this through a mixture of different forms of provision. Often in debate the whole social fund is collapsed into a single entity and therefore a single issue. But this can be misleading; to be clear about the nature of the problem faced we need to distinguish between the different elements of the fund and different possible reforms. There are two obvious distinctions which need to be made; firstly between *discretionary* and *regulated* elements of the fund and secondly between provision of lump sums through grants or via loans.

Regulated benefits are those to which people are entitled as of *right*. There is no cash limit to the budget available and so long as someone establishes their they will receive the benefit. The regulated part of the Social Fund is largely made up of grants for specific purposes: for example, winter fuel payments, the sure start maternity grant and funeral payments. A small proportion of Social Fund funds flow through regulated payments. In contrast the discretionary section of the fund is cash limited; local benefits offices have a fixed budget, allocated on the basis of a complicated formula. This means that even if people present themselves to the benefits office and demonstrate that they meet the criteria, they might not receive the payment. Receipt of the money is conditional on there being money left in the budget. It is this element of the fund that people have most reservations.

Within the regulated element of the Social Fund, all money is distributed in the form of grants. This is not the case for the discretionary part of the fund. Instead there are two systems of loans (Budgeting Loans and Crisis Loans) and one system of grants (the Community Care Grant). In terms of gross expenditure this is by far the most significant part of the fund, although the net cost is much less substantial for the simple reason that the loans element is repaid.

In the context of affordable credit, we focus on the discretionary – grants and loans – element of the Social Fund. Too often the debate about grants versus loans is simplified into an 'either-or' discussion and there is a tendency to say grants are always a good thing and loans are disproportionately blamed for the Social Fund's ills. Some have suggested a return to the single payments system, which was in place before 1988 (Conaty and Palmer 2002); others have devised new forms of grants such as 'inclusion funds' (CPAG, NCOPF and FWA 2002).

The Social Fund: nobody's friend

Cash-limited budgets
A CAB in Hampshire reported that a man with health problems was released from prison with one inadequate set of clothes, including a pair of shoes with holes in the soles. The client applied for a social fund loan for £346 for clothes, but was turned down. On review he received £83. The reasons for the social security office's decision include the fact that the social fund budget had been overspent and that one set of clothes was sufficient.

Over-reliance on loans
A pregnant woman aged 20 sought advice from a CAB in Lancashire about the local social security office's refusal to grant her a community care grant. She was in receipt of income support and needed the grant to furnish a council flat. However her application was rejected on the grounds that her circumstances were not high enough priority, even though the client informed them on the application form that she had a social worker because her eldest child had been taken into care soon after birth, as she could not cope. The CAB felt that if the client did not get the basic essential furniture for her home, there would be a strong possibility that her new baby would be taken into care.

A CAB in Buckinghamshire reported that a lone parent on income support sought advice about how she could replace her cooker which had broken down. The client had no savings with which to pay for a new one, grants were not available and she cannot afford to repay a social fund loan.

Lack of information/poor advice
A CAB in Wiltshire reported that a lone mother on IS, with a son of 8 needed help with removal expenses and the cost of new furniture. The Jobcentre Plus office advised her to apply for a crisis loan, and did not suggest a community care grant for which she may well have qualified. The crisis loan was refused and she was barred by the social fund rules from applying for a community care grant for the same items for 6 months.

High repayment rates/amounts offered
A CAB in North London reported that a family of three were allocated an unfurnished flat. They applied for a loan of £1,770, but were only granted £643. The clients were told they would have to repay the loan by instalments of £21 per week. The clients protested that they could not afford this and have asked for the repayments to be rescheduled over a longer period.

Need to widen access
A CAB in Kent reported that a working couple on a low income had been allocated an unfurnished housing association flat after staying in bed and breakfast accommodation. The clients applied to the local social security office for a crisis loan to buy furniture, but were refused. When the CAB rang the social security office, they were told that the clients had to try all alternative sources of credit before a crisis loan would be offered.

It is our view that, particularly given limited government resources, any reform should continue to use a *mix* of grants and loans. To date there has not been a coherent clearheaded debate about the correct blend of grants and loans in the Social Fund. The most fruitful attempt to date was made by the then Performance and Innovation Unit, which examined the use of loans across government departments (PIU 2002). This PIU report aimed to devise a series of criteria to assess the use of loans. Once a clear policy objective has been identified, it concluded that loans can be an appropriate response either helping to achieve greater equality, or in some ways to correct a failure of the market to provide effectively. Loans potentially have a number of advantages. These include:

- being efficient and helping to reduce costs;
- potentially targeting resources effectively;
- providing positive incentives, such as encouraging people to make best use of the money;
- being empowering and changing behaviour.

The first two points above are conditional on there being a reasonable expectation that the borrower will be able to repay the loan. The fundamental critique of a loans-based Social Fund is that this is not the case for people on low incomes and that the Social Fund can lead to over-indebtedness. But if repayments are made more affordable, the rest of the PIU's criteria do seem to stack up. Further work is needed in this area but we suggest how the loan element of the Social Fund could be transformed into a 'social lender'. The government can use its weight to offer an alternative at the extortionate end of the market.

The key elements of this 'social lender' model might be:

- Expansion of access and eligibility of loans: making the fund available to other people on low incomes in addition to those in receipt of Job Seekers Allowance and Income Support and ending its cash-limited nature so that any one in need would get access.
- Delivery through a public interest company which administers the fund and which has a pivotal role within a network of local trusted intermediaries who raise awareness within their communities.

The drawback with the first of these is cost. Some on-going resources would be needed to keep loans affordable but it need not be hugely expensive. Currently, the net cost of the loans section of the social fund is relatively low. There is a high recovery rate. In 2001/02, £547 million was lent out to people, £502 million was recovered. Recoveries provided over 92 per cent of the funds needed to meet gross loans expenditure. There is a high administrative cost of around £250 million a year. There might be some reason to suggest that if the policy were extended to more people that, benefiting from economies of scale, these costs would remain relatively fixed. As far as possible the loans section of a reformed Social Fund should be self-sustaining. It might even be possible to charge a nominal rate of interest on some loans to cover administrative costs and any loans, which are not recovered.

This revamping of the Social Fund as a more extensive social lender does not remove the need for grants, particularly for very low income households reliant on benefits who would struggle to repay loans. The benefit system is effective at helping people when they in a steady state but less so when there is a change of circumstance or when in a transitional phase (for example, during separation or divorce, or moving into/out of work). The strategic use of benefit grants is worth further consideration. One option for the reform of Social Fund grants warranting further thought is to link them more directly to life event or life stages (CPAG, NCOPF and FWA 2002). A more radical option is to provide individuals with a 'life account' which is a pot of assets which can be drawn on over a life-time (Paxton and Regan 2001) and potentially for this to become a 'welfare savings account' in to which individuals also make contributions when they are able (Paxton 2003).

The first step has to be for the government to engage in this debate which they have to date been reluctant to do. Can continuing to do nothing, in the face of such overwhelming support for reform, really be an option?

Reforming the market

There is clearly a bigger debate about over-indebtedness and problem debt which extends far beyond both the Social Fund and the availability of affordable credit. Two things that market could do better is to provide more affordable products and lend responsibly to help avoid over-indebtedness. In relation to the bigger picture of over-indebtedness a cross-cutting government review has been called for (Citizens Advice, 2003) and, at the time of writing, a strategy on over-indebtedness was expected as part of the Consumer Credit White Paper.

There is a cumulative effect whereby the most vulnerable consumers, who tend to present the highest risk to lenders, are more likely to be channelled towards the least respectable end of the market and are, therefore, subject to the most questionable lending practices (DTI, 1999). Often, it is low-income earners, who do not have a credit history with a mainstream lending agency, or those who require small loans at certain times for specific purposes, who use expensive forms of credit.

However, this is an over simplification. As well as push factors (away from mainstream financial institutions) there are also pull factors, which draw people to alternative providers. For many people it is a rational decision to opt for an expensive source of credit. The service given by alternative credit sources, with convenient door-to-door lending, one-to-one personal contact and simple product design is positively valued. Recent research concluded:

> It was clear...that people were attracted by credit services that were simple and straight forward, that were easily understood, that offered a quick decision on a loan, whose application procedures were uncomplicated, that offered weekly or regular repayment facilities and were flexible about the occasional missed payment (Jones 2001).

Codes of practice for banks and other credit lenders should include commitments to assess the borrower's ability to repay before lending. The Office of Fair Trading (OFT) should provide guidance until this becomes a legal duty (Citizens Advice 2002).

Irresponsible lending

An elderly widow sought advice from a CAB in Kent about a credit card debt. She had approached her bank asking for a temporary overdraft facility to cover a vet's bill which might exceed the funds in her account. The bank instead persuaded her to take out a credit card, but did not explain the implications to her. In particular the client did not understand the implications of using the credit card cheques sent to her, which attracted a higher interest rate. She thought that they were ordinary cheques which would clear through her bank in the normal way. The client could not afford the increasing repayments, and the bank was adding interest and late payment charges on to the debt. The client was worried about the threatening tone of the letters she was receiving from the bank.

A CAB in Buckinghamshire reported that a man sought advice from his bank about his inability to repay his credit card and loan debts when he lost his job. The bank suggested a £15,000 consolidated loan on a buy now pay later basis, although his only income was £54 per week jobseekers allowance and they must have been aware from his current account records that he only had ever been in low paid work. The repayments were due to start two months later at £410 per month.

A CAB in Kent reported that a woman who was off work waiting to have an eye operation went overdrawn on her current account. The client went to her bank to explain that she would be off work for some months to recuperate and until she went back to work, her only income would be statutory sick pay of £64 per week. The bank first offered her a bridging loan and then advised her to apply for a credit card to clear the overdraft. The client took the forms away with her to consider, but decided she did not want to borrow any more money. Nevertheless, the bank staff called her at home on four occasions and asked her to visit the bank branch again. The client did so and was pressured into completing the credit card application form by three members of staff who stood round her. As their credit score showed that she was not earning sufficient money to qualify for the new lending, the bank staff told her to exaggerate her income. The client told the CAB she did so in order to leave the bank as soon as possible as she felt very upset.

Alternatives to high cost credit for people on low incomes should also be developed. There is scope for lenders to develop low cost transparent credit products aimed at people on low incomes. Then, as we have suggested, those people whose needs cannot be met through the market should be helped through a transformation of the social fund into a social lender. This must all sit along side measures discussed previously to improve financial literacy, consumer education and the provision of advice.

Effective delivery agents

The remaining challenge we explore is about delivery. The ambition of full financial inclusion will only be realised through a variety of stakeholders 'upping their game'. The role of government and the public, private and voluntary sectors need to be revisited. So far, we have illustrated the different functions that different agents currently play. An over-arching national strategy and leadership is lacking and this should be pursued, but success will require different stakeholders to work together in new ways. We set out here some ideas for better delivery of financial inclusion policy and practice.

Trusted intermediaries

Cutting across all of this is the challenge of ensuring that products reach and engage people. Banks have some obstacles in tackling financial inclusion which are difficult to overcome, particularly due to a general lack of trust and specifically in relation to people on low incomes who can often feel uncomfortable and unconfident dealing with mainstream banks. Branches may also not exist in certain areas presenting an additional outreach obstacle.

It has been argued that community-based organisations and voluntary sector organisations would be good at filling this gap. They bring a number of benefits to the table:

- they tend to be more trusted and familiar;
- they are not-for-profit and have a value-based commitment to reach all people in their communities;
- they have greater links and knowledge of their local communities, and are able to use this to help 'reach' people and engage them;
- they often have a physical presence even in the most disadvantaged communities.

So community and voluntary sector organisations are well placed to play a more significant role in providing appropriate 'outreach' to get to people and to act as trusted intermediaries. However there are barriers that need to be overcome and drawbacks. These include:

- geographical coverage of appropriate community and voluntary sector organisations;
- the capacity of such organisations;
- the training needs to enable such organisations to be partners in financial inclusion, and the potential costs of this role.

To achieve the ambition of full financial inclusion, then we need to make sure that everyone who needs to can access financial services via a trusted intermediary. If we include a wide range of organisations in our definition of trusted intermediary, which includes advice agencies, housing associations, credit unions and other community-based organisations, then coverage is fairly extensive, particularly where the outreach function is needed most. It would helpful for the Government to carry out a comprehensive analysis of existing coverage across the country and be able to identify where different regions and communities have thin coverage, and encourage development in these areas.

Where organisations do exist there is then a need to ensure they have the capacity to play a role in financial inclusion. This is part of a wider debate on enhancing the role of the community and voluntary sector in delivering services. This ultimately requires greater investment in existing organisations and the expansion of community and voluntary sector organisations into new areas.

Commitment from the private sector

The relationship between the Government and the financial services sector has changed over time. The development of Universal Banking Services has led to greater dialogue and co-operation but has this set the stage for greater involvement of the banking sector in tackling financial exclusion, or have they had enough?

In the foreword to PAT 14, Melanie Johnson, the then Economic Secretary to the Treasury made a not so veiled threat to the banking industry. She said that the Government will work with the banking industry and that they do not want to have to legislate to compel banks to serve all sections of the community. 'But if voluntary action is unproductive and monitoring shows insufficient progress, it may be necessary to consider other options.' (PAT 14 1999)

There has been little work in assessing the overall business case for banks doing more to tackle financial exclusion. It is already an issue with selling basic bank accounts where the business case is perhaps weak. This is however taking a very limited view of the business case. A more intelligent view of the business case is needed. This view recognises that all banks benefits from a more financially literate population and see their responsibility in bringing this about, or recognise that people on low incomes can provide a market for their products and services. Witness the increased number of companies who are moving into the sub-prime lending sector.

Some banks already play a role or lead financial inclusion initiatives and we need to learn more about their reasons for doing this and spread this practice to other banks. The Government also needs to have a clear idea of where the limits of banks self-interest lie. Policymakers should ask another question: what can the banks do *well* which they may need encouragement or incentives to do so? Where the business case is not providing a powerful enough impetus to develop a financial inclusion strategy, incentives – such as a financial inclusion tax credit – and even coercion through regulation may need to be considered. Much of this depends on what a desirable and achievable role is for banks and on what their responsibilities are to their customers and potential customers. More research is needed to define these and to explore how strategies to reduce financial exclusion can be mainstreamed into the activities of banks.

Financial inclusion agencies

The appropriate development of Universal Banking Services could provide the bedrock of new types of partnership at a local level to encourage and enable people to use financial services effectively. The long-term aim of Universal Banking Services is then about acting as a key stakeholder in financial inclusion, not just to help some more people open bank accounts. Ultimately, the key challenge is to incentivise a mix of private, public and voluntary sector partners to work together. A range of local initiatives have developed in response to the needs of local communities. Cambridge Housing Association, Portsmouth Area Regeneration Trust, the Westerhailles Community Banking Agreement and SAFE at Toynbee Hall are all such examples. They all rely on a partnership approach that utilises the comparative advantages of each partner. These local initiatives show what can be achieved to tackle financial exclusion.

These initiatives are however few and far between. We think there is scope to learn from these initiatives to develop a good practice model which could evolve into the concept of *financial inclusion agencies*.

Financial Inclusion Agencies would be local partnerships between the banking sector, the local authority and community-based organisations. Recent research (Collard, Kempson and Dominy 2003) has shown that many people prefer to deal with locally-based organisations partly because of easier access but also because of the mistrust in the involvement of both financial service providers and government. However, they also wanted products and services to be delivered by established providers with well-trained staff. Consequently, the research showed that most popular is a partnership model between community organisations and a financial service provider or government.

Financial Inclusion Agencies could become a network of partnership bodies where all partners are members and with central government providing funds to initiate and secure on-going commitment. Each Financial Inclusion Agency would look at local solutions to delivering complementary set of choices and services to people who are financially excluded. They would endeavour to join-up financial inclusion services at a local level. Savings from Direct Payment could be put into a financial inclusion fund to support their development.

6. Making full financial inclusion happen

Tackling financial exclusion should be a priority for government. Without access to and understanding of financial services, individuals cannot operate fully in today's society. Financial exclusion is hindering the achievement of other government objectives in welfare reform and poverty alleviation. If there is to be a concerted drive to tackle financial exclusion, two key central elements of a new strategy are needed:

Joined–up government and a political champion

A consistent criticism of policy making in this area is that it is not sufficiently 'joined- up'. After the publication of PAT 14, different issues disappeared into different departments and are now being pursued almost as unrelated issues. The Department of Trade and Industry are active in relation to over-indebtedness, Treasury is developing savings policy and the Department for Work and Pensions (with the Inland Revenue) are leading on Universal Banking. Unsurprisingly this is not adding up to a coherent and effective strategy.

Better coherence across government might be achieved by a central unit such as the SEU revisiting PAT 14 with the engagement of all relevant departments. Joint targets on financial inclusion might galvanise departments to work together or a regular cross-departmental meeting or sub-cabinet committee which monitor and promote the issue.

Experience has shown that issues that get the buy-in across government often have a political champion who makes the links with other political priorities. As we have discussed, there is a strong political argument which links financial inclusion to many of the key themes running through government thinking. The problem of financial exclusion is embedded in debates on poverty and social exclusion, and the solution is to be found in debates about positive and innovative partnerships between the state, private sector and voluntary non-profit sector. A political champion is needed to make this case across government.

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