

Financial Services Authority

In or out?

Financial exclusion:
a literature and research review

Contents

Foreword	5
Preface	6
Acknowledgements	6
Author	6
1 Introduction: the context	7
Social exclusion	7
<i>Recent policy developments</i>	8
Financial exclusion	9
<i>Locating financial exclusion within the social exclusion debate</i>	9
About this review	10
2 The context of financial exclusion	11
Social and economic factors	11
<i>Incomes and income distribution</i>	11
<i>Labour market changes</i>	12
<i>Demographic changes</i>	13
<i>Housing policy and tenure shifts</i>	14
<i>Welfare and fiscal reform</i>	15
Financial services markets	15
<i>Restructuring of financial services</i>	15
<i>The re-regulation of UK financial markets</i>	15
<i>Developments in information technology</i>	16
<i>The 1990s recession</i>	16
<i>The impact on access to financial services</i>	16
<i>Product development</i>	17
<i>Risk assessment</i>	17

<i>Market segmentation</i>	17
<i>Mis-selling</i>	19
<i>Delivering financial products</i>	19
Overall impact of recent changes	20
3 Who is affected by financial exclusion and why?	21
Households with no financial products at all	22
Bank accounts	26
<i>Who lacks a bank or building society account?</i>	27
<i>Reasons for not having a bank or building society account</i>	28
<i>Geographical access to bank and building society branches</i>	30
Savings	31
<i>Numbers of people without formal savings and investment products</i>	31
<i>Who is without formal savings?</i>	32
<i>Reasons for not saving</i>	33
<i>Informal saving</i>	33
Insurance	35
<i>Who is without insurance?</i>	35
<i>Reasons for not having insurance</i>	36
<i>Affordability</i>	37
<i>Products and delivery mechanisms</i>	37
<i>Conditions</i>	37
<i>Lack of knowledge</i>	37
<i>Not got around to taking it out</i>	38
<i>Do not want insurance</i>	38
Pensions	38
<i>Groups with inadequate pension provision</i>	39
<i>Reasons for not having a private pension</i>	40
Credit	41
<i>The number of people without access to credit</i>	41
<i>The non-status lending market</i>	42
<i>The alternative credit market</i>	42
<i>The characteristics of people who do not use mainstream credit facilities</i>	43
<i>Non-status borrowers</i>	44
<i>People borrowing from alternative sources</i>	44
<i>Reasons for not using mainstream credit facilities</i>	44
<i>Non-status borrowers</i>	44
<i>People borrowing from alternative lenders</i>	45

4	Barriers to inclusion	46
	Access	46
	<i>Geographical access</i>	46
	<i>Access for people with disabilities</i>	47
	<i>Risk assessment</i>	47
	<i>Current accounts</i>	47
	<i>Consumer credit</i>	47
	<i>Insurance</i>	48
	<i>Racism</i>	48
	<i>Marketing</i>	48
	Lack of appropriate products	49
	Affordability	50
	Financial literacy	50
	Psychological barriers and mistrust of suppliers	51
	Language and cultural factors	51
	Impact of government policy and regulation	52
5	The consequences of financial exclusion	53
	Banking facilities	53
	<i>Handling cash and cheques</i>	53
	<i>Bill payment</i>	54
	<i>Access to other financial products and services</i>	55
	Credit facilities	55
	<i>The consequences of borrowing from non-status lenders</i>	55
	<i>The consequences of borrowing from alternative credit providers</i>	56
	Insurance	56
	Pensions	58
	Savings	60
	<i>Being without formal savings</i>	60
	<i>Being without savings altogether</i>	60
	The impact on communities	61
6	Financial exclusion in the United States	63
	The extent of financial exclusion	63
	<i>Deposit accounts</i>	63
	<i>Mainstream consumer credit</i>	66
	<i>Pensions and savings-oriented life insurance</i>	67
	Causes of exclusion	68
	<i>Deposit accounts</i>	68
	<i>Prime credit from mainstream lenders</i>	70
	<i>Pensions and savings-oriented life insurance</i>	72

The consequences of exclusion	73
<i>Deposit accounts</i>	73
<i>Credit from mainstream lenders</i>	73
<i>Pensions and savings-oriented life insurance</i>	75
Public and private-sector responses to the problem	75
<i>Deposit accounts</i>	75
<i>Credit from mainstream lenders</i>	76
<i>Pensions, savings-oriented life insurance and other savings products</i>	77
Conclusions	78
7 Overcoming financial exclusion	79
Increasing access	79
<i>Geographical access</i>	79
<i>Supermarkets</i>	80
<i>Post offices</i>	80
<i>Not-for-profit organisations</i>	80
<i>Community banks</i>	82
<i>Local exchange trading schemes</i>	82
<i>Local government and housing associations</i>	82
<i>Accessibility for people with disabilities</i>	83
<i>Risk assessment</i>	84
<i>Racism</i>	85
Appropriate financial products	85
<i>Bank accounts</i>	85
<i>Savings products</i>	86
<i>Pensions</i>	86
Affordability	87
Financial literacy and combating psychological barriers	87
Regulation	88
Monitoring financial exclusion	89
References	92

Foreword

The Financial Services Authority (FSA) is to be given a statutory role to secure protection for consumers and to promote the public's understanding of financial services and products. Research on consumers and their use and understanding of financial services will play a key part in helping to fulfil this role.

There has been a growing interest in what is termed financial exclusion. This was given impetus by the Social Exclusion Unit (SEU) set up by the incoming Labour Government in 1997. The SEU established a number of Policy Action Teams (PATs) to investigate and report on specific areas of social exclusion. PAT14 was tasked with looking at financial exclusion, and the FSA was closely involved in its work.

While the FSA will not have a statutory role in addressing financial exclusion per se, it will have a responsibility to secure appropriate consumer protection in a way that takes into account the differing experience and expertise of consumers. The FSA must, however, regulate in a way which is not unduly burdensome and which does not impede competition.

Without understanding the causes and impact of financial exclusion we risk excluding some of those who are in the most need of the protection offered by the new regulatory regime. With this in mind the FSA commissioned specific research from the Personal Finance Research Centre at Bristol University to provide us with a comprehensive review of current research and action on the topic. The report provides us with a means of identifying areas where our efforts could best be focused as well as providing a useful reference document for others. In order to make the review as comprehensive as possible it includes work in Europe and North America.

Our policy is to publish the outcome of the substantive research we commission in order to promote debate on consumer issues. We hope that others will also find this review a useful contribution to the understanding of financial exclusion, its definition, causes and consequences.

Christine Farnish
Director, Consumer Relations Division

Preface

The Personal Finance Research Centre was established in 1998 as part of the School of Geographical Sciences at the University of Bristol. A wide range of research is undertaken by the Centre on developments in all areas of personal finance and explores the implications for individuals, households and communities, as well as financial services providers and central and local government.

The Centre has completed an extensive range of research projects on household money management and financial decision-making, particularly among low-income households and benefit recipients. A great deal of its recent research has focused on people's access to, and use of, credit and other financial products.

Acknowledgements

We would like to thank a number of organisations without whose help this research could not have been completed.

First, we are very grateful to the Financial Services Authority for providing the funding for this research. We would also like to thank the many consumer organisations, trade associations and government departments that assisted us in identifying, and in some cases providing, literature for the review. In particular, we would like to thank the following organisations that provided us with extensive help on the project: Association of British Insurers; British Bankers' Association; Building Societies Association; European Commission DG 24; and Institut National de la Consommation.

Finally, we would like to thank Catherine Sumpster at the Personal Finance Research Centre for her hard work compiling the literature for the review.

Author

The review was compiled and written by:

Elaine Kempson, Claire Whyley, John Caskey and Sharon Collard.

Elaine Kempson, Claire Whyley and Sharon Collard are based at the Personal Finance Research Centre, University of Bristol.

John Caskey is based at Swarthmore College, Pennsylvania, USA.

The study was managed at the Financial Services Authority by Errol Walker, Consumer Policy & Research Department.

Tel: 020 7676 0814; e-mail: errol.walker@fsa.gov.uk

1 Introduction: the context

- 1.1 Once the preserve of the rich, financial services are now a mass market. Access, however, is far from equal and around 1.5 million (7%) households in Britain lack any financial products at all. A further 4.4 million (20%) are on the margins of financial services and usually have little more than a bank account. Between a quarter and a third of people have no savings, lack home contents insurance or do not have a private pension (Kempson and Whyley, 1999a). Moreover, the likelihood of being on the margins of personal financial services is concentrated both geographically and among certain groups of people. As such, it forms an important component of a much wider social exclusion. The people who lack access to financial services are frequently also excluded in other ways, and financial exclusion often reinforces other aspects of social exclusion.
- 1.2 As a consequence, financial exclusion is currently of widespread interest – to government, the financial services industry and consumer groups. The Financial Services Authority (FSA) has a particular interest from several important standpoints. First, it has a remit to improve consumer information and education and, generally, to raise levels of financial literacy. Secondly, as part of the regulation of the financial services sector, the FSA must have regard to the impact of regulatory requirements on the most disadvantaged or vulnerable sectors of society. Thirdly, the report of the Treasury-led Policy Action Team on access to financial services has recommended that the FSA conduct research into groups likely to be subject to financial exclusion (HM Treasury, 1999a).
- 1.3 Before embarking on fresh research, the FSA commissioned the Personal Finance Research Centre to produce an overview of existing research, covering the period since 1995.¹ The overall aims were to identify the extent, nature and causes of financial exclusion and to set these within an overall context of social exclusion and to identify the barriers to inclusion and ways of tackling them.

Social exclusion

- 1.4 Social exclusion is a term that is much used in European policy debates, but which has only relatively recently gained currency in the UK. Although it has clear links with earlier debates about poverty, disadvantage and deprivation, social exclusion is a much broader concept which,

is a shorthand term for what can happen when people or areas suffer from a combination of linked problems such as unemployment, poor skills, low incomes, poor housing, high crime environments, bad health, poverty and family breakdown.
(From website, <http://www.cabinet-office.gov.uk/seu/index/faqs.html>)
- 1.5 As these dimensions of social exclusion are typically interrelated, each one increases the likelihood of the others (see, for example, Rogaly et al., 1999).

1 The main focus is research relating to the UK, although it also covers key research in the United States.

- 1.6 Three core elements of social exclusion are commonly identified, although the analysis of them differs between commentators. They are:
- Low income related to employment status, for example lack of employment opportunities and low levels of benefit among people not in work.
 - Lack of access to services such as education, vocational training, health care and financial services.
 - Poor environment, including poor housing, deprived neighbourhoods and difficult family life.

Together, these factors can lead to social exclusion, or what the government describes as a ‘cycle of disadvantage’, the effects of which can persist throughout people’s lives and be passed between generations (Department of Social Services, 1999).

- 1.7 Burchardt et al. (1999), using panel data from the British Household Panel Survey 1991-1995, concluded that there is no distinct group of completely excluded individuals. Their study tracked a range of possible outcomes, one of which was savings, and they found few individuals who were excluded on all dimensions in any one year. Even fewer experienced multiple exclusion for all five years. The researchers conclude that it is preferable to treat the different dimensions of social exclusion separately rather than thinking about social exclusion in terms of a single homogeneous group (Burchardt et al., 1999).

Recent policy developments

- 1.8 Soon after it took over power, in December 1997, the Labour government established the Social Exclusion Unit. The Unit’s remit was to improve government action to reduce social exclusion by producing ‘*joined up solutions to joined up problems*’. In fact, the bulk of the Unit’s work has revolved around the development of a ‘national strategy for neighbourhood renewal’.
- 1.9 The Unit’s initial report, *Bringing Britain Together: a national strategy for neighbourhood renewal*, was presented to Parliament in September 1998. Subsequently, 18 Policy Action Teams were established to follow up aspects of the report during 1998 and 1999. Most of the Policy Action Teams’ reports have now been published, including one on *Access to financial services* produced by Policy Action Team 14 (HM Treasury, 1999a).
- 1.10 The work of the Policy Action Teams is currently being taken forward in the *Poor Neighbourhoods* initiative. Leading on from this, a strategy for neighbourhood renewal is to be produced for consultation in spring 2000.
- 1.11 The Social Exclusion Unit’s remit only covers England, and similar initiatives are underway in Wales, Scotland and Northern Ireland.
- 1.12 The National Assembly for Wales has issued a policy statement *Building an inclusive Wales*, which sets out plans for an annual report monitoring changes in key indicators of exclusion in Wales (Welsh Office, 1999).
- 1.13 The Scottish Social Inclusion Strategy established a programme of work to be taken forward by five Social Inclusion Action Teams (Scottish Office, 1999). The teams cover: local anti-poverty action; excluded young people; inclusive communities; evaluation and indicators; and ‘making it happen’, the remit of which was to consider examples of good practice, explore the opportunities presented by new organisational arrangements, and make recommendations about ways of overcoming barriers to promoting social inclusion. Each team produced a report by the latter part of 1999.

1.14 In Northern Ireland, the *New targeting social need* initiative aims to tackle social need and social exclusion by targeting efforts and available resources on the most disadvantaged people, groups and areas. The first Annual Report was published in November 1999, and includes draft action plans, which show how government departments will implement the initiative over the following three years (Northern Ireland Executive, 1999).

Financial exclusion

1.15 Early discussion and analysis of financial exclusion pre-dates these social exclusion developments and focused predominantly on issues of *geographical access* to services and to banking outlets in particular (Leyshon and Thrift 1993, 1994, 1995). At the root of this type of financial exclusion are three related factors. First, over the past decade there has been a considerable reduction in financial retail outlets in poorer communities, fuelled by housing policies that have created localised concentrations of poor people on housing estates on the outskirts of large towns and cities. Secondly, over the same period there has been a significant number of bank and building society branch closures, with the remaining branches concentrated in town and city centres. Thirdly, these problems of physical access have been exacerbated by low levels of car ownership among people living in poorer communities and the subsequent need to rely on expensive and often unreliable public transport.

1.16 But financial exclusion is not just about physical access caused by the changing geography of financial services provision. In the last few years, the debate has broadened to look more closely at the types of people who make little or no use of financial services and at the *processes* of financial exclusion (see, for example, Ford and Rowlingson, 1996; Kempson and Whyley, 1998, 1999a, 1999b; Office of Fair Trading, 1999a).

1.17 In particular, a number of other dimensions of financial exclusion have been identified (Kempson and Whyley, 1999a, 1999b):

- *access exclusion*: the restriction of access through the processes of risk assessment;
- *condition exclusion*: where the conditions attached to financial products make them inappropriate for the needs of some people;
- *price exclusion*: where some people can only gain access to financial products at prices they cannot afford;
- *marketing exclusion*: whereby some people are effectively excluded by targeting marketing and sales;
- *self-exclusion*: people may decide that there is little point applying for a financial product because they believe they would be refused. Sometimes this is a result of having been refused personally in the past, sometimes because they know someone else who has been refused, or because of a belief that ‘they don’t accept people who live round here’.

Together, these various forms of financial exclusion constitute a complex set of barriers to accessing and using mainstream financial services for many people with limited incomes.

Locating financial exclusion within the social exclusion debate

1.10 As research has distilled the essence of financial exclusion, it has become an increasingly prominent aspect of the social exclusion debate in the UK. Most significantly, following the Social Exclusion Unit’s

report on neighbourhood renewal in 1998, a Policy Action Team (PAT 14) was established to examine the scope for widening access to financial services. More specifically, its remit included: exploring the scope for development of credit unions; looking at ways of increasing the availability of insurance; and considering the role of retail banks, post offices and other organisations in providing access to, and delivery of, financial services in deprived neighbourhoods.

- 1.19 PAT 14's report, published in November 1999, identified product diversity as part of the answer to financial exclusion, combined with diversity in delivery channels where low use of financial services related to the area in which people lived. Recommendations regarding delivery channels included: the development of credit unions; the promotion and extension of local authority *Insure with Rent* schemes; and the development and promotion of basic account services by banks, building societies and other providers (HM Treasury, 1999a).
- 1.20 The Local Anti-Poverty Strategy Team in Scotland has made a number of similar recommendations about improving access to financial services. These include: better marketing and education on financial products, and on the benefits of credit unions; the development of credit unions, including the provision of a greater range of financial products; the development and promotion of *Insure with Rent* schemes, and more flexible insurance products; and the development of optional life insurance schemes by local authorities in partnership with the private sector.
- 1.21 Finally, in addition to the work initiated by the Social Exclusion Unit in England, the Office of Fair Trading also mounted a large-scale review of vulnerable consumers and their use of financial services, the report of which was published in January 1999 (Office of Fair Trading, 1999a).

About this review

- 1.22 The overall aim of this review has been to produce an overview of the extent, nature and causes of financial exclusion and to identify ways in which it can be tackled. The structure of the review has been influenced by the developments outlined above.
- 1.23 Section 2 begins by mapping out the factors that have shaped the situation. These include key social and economic changes as well as significant developments in the financial services sector.
- 1.24 Section 3 provides details of who is financially excluded and why. It begins by looking first at people who have no involvement with mainstream financial services at all, before going on to look at people who lack a bank account, who have no savings, who lack different types of insurance, who have no private pension provision, or who cannot access mainstream credit.
- 1.25 Section 4 discusses the barriers to financial inclusion, while Section 5 gives an overview of the consequences of people being on the margins of financial services.
- 1.26 Section 6 is written by John Caskey of Swarthmore College, Pennsylvania, USA. It provides an overview of the situation in the USA, where many of the same problems seem to exist.
- 1.27 Finally, Section 7 focuses on what needs to be done to overcome financial exclusion. It identifies a wide range of solutions that involve a similarly wide range of organisations and highlights gaps in knowledge where more research may be needed. It also identifies a need for monitoring the extent to which the current problem of financial exclusion has been overcome and any new forms it may take in the future.

2 The context of financial exclusion

- 2.1 The problem of financial exclusion has, ironically, resulted from increased inclusion that has left a small minority of individuals and households behind. Over the past few decades, there has been a steady increase in the use of financial services of all kinds. For example, in 1975 just 45% of adults had a current account; in 1998 between 80 and 85% had one (Kempson, 1994; Lynch and Haidar, 1998; Kempson and Whyley, 1998). A similar picture exists for other types of financial products, so that a general picture emerges of more people having an ever wider range of financial products, while a minority of people lacks even a bank or building society account.
- 2.2 This growing inclusion has been fuelled by important social and economic changes and together with significant developments in the financial services sector. At the same time, there have been developments in both these areas that make it unlikely that all sections of the population will be included within the financial services sector unless there is some shift in policy or practice.

Social and economic factors

- 2.3 Without doubt, the great majority of the population in the UK has seen a significant increase in living standards, compared with their counterparts 20 or 30 years ago. Average incomes have risen – partly through a real rise in average wages and partly through the growing numbers of women in employment. Fiscal changes mean that individuals retain more of their income to spend or invest as they choose. More households own or are buying their own home, creating higher levels of personal wealth. At the same time, gradual reform of welfare has put more onus on individuals to make their own provision privately rather than rely on the state.
- 2.4 There is, however, a small group of people who have not benefited from these changes. At best they have been left behind; at worst they have seen their situations worsen in a number of important ways.

Incomes and income distribution

- 2.5 Government statistics show that average incomes increased by around 40% between 1979 and 1994/5. But this increase was by no means evenly distributed. The incomes of the richest 10% of the population grew by 60–68%; while those of the poorest tenth grew by only 10%, before housing costs were taken into account and actually fell by 8% after housing costs. Indeed, income inequality was greater in the mid-1990s than at any time since the late 1940s, although it has fallen slightly in recent years (Joseph Rowntree Foundation, 1995, 1998).
- 2.6 It is, however, important to acknowledge that there is a fair degree of income mobility. Therefore, the people in the poorest tenth of the population in any one year are not necessarily the same people as were on the lowest incomes in the previous year. At the same time, it is also clear that people on very low incomes rarely move far up the income distribution and, if they do, often fall back into the lowest income group before too long. It has, therefore, been concluded that between 80% and 90% of people

in the poorest income group are experiencing long-term poverty (Joseph Rowntree Foundation, 1995, 1998). People with continuing low incomes are not an attractive market for most financial service providers – their needs are modest and the profit margins small or non-existent (Burchardt and Hills, 1998a; Kempson and Whyley, 1999a, 1999b).

- 2.7 The types of people who were most likely to be in the poorest income groups include lone parents, people without earnings (including the unemployed and long-term sick or disabled people), people in low-waged employment and pensioners. They also include disproportionate numbers of people from minority ethnic groups – in particular, African-Caribbean, Pakistani and Bangladeshi people. The majority also live in social rented housing (Joseph Rowntree Foundation, 1995, 1998).
- 2.8 On the whole, the types of people on low incomes in 1994/95 are the same as in the 1960s and 1970s. There have, however, been some important shifts in their proportions over time. For example, pensioners now make up 20% of those on below half-average incomes compared with just over a half in the late 1960s. Correspondingly, there has been an increase in the proportion who are non-pensioners – including lone parents, in particular. There has also been an increasing concentration of the poorest households in social rented housing. In 1979, for example, under half of social tenants were from the poorest two-fifths of the population; by 1994/95 it had increased to three-quarters (Joseph Rowntree Foundation, 1995, 1998).
- 2.9 Income inequality has important implications for use of financial services in its own right, but just as important are the complex set of reasons both for income inequality and the changes in the composition of the population most affected. These include changes in the labour market, demographic changes, housing policy and social security and fiscal policy.

Labour market changes

- 2.10 Several changes to the labour market have had important influences on access to financial services. First, the gap between low and high pay grew rapidly during the 1980s and early 1990s. In part, this was linked to increasing premiums for skills and qualifications – linked to the growing numbers of young people obtaining university or an equivalent level of education. At the same time, it was linked to the declining importance of trade unions and minimum wage protection, which often led to very low wages for unskilled workers until the introduction of the minimum wage in 1999. Wage rates of £2 or less per hour were not uncommon in the mid-1990s (Joseph Rowntree Foundation, 1995, 1998; Kempson, 1996; Office of Fair Trading 1999b).
- 2.11 Secondly, there has been a growth in the ‘flexible’ labour market – that is in jobs which are not full-time and permanent. This includes self-employment, nominal self-employment (people working for a single employer, but on a self-employed basis), part-time work and temporary or short-term contracts. Moreover, there is growing evidence that the least secure forms of flexible working tend to be concentrated among people who alternate between unemployment and low-waged employment (Joseph Rowntree Foundation, 1995, 1998; Kempson, 1996; Bayliss, 1997). Insecure employment greatly increases the likelihood of financial exclusion. Such people are both unattractive customers for financial service providers and, themselves, believe financial service products to be inappropriate to their circumstances (Bayliss, 1997; Office of Fair Trading, 1997, 1999c; Burchardt and Hills, 1998; Kempson and Whyley, 1999a, 1999b).
- 2.12 Thirdly, there has been a rapid decline in the number of employees that have their wages paid in cash. In 1969, three-quarters of workers were paid in this way. By 1988 it had fallen to 23% and, according to unpublished APACS data, it is now around 18%. This decline was in part due to technological developments allowing payment automated cash transfer (ACT) of money into accounts. But it was given a particular boost by the repeal, in 1987, of the Truck Act which gave weekly paid workers the

right to receive their wages in cash (Kempson, 1994; Pratt et al., 1996a). Arguably, the payment of wages by ACT has been one of the main influences on financial inclusion. Recent evidence suggests that the continued payment of social security benefits and the state pension in cash is significantly related to financial exclusion (Kempson and Whyley, 1999a, 1999b).

- 2.13 Fourthly, there has been a big increase over the past few decades in the number and proportion of women in the labour market. The *Labour Force Surveys* show that the number of women who were economically active increased from 10.46 million in 1980 to 12.3 million in the spring of 1999. This rise occurred despite a substantial fall in the proportion of economically active 16- to 24-year-olds as a result of the expansion of further and higher education.
- 2.14 More women now return to work after having a baby than used to be the case. Better-qualified women are most likely to return to full-time employment, and to pay for child care; while those with lower skills levels more commonly combine work and child care and take part-time jobs, particularly when their children reach school age. Women with partners who are not in employment are, themselves, least likely to work. The reasons for the disengagement of these women from the labour market are complex, although social security rules along with the low wages they can command almost certainly play an important part (Kempson, 1996; Joseph Rowntree Foundation, 1995).
- 2.15 While the explanations for the extent and nature of women's participation in the labour market can be complex, the end results of these changes are fairly straightforward. Many more women now have an independent income and are in jobs where a bank account and an occupational pension are the norm. On the other hand, compared with men, women are much more likely to be in low-waged part-time employment, where cash wages are more commonplace and occupational pensions much less common. The other significant trend has been the growing polarisation between two-earner and no earner households. Indeed the number of workless households rose faster than the overall official unemployment rates during the 1980s and early 1990s. It is these workless households who, as described in Section 3, make up a large proportion of the financially excluded (Joseph Rowntree Foundation, 1995, 1998; Kempson, 1996; Burchardt and Hills, 1998a; Kempson and Whyley, 1999).

Demographic changes

- 2.16 Demographic changes have also played an important part in both financial inclusion and financial exclusion. Most notable of these have been the growing numbers of lone parents and of young people living independently at an earlier age, and the fact that more people, generally, are living to an older age.
- 2.17 The rise of lone parenthood is widely documented and attributed to an increase in the numbers of single, never-married mothers and, more especially, to a growth in relationship breakdown which has disproportionately affected low-income couples. As described in Section 3, both sets of circumstances carry an above-average risk of financial exclusion. Many single mothers have never really engaged with financial services before having their first child and remain non-users if they rely on social security payments for most or all of their income. While women who were either not working or earning small amounts paid in cash prior to their separation or divorce, often lack financial products in their own name (Kempson and Whyley, 1999a).
- 2.18 Compared with two decades ago, many more young people have set up homes, independent of their parents. Independent living carries with it a greater integration into financial services than does living as part of someone else's household (Kempson and Whyley, 1998).
- 2.19 At the opposite end of the age range, more people are now living longer than was the case in earlier generations. As a consequence we are seeing a growing divide between the haves and have nots among those over pensionable age, which is reflected in wide disparities in financial inclusion. On the one hand,

there has been a rapid growth in the proportion of (younger) pensioners with higher incomes and considerable assets. More pensioners now have incomes from a personal pension and from investments and more own their own home. On the other hand, there is still a significant proportion of (mainly older) pensioners who have very low incomes and have always operated in a cash economy. These people are a significant group among the financially excluded (McKay, 1992; Joseph Rowntree Foundation, 1995, 1998; Kempson and Whyley, 1999; Rowlingson et al., 1999).

Housing policy and tenure shifts

- 2.20 One of the most notable changes in the 1980s and 1990s has been the very rapid increase in the proportion of households buying or owning their home. Over the post-war period, successive governments have developed the role of local authorities as housing providers so that, in 1980, about a third of all households were council tenants and only 54% owned, or were buying their home. The early 1980s saw a reversal of these policies, with the introduction of *Right to Buy* legislation permitting council tenants to buy their homes at a discount as sitting tenants, tightening controls on local authority spending and a greater emphasis on housing associations as social housing providers. As a consequence the number of homes for rent in the social rented sector has declined markedly and the proportion of home owners has increased correspondingly. Almost seven out of ten households now own or are buying their home (Kempson, 1996).
- 2.21 These changes have had several important consequences for access to financial services. On the one hand, rising home ownership has led to a greater use of financial services as home buyers take out mortgages and insure not only the building but the contents of their homes. Home owners also enjoy easier access to many other financial products (banking, insurance and consumer credit) because of the ways that risk are assessed by providers (see below).
- 2.22 On the other hand, growing home ownership has had some negative consequences. First, it has led to increasing concentrations of people on low incomes in social rented housing, so that there are pockets throughout the country of high unemployment and large numbers of low-income lone parents, pensioners and people unable to work through sickness or disability. It has also led to geographical pockets of high financial exclusion – both through the lack of a financial services infrastructure and through a concentration of people least likely to be using financial services (Kempson, 1966; Joseph Rowntree Foundation, 1995, 1998) (see below and Section 3).
- 2.23 Secondly, rising home ownership has brought with it a growing risk of debt and financial difficulties. While in the 1970s the great majority of people who were buying their homes on a mortgage were in secure, full-time jobs, many of the newcomers to owner occupation are not. These include both *Right to Buyers* and people who have bought homes because of a lack of rented accommodation. As the last recession showed, these were the people who were most at risk at times of economic downturn and who, even in better times, run a high risk of interrupted employment (Kempson, 1966). Mortgage arrears and other debts can be a route into financial exclusion, and is discussed in Section 3 (Burchardt and Hills, 1998a; Kempson and Whyley, 1999a, 1999b).
- 2.24 Thirdly, there has been a rise in homelessness and, at its extreme, in rooflessness. This has many causes, some linked to demographic changes such as the increase in family breakdown and young people leaving their parental home, others to changes in the housing market, such as the decline in affordable rented accommodation and the high level of mortgage possessions. Again, although the causes are complex, the end result is almost always a higher risk of financial exclusion (Kempson, 1996; Burrows, 1999; Kempson and Whyley, 1999a, 1999b).

Welfare and fiscal reform

- 2.25 Rising social security expenditure, combined with a desire to reduce the role of the state and the level of taxation, have set in train some important changes in welfare reform. These have, undoubtedly, played a part in the growing income inequalities described above. At the same time they have created a climate within which financial service providers have been encouraged to develop new products to provide income security following retirement or loss of earnings. These include private pensions and various forms of insurance to provide some degree of income replacement following job loss or long-term sickness or disability. Access to these products is, however, far from equal and, although the impact on financial exclusion has so far been limited, further welfare reform could have a far greater impact (Burchardt and Hills, 1997; Leyshon et al., 1998; Kempson et al., 1999)

Financial services markets

- 2.26 A number of factors, working in parallel, laid the foundations for a significant restructuring of the financial services industry in the UK, in the 1980s and early 1990s. This restructuring has contributed, both directly and indirectly, to financial exclusion.

Restructuring of financial services

- 2.27 The roots of many recent market developments actually lie outside the UK, in global financial markets and, in particular, in the international debt crisis of the 1980s (Leyshon and Thrift, 1995). As banks and credit institutions withdrew from business in the developing world, they sought out new national markets to replace those lost in less developed countries. This sowed the seeds for the massive expansion in financial services that occurred in the UK during the 1980s.
- 2.28 The significance of these international developments was amplified in the context of other developments that were occurring at a national level. These included the re-regulation of UK financial markets, developments in information technology and the UK debt crisis during the early 1990s recession.

The re-regulation of UK financial markets

- 2.29 The re-regulation of the UK financial system, which occurred during the 1980s, broke down the traditional boundaries that had existed between different sectors of the industry and removed some of the barriers to entering the market. The result was the emergence of highly competitive generic financial institutions offering a wide range of products and an influx of new entrants to the financial services industry, including a number of supermarkets and organisations such as the Virgin group (Kempson, 1997). Lynch and Haidar (1998) refer to this process as the hybridisation of financial services which, from the 1980s, led to the adoption of a financial supermarket model of provision among some companies.
- 2.30 The expansion of financial services markets that resulted from the increased competition necessitated a continual search for new customers. It was in this context that financial products, especially credit and mortgages, were made available to more, and wider range of, customers than ever before.

More people than ever before were drawn into the financial services system...Indeed, it seemed at times that nowhere was off-limits...the financial system began to reach into nooks and crannies of the British social fabric which it had previously shunned...

(Leyshon and Thrift, 1995: p.316.)

- 2.31 The intensity of the competition was increased by the fact that many of the new entrants, such as the new supermarket banks and companies such as Virgin, were able to operate on a very different basis to the more traditional financial institutions. First, their overheads were considerably lower than most mainstream financial providers as they did not operate through a branch network. Secondly, many were able to market their products and services on the basis of their brand image (Lynch and Haidar, 1998). Thirdly, some already had a significant advantage in that they understood their customer base through loyalty cards and other promotional activities. Consequently, these new providers were often able to ‘cherry pick’ the most profitable and least risky customers (Leyshon and Thrift, 1995), which began a process of segmentation that became increasingly marked during the 1990s.

Developments in information technology

- 2.32 The expansion in financial services markets and the intensity of the competition in these markets were both further increased by developments in information technology. These revolutionised the financial services industry in a number of significant ways.
- 2.33 New technology has enabled the creation of new, generic products and provided the means for mass marketing and ‘factory style’ processing of sales and transactions (Leyshon et al., 1998; Marshall et al., 1999).
- 2.34 It has created an ability for financial service providers to acquire, increasingly precise, information about their (potential) customers without the need for face-to-face contact and, through this, to target the marketing of products much more precisely. It has also made possible both direct selling and ‘at a distance’ delivery of financial products and services (Leyshon and Thrift, 1995).
- 2.35 Importantly, information technology has enabled financial service providers to improve greatly their ability to assess risk (Kempson, 1997).

The 1990s recession

- 2.36 The 1990s recession had three main effects on financial services in the UK. First, profits fell as markets began to contract. Secondly, levels of bad debt mounted to an unprecedented level. Thirdly, the high operating costs that more traditional financial providers faced, particularly in comparison with the new entrants to the market, became increasingly burdensome (Leyshon and Thrift, 1995).
- 2.37 This combination of factors made it impossible for financial markets to continue operating in the way they had during the 1980s and early 1990s. The ultimate outcome of the crisis has been termed a ‘flight to quality’, a search for safer products and markets, as part of an ongoing process of risk avoidance (Leyshon and Thrift, 1995).

To recompense for the over-extension of credit during the 1980s, the financial system not only rediscovered the merits of caution but is now making it a competitive strategy in its own right as it supports a wider process of restructuring.

(Leyshon and Thrift, 1995: p.316.)

The result was a re-drawing of the boundaries of financial markets, and the withdrawal of the financial services infrastructure from some people and some geographical areas.

The impact on access to financial services

- 2.38 Taken together these developments have served to fuel the dual processes of expansion and increasing segmentation in financial services provision. This has affected the type and range of products available,

the factors that influence who has access to them, and the way products and services are now delivered to customers. Each of these factors has contributed to the existence of financial exclusion.

Product development

- 2.39 A key outcome of the 1990s debt crisis in the UK was a clear shift in product emphasis from credit-related products to safer, growth orientated investment-related products and services (Leyshon and Thrift, 1995). This was boosted by the growth in ‘welfare insurance’ triggered by welfare reform (Leyshon and Thrift, 1995; Burchardt and Hills, 1997, 1998a).
- 2.40 Alongside this, there were two further developments. First, was the creation of a mass market in generic, transparent and lower-cost financial products during the 1990s (Thrift and Leyshon, 1997; Leyshon et al., 1998). Trusted trade-names and brand images were used to sell a whole range of products, previously perceived as being suitable only for more sophisticated users, to a much wider customer base. The wider selection and greater variety of financial products that were made available in this market undermined traditions of customer loyalty as some companies (particularly the new entrants) engaged in ‘cherry-picking’, and people switched between providers to maximise their benefits. This process also generated a renewed focus on short-term, high-return customers and products.
- 2.41 The overall effect of this mass market in financial products has been inclusionary. The growing numbers of people who now use them, however, has compounded the difficulties experienced by those who have been left outside the market. People who prefer, or are forced, to deal in cash face ever greater constraints on the places and circumstances in which this is acceptable, as well as higher costs (see Section 5).

Risk assessment

- 2.42 Risk assessment has always been used to determine patterns of access to financial products and services. Recent technological developments, however, have enabled the much more precise assessment of risk (Leyshon and Thrift, 1995; Thrift and Leyshon, 1997; Burchardt and Hills, 1998a; Leyshon et al., 1998).
- 2.43 Personal assessments by bank managers and insurance underwriters have been replaced by computer-based credit scoring and insurance risk assessment procedures. These are essentially statistical tools that allow financial service providers to assess the probable risk of an individual, based on the known past risk associated with other customers who share their characteristics (Kempson, 1997; Vass, 1997; Leyshon et al., 1998). These methods of acquiring ‘at a distance’ knowledge are now being used to create geodemographies of ‘good’ and ‘bad’ areas and customers (Leyshon et al., 1988).
- 2.44 While this process has meant that many more people have gained access to financial products, it also means that those who cannot gain access face greater isolation. Further, increasingly sophisticated risk assessment strategies mean that geographical areas can now be classified based on all six postcode digits. As a result, insurance companies have increased premiums in some low-income areas (Leyshon et al., 1998; Speak and Graham, 2000), although this reluctance is more likely to be manifested in higher cost premiums than in direct refusal of access.

Market segmentation

- 2.45 At the same time as the mass market for generic products was growing, however, a process began, particularly in the more risk-based sectors such as banking, credit and insurance, of increasing segmentation of the customer base (Leyshon et al., 1998). Technological developments allowed, for the first time, the use of customer-based, rather than account-based information technology. This enabled

firms to tailor products and services according to the needs of individual customers and, crucially, based on assessments of their likely profitability (Lynch and Haidar, 1998).

- 2.46 High net worth customers found themselves being marketed an expanding range of increasingly sophisticated products, often with very favourable terms and conditions, by a growing number of providers (Leyshon and Thrift, 1994; Burchardt and Hills, 1998a; Leyshon et al., 1998;). Three of the 'Big Four' high street banks in the UK, for example, introduced a 'premier service' for customers with higher than average incomes (Leyshon and Thrift, 1993).
- 2.47 Financial services firms moved towards real-cost charging and more careful risk-pricing for accounts and services (Leyshon and Thrift, 1993, 1994). Banks, for example, introduced punitive charges both for overdraft facilities and for customers who failed to retain sufficiently high credit balances in their accounts (Leyshon and Thrift, 1993; Vass, 1997).
- 2.48 Similarly, insurance premiums became based on much smaller risk pools, which has greatly increased the price differentials of insurance policies offered to people in different risk categories (Speak and Graham, 2000). Indeed, Burchardt and Hills, (1998a: p.5) note that:

[t]hose most in need of insurance and least able to self-insure are likely to be those least able to afford highly differentiated premiums.

- 2.49 This polarisation in patterns of access to financial products and services has been mirrored by a process of 'information exclusion' (Thrift and Leyshon, 1997). The same information systems and databases that are used to classify individuals' risk profiles are being used to determine the pattern of companies' marketing and promotional activities (Thrift and Leyshon, 1997; Leyshon et al., 1998).
- 2.50 The result has been a clear divide in information provision for different types of customers (Thrift and Leyshon, 1997). At one extreme there is a group of more sophisticated, and sought after, customers who are catered for by an 'explosion in financial media' and a growth in the number and range of financial intermediaries. At the other extreme are those who fall under the 'information shadow'. This group of people do not receive marketing or promotional information and may have little contact with financial services companies, who are not especially interested in attracting them as customers.
- 2.51 This has created a clear polarisation between the 'super-included', who have access to a wide range of products and a number of financial providers competing with each other to serve them, and those who are excluded from mainstream financial services provision altogether (Rossiter and Kenway, 1997; Thrift and Leyshon, 1997).

the market pressures that deluge better-off households with financial offers they rarely need, also leave behind islands of exclusion where financial services for poor households are virtually non-existent.

(Rossiter and Kenway, 1997: p.7.)

- 2.52 Crucially, they are excluded in two respects,

because they do not display the database characteristics required by producers or the knowledge increasingly demanded of consumers.

(Leyshon et al., 1998: p.47.)

Mis-selling

- 2.53 Fierce competition, in the wake of de-regulation resulted in the notorious cases of pensions and endowment mis-selling. This has had two important effects from the point of view of financial exclusion.
- 2.54 First, it has led to tighter regulation of the sale of investment products, which, as is discussed later, has placed a disproportionate financial burden on products with low premium or contribution rates. This, in turn, has deterred people with only modest amounts to invest (Personal Investment Authority, 1997; Vass, 1997; Association of British Insurers, 1999a; Pearl Assurance, 1999).
- 2.55 Secondly, it has seriously undermined public confidence and especially so among the groups of people who currently have few, if any, dealings with financial service companies (Hedges, 1998; Pegram Walters Associates, 1995; Rowlingson et al., 1999; Wood, 1999).

Delivering financial products

- 2.56 One of the most visible, and most widely discussed, developments in financial services provision during the 1990s is the change in the way that financial products are delivered to consumers. Technological developments meant that branches and face-to-face contact were no longer a prerequisite for delivering financial products and services (Leyshon et al., 1998; Burchardt and Hills, 1998a). The new entrants that joined the market place after re-regulation, have made wide use of 'at a distance' methods of acquiring market knowledge, direct or telephone sales, remote delivery of services, for example through cash machines and over the internet, and 'factory style' processing operations at out-of-town sites.
- 2.57 This has necessitated a systematic re-assessment of costs among mainstream financial institutions and ushered in a period of cost-reduction and a re-direction of resources to maximise returns. Leyshon and Thrift (1993) note, for example, that in the 1980s the operating expenses of British banks accounted for around 65% of gross income, largely due to the *extensive and expensive distribution networks that most financial services firms had used to attract customers*' (p.233). The result was a spate of branch closures, which was also fueled by mergers between banks during the 1980s and 1990s. At the end of 1998 there were 14,904 branches of banks and building societies in Britain; 5,679 fewer than in 1988 (Kempson and Jones, 2000).
- 2.58 Even the non-converted building societies, who have remained more committed to the maintenance of a branch network than banks, have been forced to re-think their approach. Some branches have been closed, although closures have been more limited, less spatially concentrated and have also been accompanied by the openings of new outlets in areas where bank branches have closed (Marshall et al., 1999).
- 2.59 The pattern of branch closures has been spatially uneven, focusing on deprived urban areas, populated by people on low incomes (Leyshon and Thrift, 1993, 1995; Mayo, 1997; Thrift and Leyshon, 1997; Leyshon et al., 1998). The process has been referred to as 'financial desertification' (Thrift and Leyshon, 1997) as some geographical areas have suffered a complete physical withdrawal of financial services.
- 2.60 While this has been occurring, a number of banks have begun to re-emphasise their commitment to face-to-face, relationship banking for potentially more profitable customers. For example, alongside its strategy of selective branch closures, the Midland Bank decided to refocus on some branches, based in affluent areas, to attract more small company business and more professional and managerial retail business through face-to-face personal relationships (Leyshon et al., 1998).

Overall impact of recent changes

- 2.61 The overall impact of rises in prosperity and changes in the financial services market has been a large increase both in the number of people using financial services of all types and in the range of products they use. More recently, though, there has been a growing segmentation of the market in terms of access, the design of products and their delivery. Most of this has been driven by fierce competition for the most profitable customers, with developments largely reflecting their needs.
- 2.62 In contrast, financial service providers have not, by and large, responded to the needs of people where profit levels will be lower. Nor have services responded to important changes such as the growing ‘flexibility’ of the labour market. As sections 3 and 4 show, many people have simply been left behind.

3 Who is affected by financial exclusion and why?

- 3.1 Recent research has shown that around 1.5 million (7%) households in Britain do not have any mainstream financial products at all. In addition a further 4.4 million (20%) are on the margins of financial services and have either one or two financial products only – usually bank or building society accounts or, among elderly home owners in particular, buildings insurance (Kempson and Whyley, 1999a, 1999b).
- 3.2 While this is the sharp end of financial exclusion, many more individuals and households lack specific types of financial services. For example,
- between 6% and 9% of adults have no bank or building society account of any kind (Kempson and Whyley, 1998);
 - between 15% and 23% of adults lack a current account (Kempson and Whyley, 1998);
 - 31–37% of households have no savings or investment products (Kempson, 1998; Office of Fair Trading, 1999c; Rowlingson et al., 1999);
 - 27% of employees have no occupational or private pension (Budd and Campbell, 1998);
 - 20–26% of households have no home contents insurance (Whyley et al., 1998; HM Treasury, 1999a; Office of Fair Trading, 1999c);
 - 45% of households have no life insurance cover (Office of Fair Trading, 1999c);
 - 29% have no access to credit from a mainstream provider (Office of Fair Trading, 1999c).
- 3.3 The likelihood of being on the margins of personal financial services is concentrated both geographically and among certain groups of people. This holds true for people who lack bank accounts, savings, pensions, key forms of insurance and access to credit as well as those who have no financial products at all. Those most likely to be on the margins of financial services include people who are unemployed, unable to work through sickness or disability, single pensioners and lone parents. It is also much more common in African-Caribbean, Pakistani and Bangladeshi households than it is among other ethnic groups. Above all, it is a function of household income.
- 3.4 Geographically, financial exclusion is concentrated on local authority housing estates, especially those in areas of high deprivation. It is also higher in Scotland and Wales than it is in England and, within England, it is highest in Greater London and the North West.
- 3.5 In general, use of specific financial products follows the overall patterns of use. There is, however, evidence of a hierarchy. People who have only one or two products are most likely to have a current account or savings account with a bank or building society. At the other extreme, insurance provision

for ill health or loss of income is very rare among those who are most excluded, as are most investment products.

Households with no financial products at all

- 3.6 There is little research that focuses on the sharp end of financial exclusion – i.e. those who lack any financial products at all. Most research looks at access to specific types of financial services such as banking, savings, insurance, credit or pensions. The main study in this area has analysed access at the household level, on the grounds that some financial products (such as home contents insurance) may be taken out in one name only, but actually cover everyone in the household. It does, however, have a small section on the situation within households (Kempson and Whyley, 1999a).
- 3.7 Using data from the Government's *Financial Resources Survey*, this research shows that, while only 7% of households in Britain have no mainstream financial products at all, the proportion is a good deal higher for some groups than it is for others.
- 3.8 Lone parents, unemployed people and those unable to work through long-term sickness or disability all have very low levels of engagement with financial services. The longer the head of household has been out of work the greater the likelihood of the household being at, or on the margins of financial exclusion (Kempson and Whyley, 1999). The level of exclusion is, however, at its most extreme for people in receipt of Income Support, 35% of whom have no financial products at all, with a further 55% having either one or two only. Indeed, statistical modelling has shown that, all other things being equal, being in receipt of Income Support has by far the largest effect on financial exclusion (Kempson and Whyley, 1999).
- 3.9 Other households on a low income – such as those headed by students and part-time workers – also have an above-average likelihood of financial exclusion. Statistical modelling has shown that, when other factors are controlled for, low income significantly increases the odds of financial exclusion (Kempson and Whyley, 1999).
- 3.10 Being on a low income affects use of financial services in a number of ways. It means that insurance is unaffordable, that there is little opportunity for saving, that there is limited access to private pensions or to credit and that using a bank account is too problematic.
- 3.11 Being a woman does not per se increase the likelihood of financial exclusion, but households headed by women in certain circumstances are more likely to be financially excluded. This includes single pensioners and lone parents, many of whom are left on a low income and without financial products in their own names when they are widowed or when they separate from their partner. Some of them find that they cannot get bank accounts, insurance or credit in their own name. Many more do not even apply either because they believe they will be turned down or because they consider financial services inappropriate or unaffordable for someone in their circumstances (Kempson and Whyley, 1999b).
- 3.12 The links between ethnicity and financial exclusion are complex and vary between different groups. African-Caribbeans, Pakistanis and Bangladeshis, especially, are over-represented among low-income households – including those in low-waged employment as well as people dependent on state benefits for most or all of their income. Indeed, statistical modelling shows that low income is the main explanation for African-Caribbeans being at, or on the margins of financial exclusion. The picture for Pakistanis and Bangladeshis, however, is more complex. Here language, culture and religion all have an important part to play (Kempson and Whyley, 1999a; Office of Fair Trading, 1999d).

Table 3.1: Numbers of financial products by household circumstances

	Number of financial products ^a						Weighted Base
	None	Low	Medium-Low	Average	Medium-High	High	
	%	%	%	%	%	%	
<i>All households</i>	7	19	20	11	21	22	26,435
Age of household head (years)							
16–19	26	57	13	2	2	—	112
20–29	11	27	18	11	19	15	3,211
30–39	6	16	15	11	26	26	5,272
40–49	4	11	15	11	25	34	4,738
50–59	5	13	17	11	23	32	3,982
60–69	6	18	24	13	19	19	3,813
70–79	7	27	29	13	15	9	3,522
80+	10	39	27	8	10	6	1,785
Household type							
Single, no children	11	25	20	11	19	14	3,581
Couple, no children	2	10	15	12	28	33	4,515
Three+ adults, no children	1	10	18	12	26	32	1,911
Single pensioner	12	37	28	9	9	5	4,132
Couple pensioners	3	16	27	15	21	18	3,783
Lone parent	23	42	17	7	7	4	1,790
Couple with children	3	11	14	10	27	35	5,861
Three+ adults with children	3	11	20	12	24	30	862
Ethnicity							
White	6	19	20	11	21	23	25,215
Black	16	37	22	8	11	7	440
Indian	3	17	26	16	18	19	282
Pakistani/Bangladeshi	14	42	29	7	6	2	211
Other	7	29	21	8	21	14	287
Age completed education (HoH, years)							
16 or under	8	23	22	11	19	16	19,151
17–19	3	11	15	11	26	35	4,084
20+	—	7	12	10	25	45	2,939
Housing tenure							
Owned outright	—	11	29	15	24	20	6,818
Mortgagor	—	1	12	14	33	40	10,605
Local authority tenant	23	51	19	4	2	—	5,348
Housing association	20	50	23	4	2	1	1,190
Private tenant	9	39	28	10	10	5	2,474

continued

Table 3.1: Numbers of financial products by household circumstances (continued)

	Number of financial products ^a						Weighted Base
	None	Low	Medium-Low	Average	Medium-High	High	
	%	%	%	%	%	%	
<i>row percentages</i>							
Standard region							
North, including Cumbria	9	25	22	13	19	13	1,619
Yorkshire and Humberside	6	21	22	11	20	20	2,305
North West	9	21	20	12	20	19	2,921
East Midlands	5	19	19	12	22	23	1,926
West Midlands	6	20	20	11	21	22	2,407
East Anglia	4	17	19	12	25	23	1,067
Greater London	9	23	20	10	19	19	2,961
South East (excluding London)	3	14	17	11	24	32	5,119
South West	4	17	20	11	23	27	2,297
Scotland	13	25	19	10	19	15	2,358
Wales	8	23	25	12	18	14	1,455
Local levels of deprivation^b							
1 (most deprived)	11	27	20	11	16	15	5,699
2	7	23	23	11	21	16	3,931
3	5	19	21	13	24	20	2,406
4	4	15	20	13	23	25	2,440
5	4	13	18	11	23	31	2,416
6	2	13	16	11	24	34	2,157
7 (least deprived)	2	13	17	11	24	34	3,573

Source: Kempson, E and Whyley, C (1999a).

a Low: 1 or 2 products; Medium-low: 3 or 4 products; Average: 5 products; Medium-high: 6 or 7 products; High: 8 or more products.

b Analysis based on the Department of the Environment, Transport and Regions (DETR) *Deprivation Index* and restricted to England and Wales.

HoH: Head of Household.

Base: all households 22,622.

3.13 There is much less of a relationship between age and financial exclusion. As might be expected, very young householders (aged under 20 years) are the ones least likely to be engaged with financial services, although those aged over 80 years also have fairly low levels of engagement. Statistical modelling, however, suggests that it is not so much their age as the circumstances of these two groups that explains their disengagement. Teenage householders include a disproportionate number of lone parents and students, while the over-80s include a disproportionate number of single female pensioners (Kempson and Whyley, 1999).

3.14 Financial exclusion also has a clear geographical dimension to it, with statistical modelling showing that it is not just who you are that determines engagement with financial services, but that where you live is also important. Financial exclusion is highest in Scotland, where 13% of households have no financial products and a further 25% have only one or two. Other regions with higher than average levels include the North, North West, Greater London and Wales. Statistical modelling shows that these differences cannot be explained by the economic circumstances of their populations (Kempson and Whyley, 1999a).

Table 3.2: Numbers of financial products by socio-economic circumstances

	<i>row percentages</i>						
	Number of financial products ^a						Weighted Base
	None	Low	Medium-Low	Average	Medium-High	High	
	%	%	%	%	%	%	
<i>All households</i>	7	19	20	11	21	22	26,435
<i>Net weekly household income</i>							
No income	2	18	17	13	22	27	179
£1–50	6	26	28	13	18	9	321
£51–100	16	39	29	6	8	3	2,785
£101–150	16	37	26	10	9	4	4,490
£151–200	9	29	25	13	17	8	3,665
£201–300	4	15	22	16	26	18	5,279
£301–400	—	6	16	12	34	32	3,631
£400–500	—	3	8	10	31	48	2,276
more than £500	—	1	6	7	26	60	3,193
<i>Net equivalent weekly household income</i>							
No income	2	18	17	13	22	27	179
£1–50	4	19	24	16	23	14	213
£51–100	8	28	32	9	16	7	791
£101–150	15	35	29	9	9	4	4,058
£151–200	13	34	23	10	13	6	5,282
£201–300	4	17	22	14	25	19	6,769
£301–400	1	7	14	12	32	35	3,976
£400–500	—	3	10	11	30	47	2,127
more than £500	—	2	6	8	25	59	2,433
<i>Receipt of income-related benefit</i>							
None	—	8	20	14	28	31	18,289
Council Tax Benefit only	2	24	39	13	15	6	1,229
Income Support only	4	18	27	13	21	18	589
Council Tax Benefit & Income Support	3	32	40	13	9	3	974
Housing Benefit only	13	62	21	2	2	—	484
Housing Benefit & Council Tax Benefit	21	58	17	3	1	—	1,403
Housing Benefit & Income Support	36	49	9	2	3	2	365
Housing Benefit, Council Tax Benefit & Income Support	35	55	9	—	—	—	3,102
<i>Economic activity status (HoH)</i>							
Self employed	—	6	16	12	29	37	2,386
Full-time employment	—	9	16	12	29	34	10,981
Part-time employment	6	29	22	12	17	15	442
Unemployed	19	38	20	8	9	7	1,565
Retired	8	29	28	11	14	9	7,262
Sick/disabled	19	32	22	10	11	7	1,573
Student	8	40	28	8	10	6	274
Other inactive	22	32	14	6	12	14	1,951

continued

Table 3.2: Numbers of financial products by socio-economic circumstances *(continued)*

	Number of financial products ^a						row percentages
	None	Low	Medium-Low	Average	Medium-High	High	Weighted Base
	%	%	%	%	%	%	
No. of years since last worked (HoH)							
0	—	9	16	12	29	34	13,809
1	8	31	22	12	15	13	832
2	10	29	23	11	15	13	810
3	13	25	22	11	13	16	739
4	13	29	22	10	14	11	782
5	10	31	23	10	14	11	714
6-10	13	27	25	11	14	11	2,455
11-16	12	32	27	10	12	7	3,620
21 or more	16	39	25	8	9	4	1,906

Source: Kempson, E and Whyley, C (1999a).

- a Low: 1 or 2 products; Medium-low: 3 or 4 products; Average: 5 products; Medium-high: 6 or 7 products; High: 8 or more products.
- b Analysis based on the Department of the Environment, Transport and Regions (DETR) *Deprivation Index* and restricted to England and Wales.
- HoH: Head of Household.
- Base: all households 22,622.

- 3.15 At a more local level, financial exclusion is commonest in the most deprived local authorities (as measured by the DETR *Deprivation Index*) and is especially common in social rented housing. For example, almost a quarter of council tenants have no financial products at all and a further half of them have only one or two. Once again, statistical modelling shows that living in an area of high deprivation or in social rented housing reduces the level of engagement with financial services, even when personal characteristics have been controlled. In other words, a household living on a council estate in an area of high deprivation is much more likely to be excluded than an identical household living elsewhere (Kempson and Whyley, 1999).
- 3.16 A number of studies have identified a ‘desertification’ of financial service providers in areas of very low income, which seems to create both physical and psychological barriers to use of financial services among the populations affected (Kaur et al., undated; Pratt et al., 1996a, 1996b; Thrift and Leyshon, 1997; Kempson and Whyley, 1999a, 1999b; Speak and Graham, 2000).

Bank accounts

- 3.17 Access to banking has been fairly extensively researched from a number of perspectives, including individuals, households, communities and financial service providers.
- 3.18 Interpreting statistics on access to bank and building society accounts is, however, problematic for a number of reasons. Primarily, there are very real problems of definition. As banking has become more sophisticated, so the traditional distinction between a current account and a deposit account has become blurred. Consequently, attempts to measure the level of account holding by type of account result in rather different statistics. The situation is further complicated by the fact that some studies have measured account holding by individuals and others within households. Although the primary studies make it clear which level of analysis has been used, others are not always so rigorous when they

cite the results. The following section attempts to pick a way through this minefield, drawing on the original studies as opposed to those that merely quote their results.

3.19 Various surveys have measured the level of current account holding by individuals (that is, those aged 16 years or over).

- The *Family Resources Survey* gives a figure of 23% of individuals lacking a current account (Kempson and Whyley, 1998).
- Surveys for APACS put the proportion at 17% (Kempson and Whyley, 1998).
- Two surveys using the ONS Omnibus found that 15% of individuals did not have a current account in their name (Kempson and Whyley, 1998; Office of Fair Trading, 1999c).

3.20 Similarly, analysis of current account holding at the household level has also resulted in a divergence of findings.

- The *Family Resources Survey* shows that 20% of households lack a current account (Kempson and Whyley, 1998)
- The two surveys using the ONS Omnibus survey put the figure at 12% (Kempson and Whyley, 1998; Office of Fair Trading, 1999c)
- A much earlier household survey found that 19% of households did not have a current account ‘that they used to manage their money’ (Kempson, 1994).

3.21 There is, however, less divergence in the figures for account holding in general (that is including both current and deposit accounts). Depending on the survey, the proportion of households lacking a bank or building society account of any kind is between 6% and 9% (Kempson and Whyley 1998; Office of Fair Trading, 1999c). The proportion of individuals with no account of any kind is around 12% (Kempson and Whyley, 1998).

3.22 The reasons for these disparities are explored fully in a report to the British Bankers’ Association (BBA) (Kempson and Whyley, 1998) and were highlighted in the Treasury report *Access to financial services* (HM Treasury, 1999a). They are currently being explored by a group of technical experts drawn from the Treasury, BBA, APACS, Department of Social Security and independent researchers.

Who lacks a bank or building society account?

3.23 In contrast to the figures on account holding, there is far more consistency about who lacks a bank or building society account and why, and given the fact that if people have any financial product it is likely to be such an account. The findings mirror closely those relating to financial exclusion generally.

3.24 Non-account holding is, therefore, concentrated among people on low incomes, and those on Income Support in particular. It is especially high for unemployed people, lone parents and people who are unable to work through long-term sickness or disability and above average for people who are retired or who are in low-paid work (Kaur et al., undated; Pratt et al., 1996a, 1996b; Kempson and Whyley, 1998). A qualitative study of homeless people in Scotland found very low levels of account holding, with only 11 of the 39 people interviewed having a bank or building society account of any kind (Burrows, 1999). Similarly, non-account holding is very high for households headed by people in these circumstances (Kempson, 1994; Office of Fair Trading, 1999c).

- 3.25 Women are much less likely to have an account in their own name than men, but this is largely explained by their lower incomes and their personal circumstances, not by gender alone. There are subtle differences between men and women in the factors that are related to account holding. In particular being a tenant, being non-white, having dependent children, being out of work and having low net personal income all have a greater effect on women's account-holding than they do on men's (Kempson and Whyley, 1998). In view of this it is not surprising that households headed by women (lone parents and single pensioners in particular) have a low incidence of account-holding (Kempson, 1994; Office of Fair Trading, 1999c).
- 3.26 African-Caribbean, Pakistani and Bangladeshi people are disproportionately likely to be without an account, and account holding among Pakistani and Bangladeshi women is incredibly low (Kempson and Whyley, 1998; Office of Fair Trading 1999d). As with financial exclusion generally, the low incidence of account-holding in the African-Caribbean population is largely explained by their personal and economic circumstances rather than their ethnicity. Statistical modelling found that African-Caribbean people had the same likelihood of lacking a bank or building society account as others in their circumstances and that they lacked accounts because they were disproportionately living on low incomes. The same was true, to some degree, for Pakistani and Bangladeshi people, but here there was an additional dimension related to their ethnicity (Kempson and Whyley, 1998; FSA, 2000).
- 3.27 Account holding is lowest among people aged under 20 years and over 80 years, but for rather different reasons. In the main, young people have not got round to opening an account, while the very elderly are part of the 'cash-only' generation, who have never had an account (Kempson and Whyley, 1998).
- 3.28 There are also clear geographical variations in account holding. For example, compared with the British average, far fewer people living in Scotland have an account (Whyley and Kempson, unpublished data). There are also important differences by housing tenure, with social tenants being much more likely to lack an account than owner occupiers (Kempson and Whyley, 1998).

Reasons for not having a bank or building society account

- 3.29 There are various explanations for why individuals and households lack bank or building society accounts. The most important distinction to draw is that some people have disengaged from banking, while others have never had an account at all. In total, around a third of those without a current account have had one in the past but have now closed it down, the remainder have never had an account at all. In other words, there is a good degree of turnover among people without an account (Kempson and Whyley, 1998).
- 3.30 The people who have never had an account are a disparate group and the reasons for them being outside the banking system vary greatly. They include:
- Those who have never needed one and use a savings account instead, most of whom are elderly.
 - Younger people who have yet to open an account.
 - Women who have always relied on their husband's account.
 - Women who became single mothers at a very young age.
 - People who say that they prefer a cash budget, many of whom think they would be turned down if they applied for an account. They tend to live on marginalised estates and to have tenuous links with the labour market.

- Pakistani and Bangladeshi people for whom language, culture, levels of knowledge and religion are all important barriers.
- A very small number who say they lack an account because banks have turned them down – either because they could not provide proof of identity or address or because they were not sufficiently credit-worthy for a conventional current account. This is especially common among homeless people.

3.31 People who have had an account in the past, typically closed it after a drop in income:

- following job loss, especially if they have been out of work for some time;
- after retirement, especially if they are manual workers with no occupational pension;
- as a result of long-term sickness or disability.

3.32 These three groups each divide into people who decide to close their accounts to keep tight control over their money and those who have closed them after getting into financial difficulties.

3.33 In addition, other situations where people decide to close their accounts are:

- When women give up work to have children – usually where their partner is in low-paid work or he has taken responsibility for both controlling and managing the household budget.
- Following a bad experience with an account – most commonly after incurring charges for inadvertently overdrawing.

Some get into financial difficulties and have their accounts closed by the bank or building society because they are overdrawn.

3.34 Finally, some women who previously had joint accounts with their husbands are left without one in their own name when they divorce, separate or are widowed. Some of these choose not to apply for one in their own name because they are living on a low income and want to keep close control over their finances. Others apply, but are turned down although much more commonly they do not bother applying as they believe they will be turned down (Kempson, 1994; Finch and Elam, 1995; National Consumer Council, 1995; 1997; Kempson and Whyley, 1998; Burrows, 1999; Office of Fair Trading 1999c, 1999d).

3.35 In addition to the people who have no account at all, there is a smaller group – about 5% of the adult population – that have an account, but they make little use of it. Some of these have suspended accounts under circumstances similar to those where others close them down – job loss, retirement, long-term sickness or disability. Indeed many people first suspend their account leaving just a few pounds in it, just in case there is an upturn in their finances. If this does not happen, they close it altogether. The second group who make minimal use of their accounts are those who have basic accounts with very few facilities. For some of them it is a matter of choice – they prefer to have a simple account without a cheque book or cheque guarantee card because it allows them to keep control over their money. For others, it is a decision made by their bank or building society, which is unwilling to give them a cheque book, cheque guarantee card or debit card because of their age or economic circumstances (Kempson and Whyley, 1998; Office of Fair Trading 1999c; Speak and Graham, 2000).

Geographical access to bank and building society branches

- 3.36 Other research has approached the issue of access to banking from the rather different standpoint of geographical access. As noted in Section 2, these studies typically show that the bank branch infrastructure is far poorer in low-income neighbourhoods and that branch closure rates are higher (Kaur et al., undated; Leyshon and Thrift, 1996a, 1996b; Pratt et al., 1996a, 1996b; Thrift and Leyshon, 1997; Speak and Graham, 2000). On the whole, building societies have lower rates of branch closure than banks (Marshall et al., 1999; Kempson and Jones, 2000).
- 3.37 One of the most detailed studies (Thrift and Leyshon, 1997), using a GIS approach to map branch closures at ward level, showed that the decline in branches was greatest in three types of ‘struggling areas’:
- multi-ethnic areas characterised by pensioners, lone parents, high unemployment and local authority flats;
 - areas characterised by blue-collar families, lone parents and local authority terraced housing;
 - areas characterised by blue-collar families with children, and private rented terraced housing and bedsits.

In addition, though, the decline was also very high in:

- aspiring areas, characterised as academic centres and student areas, with young educated white-collar singles and couples, and private rented bed-sits and flats.
- 3.38 Another study (Kaur et al., undated), covering just London, mapped the pattern of closures against the DETR *Deprivation Index*. This showed that, on average, London’s wealthiest wards had five times as many branches as the poorest ones and that closures were highest in the wards with the greatest level of deprivation.
- 3.39 In contrast, a recent study (Kempson and Jones, 2000) of communities that are distant from a bank or building society branch has found that they did not include disproportionate numbers of unemployed, retired or disabled people. This finding is not, necessarily at odds with earlier research, for a number of reasons. In contrast to earlier research it was a study of areas without a branch, as distinct to areas affected by closures. So it only included areas where the last branch had closed, not those where there had been a reduction in the branch presence. It also included areas that had never had a branch, many of which would be new estates of owner-occupied housing (Kempson and Jones, 2000).
- 3.40 Despite the rapid decline in the numbers of bank and building society branches in recent years, 85% of the urban population still lives within a mile of the nearest branch and 85% of the rural population lives within four miles of one. The majority of people living more distant than this did not face great problems getting to a branch. But a significant minority (around 2% of the population living distant from a branch) faced real difficulties and had scaled down their use of banking services accordingly, and at the extreme had suspended or closed their account. Very elderly people, those with disabilities that limited their mobility and women caring for young children full-time (and lone parents in particular) were greatly over-represented among this group; and especially so if they lacked their own transport (Kempson and Jones, 2000).
- 3.41 This finding is consistent with earlier research showing that less than 1% of those lacking a current account said it was because they did not have access to a branch (Kempson and Whyley, 1998; Office of Fair Trading, 1999c). There is, however, clear evidence that the effects of limited access are more subtle than these findings suggest. In particular, it creates a psychological barrier to banking that is, in all

probability, greater than the physical one especially for those that have never had an account (Kaur et al., undated; Pratt et al., 1996a, 1996b; Thrift and Leyshon, 1997; Kempson and Whyley, 1999a; Speak and Graham, 2000).

Savings

- 3.42 Access to savings products has been the focus of some research, although interest in this area of financial services provision has been more limited. This is largely because access to these products is perceived to be desirable rather than essential. However, it is generally recognised that savings provide security (actual and psychological), act as a safety net in the face of unforeseen events and smooth the household budget during times of financial constraint. Savings are particularly important in the light of the shift in welfare provision, outlined in Section 2, which has made individuals more responsible for their own future security. The Government's recognition of the importance of encouraging and facilitating saving is reflected in the launch of Individual Savings Accounts (ISAs) in April 1999. It is still too early to judge the extent to which ISAs have been successful in breaking down inequalities in patterns of saving. The early signs, however, have not been encouraging.

Numbers of people without formal savings and investment products

- 3.43 As with bank accounts and pensions, various research studies have reported different numbers of people without formal savings products. There is much less variation in relation to savings, however, than is the case with other financial products. Recent surveys suggest that around a third of people are without any formal savings. For example, a Gallup poll commissioned by Yorkshire Bank (Yorkshire Bank, 1999, press release) found that 32% of people had no savings at all. Rowlingson et al. (1999) put the figure at 37% of individuals, based on analysis of the 1995/6 *Family Resources Survey* (FRS). However, Kempson (1998) notes an important omission in the FRS – it excludes both general endowment savings products and life insurance.
- 3.44 A slightly lower number of households have been found to lack savings. A survey commissioned by the Office of Fair Trading (OFT) as part of the *Vulnerable Consumers* study, found that 24% of households had no savings (Office of Fair Trading, 1999c). Household level analysis of the FRS, bearing in mind the limitations outlined above, found 31% of households to be without any formal savings products (Kempson, 1998).
- 3.45 A precise measurement of the number of people or households with access to savings products is problematic for a number of reasons. First, surveys have concentrated on formal savings products, yet qualitative research has shown that a relatively high proportion of people without formal savings products actually save by informal methods (Kempson, 1998).
- 3.46 Secondly, there is a variety of different savings and investments that vary in their availability. As a result, it is important to recognise that even people who have money in savings may not have access to all products. Further, some people may be forced to save in ways that are inappropriate to their circumstances, or that do not give value for money because their access to savings products is restricted. Again, this is difficult to measure.
- 3.47 Thirdly, the amount of money that people have saved is almost as important as whether they have any savings at all. People who have only a very small amount of money in savings, which they are unable to increase, may not be significantly better off than those without any savings accounts at all.
- 3.48 Finally, as with other financial products, being without savings at any point in time does not mean that people have never had any. People often save for specific purposes, and those currently without any

savings may have spent them and not yet resumed putting money by. Older people, in particular, may have been regular savers earlier in their lives, but run down their savings after retirement. Equally, some groups, particularly young people may simply have chosen not to save at this point in their lives. They may decide to start saving or investing in the future, and have no difficulty accessing the financial products and services they require.

Who is without formal savings?

- 3.49 The likelihood of having savings, the amounts of money people have put by and the way that they save all vary widely between different groups. Research suggests important links between saving, income level and personal or family circumstances. Crucially, however, these factors do not just impact independently on access to savings, but also interact and compound one another. The following sections identify the characteristics of those who are least likely to have any formal savings at all. It looks, then, at the characteristics of people who tend to save money by informal methods.
- 3.50 Kempson (1998) found that six in ten low-income households (with net weekly incomes below £150) were without savings compared with just one in three people in the population as a whole. Where low-income households did have formal savings they tended to be small amounts, held in liquid form in a bank or building society account. Further, qualitative evidence also suggests that very few low-income households manage to add to any savings they have (Kempson, 1998). Having a low income and, in particular, a low disposable income has also been found to be associated with being a non-saver (McKay, 1992; Barker (undated) unpublished data) and having low levels of financial wealth (Rowlingson et al., 1999).
- 3.51 Personal and household circumstances have also been identified as important factors in explaining the likelihood of different groups of people and households having savings. Employment status is a key factor, with much lower levels of saving among people who are unemployed or not working due to sickness or disability (Kempson, 1998). Barker (undated, unpublished data) also noted a social class effect, which is probably a reflection, at least in part, of the income effect demonstrated by others. This study found the highest likelihood of saving, and the highest levels of saving, among people from social class A or B. Non-saving, on the other hand, was associated with being from social classes C1, C2, D or E.
- 3.52 Another important finding is that levels of saving are lower among all minority ethnic groups than they are among the white British population (Kempson, 1998). Saving is particularly unlikely among African-Caribbeans, Pakistanis and Bangladeshis. This will, in part, reflect the income effect outlined above, as all three of these minority ethnic groups have lower than average incomes. However, Kempson (1998) notes that income, alone, is insufficient to explain the very low levels of saving among these groups, as they are much lower than even the lowest income households among the white population. Further, where these households did have savings, they had far fewer types of account than comparable white households. Consequently, it is important to recognise the importance of cultural factors in explaining whether and how people from some minority ethnic groups save money.
- 3.53 Lifestage, linked with age, also has an important effect, and those with low net or disposable incomes are far less likely to have savings than others. Consequently, young single people, young couples with children, lone parents and people who have experienced ‘lifestage disruptions’, such as having children or getting divorced are much less likely to have formal savings than ‘empty nesters’ and, in particular, pensioners (Barker (undated), unpublished data; Kempson, 1998; Rowlingson et al., 1999).
- 3.55 Other factors that have been found to depress the likelihood of saving include leaving school without any educational qualifications (Office of Fair Trading, 1999c); living in rented housing (McKay, 1992) and living in a homeless hostel (Burrows, 1999).

Reasons for not saving

- 3.56 On the whole, being without savings products is the result of self-exclusion. There is little evidence of direct exclusion in the provision of savings facilities – providers have no incentive to limit access to them because there is no risk involved. However, it is important to recognise that a number of factors that relate to the provision of formal savings products are likely to encourage self-exclusion.
- 3.57 Some people are deterred by the fairly high minimum amounts required to open some building society savings accounts and, perhaps more importantly, by a belief that a minimum deposit is always required (Kempson, 1998; Personal Investment Authority, 1997; Vass, 1997; Rowlingson et al., 1999). Lack of knowledge about savings products also prevents some people from making use of formal savings facilities (Vass, 1997; Personal Investment Authority, 1997; Rowlingson et al., 1998) and a lack of confidence in providers of savings facilities (Personal Investment Authority, 1997).
- 3.58 In addition, the closure of bank and building society branches in some areas can make it difficult for people to gain physical access to a formal method of saving (Vass, 1997) and, as already discussed, increases the psychological barriers and mistrust (Kempson and Whyley, 1999a).
- 3.59 It has been suggested that the low returns given by the formal savings schemes that are easily accessible to people with little income to spare may also act as a deterrent (National Consumer Council, 1995). Although other research has shown that people with only modest amounts to save are much less interested in the rate of interest than they are in the security of their savings (Kempson and Whyley, 1999a).
- 3.60 As the characteristics of people without savings suggest, however, it is issues of affordability that play the biggest part in explaining why many people do not save in formal accounts. Many people with low incomes cannot afford to save at all, especially when they are young and have dependent families (McKay, 1992; National Consumer Council, 1995; Personal Investment Authority, 1997; Rowlingson et al., 1999). Some pensioners are also without savings because they have run them down after retirement (Vass, 1997).
- 3.61 Linked to this is the fact that the amount of money people can afford to save and what they are saving for play an important role in determining whether or not they use formal savings facilities. Bank and building society accounts are used by people on low incomes when they want to put money away for ‘a rainy day’. In contrast, those who are saving small amounts of money to fulfil short-term needs or pay for specific items are much more likely to save in informal ways (see below) (Barker (undated), unpublished data; Kempson, 1998).
- 3.62 Finally, the difficulty that some migrant communities encountered in trying to access formal financial products when they arrived in Britain is one reason why many have set up their own informal savings and loans organisations (see below) (Srinivasan, 1995; Sterling, 1995).

Informal saving

- 3.63 Research suggests that the groups who are least likely to save in formal accounts are, in fact, most likely to be saving via informal means.
- 3.64 A Gallup survey commissioned by Yorkshire Bank found that more than half of the population saves loose change in jars or piggy banks (Yorkshire Bank, 1999, press release). Further, a quarter of people have accrued between £20 and £50 in loose change, while 18% have more than £50 saved in this way. This method of saving was most likely among people aged 16–34 years who were also those least likely to have formal savings accounts.

- 3.65 Kempson (1998) found widespread evidence of informal saving, particularly among low-income households and people from minority ethnic groups. Many low-income households without any formal savings products did, in fact, save regularly in a variety of ways including:
- putting loose change in jam jars, boxes, envelopes, etc;
 - letting benefits mount up before drawing them;
 - letting additional income from, for example, casual earnings, commission or maintenance payments mount up;
 - buying savings stamps;
 - over-paying through pre-payment meters;
 - encouraging children to save in money boxes;
 - paying into Christmas clubs;
 - giving money to a third party to look after.
- 3.66 Households that saved informally were generally headed by someone who was not working because they were unemployed, sick or disabled, retired or lone mothers. Informal savers who were in employment tended to be headed by someone who had had a period of unemployment or were families with children who had very low disposable incomes.
- 3.67 The research found that the way low-income households saved was linked with their purpose for saving. It drew a distinction between ‘putting into savings’, ‘saving up’ and ‘putting money by’. Putting into saving was usually for no particular purpose and was more likely to involve formal savings products. On the other hand, saving up for household goods, holidays or events such as Christmas, and putting money by towards regular household bills, were much more likely to be done through informal methods of saving (Kempson, 1998).
- 3.68 Similarly, African-Caribbeans, Pakistanis and Bangladeshis, the minority ethnic groups that were least likely to be saving formally, were also most likely to be using informal methods of saving. Rather than keep small change at home, however, these groups tended to use informal savings associations (Srinivasan, 1995; Sterling, 1995; Herbert and Kempson, 1996; Kempson, 1998).
- 3.69 African-Caribbeans made much greater use of credit unions than most white British households. In fact, many British credit unions had their origins in African-Caribbean communities and a large proportion of credit unions today, particularly those in major cities, are still linked with these communities (Kempson, 1998).
- 3.70 In addition, ROSCAS (Rotating Savings and Credit Schemes) are also prominent among minority ethnic communities. While most African-Caribbean ROSCAS have been converted into credit unions, in Pakistani and Bangladeshi communities they have tended to remain informal. Different ethnic groups have their own names for these schemes. African-Caribbeans call them *pardners or sou sous*, Pakistani schemes are called *kommittis*, and Indians have *kametis, kuris or chittis*. However, the basic principles are the same for all of these schemes. They are generally based on a group of friends, relatives or work associates who save collectively and take turns to have access to the money saved. Each scheme usually has around 10–30 members, who each agree to save a fixed amount per week. The money is collected by a banker and schemes are based on mutual trust. Members of these schemes often refer to them as a

method of ‘enforced saving’ because failing to maintain payments to the scheme would result in a loss of respect within the community (Srinivasan, 1995; Sterling, 1995; Herbert and Kempson, 1996; Kempson, 1998).

Insurance

- 3.71 Access to insurance has received a great deal of attention in financial exclusion debates. The figures on the numbers of people who are without insurance of any kind are, however, sketchy and difficult to collate meaningfully, not least because there are a number of different types of insurance.
- 3.72 Figures from the Association of British Insurers suggest that in 1998 around 10% of households were without insurance cover of any kind (HM Treasury, 1999a).¹ However, these figures are difficult to interpret as they include insurance which is compulsory for certain groups, such as motor insurance and buildings insurance, but irrelevant for others.
- 3.73 The numbers of households without particular types of insurance, however, were much higher. For example,
- 26% did not have home contents insurance;
 - 87% did not have mortgage payment protection insurance (MPPI);
 - 91% had not taken out medical insurance;
 - 93% did not have personal accident insurance.
- 3.74 Two other studies found that around one in five people lacked home contents insurance (Whyley et al., 1998; Office of Fair Trading, 1999c).
- 3.75 A study of mortgage payment protection insurance (Ford and Kempson, 1997) found that only 25% of people with mortgages had taken out this type of insurance. Further, the research found that three-quarters of the mortgagors that were at greatest risk of needing mortgage payment protection insurance did not actually have a policy.
- 3.76 Finally, the consumer survey undertaken for the Office of Fair Trading study of vulnerable consumers found that 45% of households did not have any type of life insurance (Office of Fair Trading, 1999c).

Who is without insurance?

- 3.77 The characteristics of those who are most likely to be uninsured vary according to the type of insurance involved. Predictably, however, it is those who are perceived to have the highest risk of needing to claim on a policy that are most likely to be excluded. Research evidence in this area is, however, patchy and focuses predominantly on home contents insurance, although there have been some studies of people who are without other types of insurance.
- 3.78 Households that are least likely to have home contents insurance (Whyley et al., 1998; Office of Fair Trading, 1999e) and life insurance (Office of Fair Trading, 1999e) are remarkably similar groups. Both the very young and the very old are less likely to have a policy than those in the middle of the age spectrum.

1 Figures include insurance for buildings; home contents; motor; medical; mortgage payment protection; holiday; personal accident; and any other type of insurance.

Marital status is also important, with single people less likely than couples to take out insurance. Lone parents, in fact, have a strikingly low likelihood of being insured. People from minority ethnic groups are also over-represented among those without home contents insurance (Whyley et al., 1998)

- 3.79 Being without educational qualifications has also been found to have a significant relationship with the likelihood of being uninsured (Office of Fair Trading, 1999e). Around a quarter of households headed by somebody without educational qualifications were found to be without home contents insurance, compared with just 18% of the general population. Similarly, nearly two-thirds had not taken out any life insurance products, compared with 45% on average.
- 3.80 Finally, people living in rented accommodation, especially those who rent their home from a local authority, were found to be much less likely to have taken out a home contents insurance policy than people who owned their own homes (Whyley et al., 1998).
- 3.81 More important, however, than the personal characteristics of people without insurance, is the relationship between a household's financial circumstances and their likelihood of being insured. Industry figures show that just over two-thirds of households in the lowest income quintile have no insurance of any kind, compared with one in nine households overall (HM Treasury, 1999a). This pattern holds across a range of different types of insurance, with lower income households being markedly less likely to have cover than those with higher incomes.
- 3.82 Other research has found a significantly lower likelihood of having both home contents insurance and life insurance products among people with low incomes particularly if they are not in paid work and who receive income-related social security benefits (Whyley et al., 1998; Office of Fair Trading, 1999c). Further, the likelihood of having home contents insurance is reduced the longer the head of household is out of employment (Whyley et al., 1998). However, statistical modeling suggests that it is not simply income level that is important in determining the likelihood of a household being insured, but the level of financial strain they are under. Those who said they found it 'difficult to make ends meet' were much less likely to have home contents insurance, regardless of their level of income, than people who were able to 'get by' without difficulty (Whyley et al., 1998).
- 3.83 However, research evidence also indicates that being without insurance can be part of a wider process of financial exclusion. A relationship between being without insurance and lacking other financial products, particularly current accounts, is apparent (Whyley et al., 1998; Office of Fair Trading, 1999c). In addition, people living in large urban conurbations or deprived areas that are likely to be deemed higher risk for claims on home contents policies are also less likely to have cover (Leyshon and Thrift, 1995; Whyley et al., 1998).

Reasons for not having insurance

- 3.84 Research has identified a variety of reasons for being without insurance, ranging from direct access-exclusion to self-exclusion. Direct exclusion from insurance is rare. For example, just 2% of people without home contents insurance said it was because they had been refused a policy (Whyley et al., 1998). Research does suggest, however, that, although they are not refused cover, some people are given the run-around by insurance companies that are reluctant to insure them (Whyley et al., 1998; Speak and Graham, 2000). Evidence also indicates that, while direct exclusion accounts for only a small number of cases, a number of barriers exist which encourage people to self-exclude (Kempson, 1997; Whyley et al., 1998; Association of British Insurers 1999a, unpublished). There still remain, however, a significant proportion of people who have simply chosen not to take out insurance, although they may do so in the future.

Affordability

- 3.85 The main reason given by people for being without insurance is that they cannot afford a policy (Whyley et al., 1998; Office of Fair Trading, 1999c). However, there are several components to affordability in relation to insurance. Statistical modelling suggests that being unable to afford home contents insurance due to a low income was only significant in explaining why tenant households did not have cover (Whyley et al., 1998). Owner-occupiers, particularly those who had been insured in the past but let a policy lapse, were more likely to be without insurance due to financial strain – in other words, a lack of *disposable* income.
- 3.86 Further, more sensitive risk-pricing of insurance products means that cover is, by definition, more expensive for those who are most likely to need to claim (Speak and Graham, 2000; Leyshon and Thrift, 1993; Whyley et al., 1998). This can also explain why some people let insurance policies lapse – the National Consumer Council (1995) found that people often said their premium had been increased after they had made a claim. This means that some may be unable to afford to take out a policy even though they do not have a low income.

Products and delivery mechanisms

- 3.87 Insurance can also be unaffordable to some groups of people because of the types of policies that are available, or the way that they are delivered to customers, are inappropriate. For example, home contents policies often have a relatively high minimum sum insured, often far greater than the value of the goods that some households wish to insure (Whyley et al., 1998).
- 3.88 More importantly, though, it is rarely possible now for people with low incomes to pay for insurance policies in a way that suits their budget. It is impossible for many people with constrained circumstances to pay the annual premium for their policy in one go. Yet doorstep collection of insurance premiums is now extremely rare and payment by direct debit is only possible for people with a bank account. Even low-income households with access to banking facilities may prefer not to use direct debits. Some are worried about incurring charges by over-drawing their account, others budget on a weekly or fortnightly basis and find monthly payments difficult to maintain (Kempson, 1997; Whyley et al., 1998; HM Treasury, 1999a; Kempson and Whyley, 1999a).

Conditions

- 3.89 In addition, the conditions attached to policies can, along with the price, make insurance products seem poor value for money. For example, some people are only able to obtain home contents insurance if they fit expensive locks and other forms of security to their home. Fulfilling these requirements can sometimes cost more than the price of the policy (Whyley et al., 1998). In addition, some people who are sold creditor insurance, such as mortgage payment protection insurance, are excluded from claiming against the risks they are most likely to experience (Bennett, 1995; Office of Fair Trading, 1996; Ford and Kempson, 1997). In these circumstances there can appear to be very little ‘value added’ to paying for insurance.

Lack of knowledge

- 3.90 Lack of knowledge is also frequently cited as a reason for being without insurance. This has been increasingly so as the terms and conditions of policies have become tighter and the media has highlighted stories of people who have been unable to claim on the insurance policies they have taken out. The potential for mis-buying and mis-selling of insurance, and the long-term problems that this can cause, are increased in the context of the growth in ‘welfare insurance’ (Burchardt and Hills, 1997).

- 3.91 A number of research studies have highlighted the lack of knowledge and information as a barrier for taking out cover (Ford and Kempson, 1997; Whyley et al., 1998; HM Treasury, 1999a). Research has also identified a general concern about the terms and conditions of policies and a fear of misreading or misunderstanding the ‘small print’ (National Consumer Council, 1995). This issue has been found to be a particular barrier to people from minority ethnic groups for whom English is not the first language (Office of Fair Trading, 1999d).
- 3.92 The problems caused by a lack of information about insurance products is amplified by the fact that some people do not receive any marketing literature or attempts to persuade them to take out a policy. A survey (Office of Fair Trading, 1999c) conducted as part of the *Vulnerable Consumers* initiative found that marketing activity tended to focus on people who already had a policy of some kind, rather than those who were without insurance. So, for example, just a quarter of people without a home contents insurance policy had received marketing literature in the year prior to the survey, compared with nearly half of those who already had this type of cover. Whyley et al. (1998) found a small group of people without home contents insurance who had simply never thought about taking it out, were not at all insurance conscious and were often marginalised from financial services in general. This group accounted for 10% of households without home contents insurance. A more recent survey found 7% of those without insurance had never thought about taking out a policy (Office of Fair Trading, 1999c)

Not got around to taking it out

- 3.93 Between a tenth and a fifth of people without home contents insurance were found to have simply ‘not got around’ to taking out a policy, even if they had intended to do so (Whyley et al., 1998; Office of Fair Trading, 1999c). These were often younger people, without financial problems, who recognised the value of having insurance cover but had not done anything about obtaining it.

Do not want insurance

- 3.94 Finally, some people without insurance have not taken out a policy because they have chosen to remain uninsured. For some, this is because they have simply decided that they do not need it or would prefer to take the risk of remaining uninsured. This has been found to be the case in relation to home contents insurance. One survey, for example, found that 14% of people without this type of cover said that they did not need it and 4% said that they had not taken it out because they preferred to take the risk (Office of Fair Trading, 1999e). In addition, Whyley et al. (1998) found that people who had never had home contents insurance were more likely to be those that had little need for it.
- 3.95 A small number of people without insurance, however, are uninsured because they have negative views of the principle of insurance or of the companies that provide it (National Consumer Council, 1995; Ford and Kempson, 1997; Clarke and Parker, 1997; Whyley et al., 1998). Often this is the result of bad past experiences of claiming on an insurance policy (National Consumer Council, 1995). It can also be related to religious beliefs among some minority ethnic groups (Whyley et al., 1998).

Pensions

- 3.96 According to Treasury statistics, approximately 27% of all employees are neither members of occupational pension schemes nor have personal pensions. Of these, 12% are in SERPS and 15% (mostly people on low incomes) have no secondary pension cover at all but may accrue some pension entitlement over their lifetime (Budd and Campbell, 1998).
- 3.97 Other surveys report slightly different proportions of the population who have no occupational or personal pension, largely because they use different bases for their calculations. They include:

- 46% of all adults below retirement age (MORI, undated);
- just over 40% of all employees and self-employed (NOP, undated);
- 32% of households where neither partner has either an occupational or a personal pension (Kempson, 1998).

Groups with inadequate pension provision

- 3.98 At present all those earning more than £64 a week, and who are in employment, must make contributions either to the SERPS scheme, or to an occupational or personal pension. This does not, however, extend to self-employed people. As a consequence, people lacking a private pension are concentrated among the self-employed, those in low paid and part-time work and those not in the labour market at all (Office of Fair Trading, 1997).
- 3.99 The 1998 NOP *Financial Research Survey* found that people in full-time employment were twice as likely to have some form of private pension provision as those in part-time work (two-thirds, compared with one-third). There was, however, a modest increase in the proportion of part-timers with an occupational pension from 18% in December 1994 to 25% in December 1998 (NOP undated).
- 3.100 The *NatWest Pensions Index* shows that men have higher levels of pension-holding than women (NatWest, 1998). While data from the 1991/92 *General Household Survey* indicated that 49% of women in employment lacked either an occupational or a personal pension, compared with 24% of men (Burton, 1996). The 1994 ONS survey of people making the transition to retirement similarly found that women had much poorer pension provision than men – 81% of men, but only 42% of women had, at some time belonged to an occupational pension scheme (Disney et al., 1997).
- 3.101 Finally, there is clear evidence of variations in personal pension-holding between different ethnic groups. While 24% of white men in employment had no personal pension in the 1991/92 *General Household Survey*, the proportions for Indian and ‘Black’ men without a personal pension were a good deal higher (33 and 39% respectively). Also, 70% of Pakistani and Bangladeshi men had no pension provision beyond the basic state pension. In contrast, pension-holding among Indian and ‘Black’ women in employment was about the same as their white counterparts. There were, however, no Pakistani or Bangladeshi women in employment in the survey, and consequently none with a personal pension (Burton, 1996).
- 3.102 Likewise, analysis of the 1995/96 *Family Resources Survey* at the household level identified that African-Caribbean, Pakistani and Bangladeshi households were much more likely to be without any personal pension provision than the national average. Nationally 32% of households had no personal pension, while 61% of African-Caribbean households and 79% of Pakistani and Bangladeshi households had none (Kempson, 1998).
- 3.103 Even among those with either an occupational or personal pension there are some who have inadequate provision. There are several reasons for their under-investment:
- They have started paying in to a pension relatively late in their working life without investing higher amounts to compensate.
 - They have paid in too little throughout their working life.
 - They have withdrawn money invested in pension schemes.

- They have ceased paying in to a pension scheme – often following a change of job or from being employed to being self-employed.

3.104 The extent of under-provision of pensions is revealed by the *NatWest Pensions Index*, which shows that half of the workforce are likely to retire on a pension of £106 a week or less (at June 1998 prices) (NatWest, 1998).

Reasons for not having a private pension

- 3.105 There is a range of reasons why people lack a private pension or have inadequate provision. These include lack of opportunity, lack of interest, lack of disposable income and lack of knowledge or mistrust of pension providers. In addition, religious and cultural factors are important reasons for people from some ethnic minorities.
- 3.106 Many women, in particular, lack pensions through *lack of opportunity*. Either they are out of the labour market altogether and, even if they could afford a private pension, would not be eligible to have one, or they are in low-paid, part-time jobs. Consequently, women in these positions tend often look to their husbands to provide them with a pension in their retirement (Burton, 1996; Disney et al., 1997; NatWest, 1999; Rowlingson et al., 1999; Wood, 1999).
- 3.107 Men who work in low-paid and insecure jobs similarly lack private pensions because their employer does not offer an occupational scheme and so they have relied on SERPS (McKay, 1992; Office of Fair Trading, 1997; Wood 1999). Statistical modelling on 1991/92 *General Household Survey* data showed that, all other things being equal, employees' holdings of both personal and occupational pensions were influenced by the size and nature of the employer worked for (Burton, 1996).
- 3.108 *Lack of interest* in pensions manifests itself in different ways. First, many young people feel that retirement is too distant for pensions to be taken seriously. This leads to under-provision at best and to no provision at all if they remain on a low income throughout their working lives (Pegram Walters Associates, 1995; Burton, 1996; Hedges, 1998; Rowlingson et al., 1999; Wood, 1999).
- 3.109 Secondly, self-employed people, in contrast, often see their business as providing security for their old age and, as a consequence, are much less interested in taking out private pensions than are employees (Burton, 1996; Rowlingson et al., 1999). This was particularly so among Pakistani and Bangladeshi small business owners and, in part, explains the low level of pension holding in these communities, where levels of self-employment are well above-average (Kempson, 1998).
- 3.110 Thirdly, low pension holding in the Pakistani and Bangladeshi communities has been linked to the fact that many people remit money to overseas accounts, with the intention of returning to their country of origin in their old age (Kempson, 1998).
- 3.111 Much of the recent research on pensions among people in the Stakeholder Pension target group has identified *lack of disposable income* as a key factor influencing their private pension holding. Having delayed taking out a pension while they are young, these people then find that the demands that children place on a household budget make it difficult to save, except for immediate needs. Consequently, taking out a private pension is delayed still further, especially by those who are self-employed or who work for employers that do not provide an occupational pension scheme. As their children grow up, so they begin to think about providing for their retirement only to find that they cannot afford the level of contributions they would need to make to provide them with an adequate pension that would take them outside the reach of means testing. This has been typified as a cycle of 'too young', 'too hard up', 'too late' (Pegram Walters Associates, 1995; Hedges, 1998; Rowlingson et al., 1999; Wood, 1999).

- 3.112 *Knowledge* or, more accurately, a lack of it, is a key influence on the take-up of pensions. First, because few people understand how personal pension contributions will translate into an income in old age, they are not in a position to calculate how much they need to contribute to a pension in order to secure an adequate income after retirement. Secondly, those able to join occupational schemes frequently know little about the portability of their pension and, so, often do not join the scheme if they lack job security.
- 3.113 This lack of knowledge is often compounded by *mistrust* of pension providers – which derives in part from the Maxwell scandal and in part from past pension mis-selling. There is also widespread anxiety about how to access independent advice and, more importantly, how to determine whether advice is non-partisan (Pegram Walters Associates, 1995; Age Concern, 1998; Hedges, 1998; Rowlingson et al., 1999; Wood, 1999).
- 3.114 Finally, studies of ethnic minorities identify clear *religious and cultural influences* on providing for one's old age, which go some way towards explaining why Pakistani and Bangladeshi people are very unlikely to have any pension provision. Islamic teaching prohibits the receipt of interest on investments and this tends to influence views on financial services generally. This, coupled with a lack of familiarity with British financial services, acts as a deterrent to taking out formal savings products. At the same time, investments are made in children's futures, with the expectation that children will, in turn, care for their parents in old age (Burton, 1996; Kempson, 1998).

Credit

- 3.115 In some respects, credit is not perceived to be central to debates on financial exclusion. This is partly because borrowing is often seen as something that exacerbates the problems faced by low-income households, as making repayments reduces their already limited disposable income. It is also, in part, because research has found that financially excluded households do not generally prioritise credit as a financial product to which they would like access (Kempson and Whyley, 1999a).
- 3.116 However, while borrowing money to supplement a low income may not be desirable it may, in some circumstances, be unavoidable – either to buy essential household items or to make ends meet (Kempson and Whyley, 1999a).

The number of people without access to credit

- 3.117 Over recent decades there has been a rapid growth in the range of consumer credit products available and in the marketing of these products, particularly to the lowest risk/highest profit customers. In addition, intense competition in the financial services market has made credit available to a relatively wide customer base. Consequently, use of credit has increased dramatically, and is now the norm rather than the exception that it was two decades ago. The majority of households in the UK now have access to, and make use of, mainstream consumer credit facilities such as credit and store cards, unsecured personal loans or hire purchase. In fact, a recent survey found that only 33% of all households used no 'high street' credit, that is mortgages, personal loans, overdraft facilities, credit and store cards or hire purchase agreements (Office of Fair Trading, 1999c).
- 3.118 Measuring the number of people who are excluded from credit facilities is difficult, as not everyone without credit needs or wants it. Some people have sufficient resources, from savings or income, to meet their needs without borrowing. Others disapprove of borrowing and make a free and unconstrained choice not to use credit. Indeed, 29% of those without any form of credit said that it was because they were opposed to borrowing (Office of Fair Trading, 1999c). This equates to 8% of all households.

- 3.119 Only a very small, although potentially growing, number of people are completely without access to any form of credit. Rather what tends to happen is that some people are excluded from access to mainstream credit sources – such as banks, building societies or credit card companies – and have to borrow from other sources. The higher costs, less favourable conditions and less scrupulous sales practices attached to loans from some of these sources can add considerably to the financial problems of people who are already vulnerable. In addition, those with the most restricted access to credit may be forced to borrow from unregulated, illegal moneylenders (see Section 5) (Rowlingson, 1994; Burrows, 1999; Speak and Graham, 2000).
- 3.120 In this context, being excluded from credit has come to mean being unable to access *mainstream* credit facilities. Research suggests that the people affected fall into two broad groups:
- People with poor credit records or a history of bad debt.
 - People living on low incomes.
- 3.121 The first group have no option other than to turn to *non-status lenders* to fulfil their credit needs. People in the second group may have to look outside mainstream credit provision altogether. A range of alternative providers – such as moneylenders and pawnbrokers – operate to meet the needs of this second group. Looking at the size of each of these markets provides a good estimate of the number of people who are excluded from mainstream credit facilities, as the people borrowing from these sources are most likely to be those with a need for credit that cannot be met by mainstream sources.

The non-status lending market

- 3.122 The growth of the non-status market was fuelled by the recession in the early 1990s. For example, 454,280 households, between the beginning of 1990 and the end of 1998, had their homes repossessed as a result of mortgage arrears. In 1998 alone, 1,888,282 new county court judgements were made, although this includes people with more than one judgement (Kempson and Whyley, 2000).
- 3.123 Consequently, there has been a growth in financial institutions that cater specifically to people for whom mainstream lending practices are, more or less, suitable, but who do not have a good enough credit rating to gain access to them. At its most respectable end, the activities of these companies closely resemble those of mainstream banks and building societies. They operate in a very similar way but provide credit at higher cost to cover the additional risks associated with their customer base. However, the least respectable institutions are very different from mainstream lenders. They not only lend at much higher interest rates and on rather different terms than the more respectable non-status lenders, but also cater for customers with a history of bad debt. Indeed, there is concern that some of these institutions specifically target vulnerable people and encourage them to take out loans that they are unlikely to be able to repay.
- 3.124 Quantifying the level of use of non-status credit is also difficult. The best indication comes from data supplied from the NOP *Financial Research Survey* (Kempson and Whyley, 2000), which shows that 1% of the adult population has a loan (other than a mortgage or second mortgage) that is secured on their home. That is around 450,000 people. Of course, not all of these will be non-status loans, while, at the same time, there will be mortgages and second mortgages that are non-status. Either way, the numbers are likely to be small.

The alternative credit market

- 3.125 Likewise, there are no reliable figures on the numbers of people excluded from mainstream credit because they have low and insecure incomes. But, it will certainly not be fewer than those without a

bank account. It is also difficult to provide estimates of the size of the alternative credit market, as reliable statistics are scarce, and where figures are obtainable from the industry, they often do not tally with those provided by surveys.

- 3.126 The Consumer Credit Association (CCA) estimates that around three million people have loans from one of their members or another licensed moneylender. On the other hand, surveys consistently put use of moneylenders at around 1–2% of the population, or 450,000–900,000 people (Kempson and Whyley, 2000). There are several possible explanations for this discrepancy.²
- 3.127 It is, however, just about impossible to provide a reliable estimate of the extent of illegal moneylending. In Glasgow alone, it is estimated that about 100 illegal moneylenders are at work at any one time, and each lender could have up to 50 customers (Burrows, 1999). If all the major cities in the UK had a similar penetration, there could be over 60,000 people using illegal moneylenders at any one time (Kempson and Whyley, 2000).
- 3.128 All the evidence suggests that fewer people use pawnbrokers than borrow from a moneylender. Around 0.1% of the adult population (or around 50,000 people) admit to using a pawnbroker in the course of a year (Kempson and Whyley, 2000). Once again this is likely to be an underestimate as there is much the same reluctance to admit to pawning as there is to using a moneylender. There are no industry estimates of the number of users of registered pawnbrokers, although the National Pawnbrokers Association estimate that there are around 800 shops in Britain. Extrapolating from research conducted in the USA one arrives at an average figure of around 1,000 customers and 4,000 pledges per shop per year. If the level of use in Britain were similar, this would give somewhere in the region of three-quarters of a million users per year (Kempson and Whyley, 2000).
- 3.129 Agency mail order catalogues are used by 19% of the adult population, or about eight million people. However, the great majority of these are people who either purchase through their own account (43%), or are agents themselves (26%). About a third of users buy items through an agent and so would not receive the agent's commission to offset the higher price of the goods sold on credit through mail order. This is equivalent to 2.75 million people (Kempson, 1997).
- 3.130 There is, apparently, very little overlap between the customers of moneylenders, pawnbrokers and mail order catalogues. Even among the lowest income group (households with net incomes of up to £100 a week) only 17% of people using agency mail order said they were also using a moneylender or pawnbroker (Kempson, 1997), although, for the reasons given above, this will almost certainly be an underestimate.
- 3.131 There are also some newer forms of alternative credit such as cheque cashers. Far less is known about these forms. All that can be said with any confidence is that because many cheque cashers are also moneylenders or pawnbrokers, there is almost certainly an overlap between the number and types of people who use these organisations.

The characteristics of people who do not use mainstream credit facilities

- 3.132 A closer look at the characteristics of the people who borrow from non-mainstream credit sources illustrates two quite distinct groups who lack access to mainstream credit facilities.

2 First, it is clear that some people are reluctant to admit to using a moneylender. Secondly, some lenders, including key national companies, provide more than one loan to a client at a time and this is not allowed for in the CCA estimates of the total number of customers. Thirdly, many people buy goods on instalments, rather than taking cash loans and they may well categorise this as buying on hire purchase when questioned in surveys.

Non-status borrowers

- 3.133 As loans from non-status lenders are frequently secured on the borrowers' property, users tend to be homeowners rather than tenants. The people who borrow from the least reputable non-status lenders are usually in serious financial difficulty, have at least one county court judgement and cannot obtain credit from the more reputable end of the market.
- 3.134 Data supplied by NOP show that 84% of people with (non-mortgage) loans secured against their home are in social classes C, D or E. All these groups are over-represented among people with secured loans, relative to their proportions in the population as a whole (Kempson and Whyley, 2000).
- 3.135 This same data shows that 91% of all secured borrowers are aged between 25 and 54, with people of these ages being over-represented relative to their proportions in the adult population. Use is similarly concentrated among older families (30%), older couples (26%) and young families (20%). It is disproportionately located in the South of England, where 47% of people with secured loans live (compared with 31% of the adult population). Secured borrowers are greatly under-represented relative to the population in London and in the Midlands (Kempson and Whyley, 2000).

People borrowing from alternative sources

- 3.136 Users of alternative sources of credit, on the other hand, are those living on long-term low incomes, who are likely to rent their homes and who tend to be families with dependent children. Most of them borrow to make ends meet or to pay bills as a result of ongoing income inadequacy (Kempson et al., 1994; Kempson 1996; Kempson and Whyley, 1999a). Although the people using each of the various types of alternative credit all have very similar characteristics, research suggests that people tend to use just one of these sources rather than a combination of different lenders (Kempson et al., 1994).
- 3.137 In addition, there are some groups of people to whom even licensed moneylenders are reluctant to lend, including lone parents, the long-term unemployed, hostel dwellers and people living in high crime areas (Rowlingson, 1994; Burrows, 1999; Speak and Graham, 2000). These groups are particularly prey to illegal or unlicensed moneylenders.

Reasons for not using mainstream credit facilities

- 3.138 There are a number of reasons why people do not use mainstream credit facilities and these differ for the two groups described above. Compared with other financial services, however, there are much higher rates of denied access.

Non-status borrowers

- 3.139 The vast majority of people borrowing from non-status lenders are simply unable to access mainstream sources of credit. Indiscriminate lending in the 1980s and followed by the recession of the early 1990s resulted in a substantial increase in the numbers of people with poor credit records, a history of bad debt and, in some cases, County Court Judgements against them. In addition, mainstream lenders have tightened their lending criteria and introduced more rigid credit-scoring criteria. This has made it very difficult for people with a history of debt problems to gain access to mainstream credit (Kempson and Whyley, 2000).
- 3.140 In addition, many of the people who are borrowing in this market are trying to obtain a loan to repay their existing debts. They are unable to borrow from mainstream lenders because they have reached, or already exceeded, their credit limit from these sources (Kempson and Whyley, 2000).

- 3.141 The more relaxed lending criteria of non-status lenders make it easier for people with unfavourable financial circumstances to borrow from them. In fact, evidence suggests that the least reputable of these lenders pay very little attention to their borrowers' ability to repay a loan, as long as it is secured on the customer's property (Kempson and Whyley, 2000).
- 3.142 Widespread media advertising also helps non-status lenders to attract new business, particularly as they often encourage people to borrow as a way of reducing and simplifying their existing debt repayments. Further, predatory sales practices, including cold-calling people who have had County Court Judgements issued against them, also encourage some people to borrow at the less reputable end of this market.
- 3.143 Related to all of these issues is the fact that many people remain unaware that there are alternatives to further borrowing as a way of addressing debt problems. Few people know that they could contact their creditors and negotiate reduced payments or that specialist money advice is available free of charge from citizens advice bureaux and other advice centers (Kempson and Whyley, 2000).

People borrowing from alternative lenders

- 3.144 This group of people is excluded from mainstream credit provision for a number of interrelated reasons. First, because of their financial circumstances, they are unlikely to pass the credit scoring needed to gain access to most consumer credit. In fact, many people do not even bother applying for consumer credit because they have 'second guessed' the likely outcome of credit scoring.
- 3.145 Secondly, it is equally important to recognise that people do not necessarily use alternative credit providers for negative reasons. Many choose to borrow from this market, despite the higher costs associated with doing so, because the mainstream market cannot meet their needs. This group of people is generally seeking small sums of money for relatively short periods of time. They are attracted to alternative providers because they offer:
- easy, quick and non-bureaucratic access;
 - simple, straightforward and transparent products;
 - manageable repayments, made on a weekly basis, that do not require banking facilities;
 - no hidden charges or penalties for default;
 - a flexible and sympathetic approach to repayments.

(Kempson et al., 1994; Rowlingson, 1994; Ford and Rowlingson, 1996; Opinion Leader Research, 1999; Consumer Credit Association, 1999).

- 3.146 Thirdly, the proactive marketing and recruitment strategies used within the home credit industry cannot be ignored (Rowlingson, 1994; Ford and Rowlingson, 1996).

4 Barriers to inclusion

- 4.1 In the previous section it was clear that different types of people lacked specific financial products for a whole range of reasons. From this, together with Section 2, it is possible to identify a range of barriers that need to be overcome if more people are to be included within the financial services sector. These include access difficulties of different kinds, a lack of appropriate financial products, affordability, lack of appropriate delivery mechanisms, poor levels of knowledge, psychological barriers, including a mistrust of suppliers, language and cultural factors as well as the impact of legislation and regulation. Not all of these apply to all financial products and even where they do they may differ slightly in nature, as this Section shows.

Access

- 4.2 There are several important aspects to access barriers. These include geographical access, access for people with disabilities, risk assessment, racism and marketing.

Geographical access

- 4.3 As already noted, there is considerable evidence that the level of bank branch provision is notably poorer in low-income communities. So far, this seems to have resulted in such neighbourhoods having a more restricted choice (Kaur et al., undated; Thrift and Leyshon, 1997; Vass, 1997; Office of Fair Trading, 1999a), rather than a greater likelihood of having no bank or building society branch at all (Kempson and Jones, 2000). Moreover, it has been concluded that there is no evidence to suggest that banks or building societies are ‘red-lining’ poor neighbourhoods (Kaur et al., undated). Instead, economic decisions have been driving decisions regarding branch provision in areas where few people need more than very basic transactional banking and have little money to invest. It should, however, be noted that many of the small local building societies remain committed to their local community and are reluctant to close branches (Marshall et al., 1999).
- 4.4 There is little doubt that the types of people who are especially at risk of financial exclusion – lone parents, people unable to work through long-term sickness or disability and very elderly people on low incomes – are also the ones who face most difficulties getting to a branch if it is distant. Similarly, they are the ones who are most resistant to automated banking, such as cash machines or ATMs (Office of Fair Trading, 1999a; Kempson and Jones, 2000) and also have least access to them (Office of Fair Trading, 1999a; Thrift and Leyshon, 1997). Several studies have shown that these groups feel more comfortable using building societies and especially post offices, than they do using banks (Finch and Elam, 1995; Pratt et al., 1996a, 1996b; Kempson and Jones, 2000).
- 4.5 Financial pressures are not, however, only affecting the banking industry. Similar effects are being felt also by the insurance industry, with considerable pressure on the home service companies that have traditionally served the needs of people on the margins of financial services. As a consequence, many of the companies that used not only to sell insurance door-to-door, but also collected premiums in

that way, have withdrawn from this method of service delivery (Whyley et al., 1998; Insurance Trends, 1999).

Access for people with disabilities

- 4.6 Access to financial services is exacerbated by a variety of disabilities. These include mobility problems, which prevent people getting to the branches of service providers (Office of Fair Trading, 1999a; Kempson and Jones, 2000). They also extend to visual, hearing and other impairments, which limit people's ability to use cash machines, read printed literature and use the telephone (Thomas, 1998; Office of Fair Trading, 1999a; FSA, 2000; Kempson and Jones, 2000).

Risk assessment

- 4.7 Developments in risk assessment, discussed in Section 2, have given many more people access to financial services and have reduced the price for large numbers of consumers. By their very nature, however, they do discriminate against people who have low and insecure incomes, who have a history of bad debt, who live in particular neighbourhoods or who are homeless. Their effects, however, vary between different types of product.

Current accounts

- 4.8 While the Office of Fair Trading has estimated that individual banks turn down between 13% and 41% of applications for current accounts, two independent surveys show that this is not the major reason why people have no account at all (Kempson and Whyley 1998; Office of Fair Trading 1999a).
- 4.9 On the other hand, it is equally clear that credit scoring results in people who are judged to be a high risk being offered accounts with such limited facilities that they are of little practical use (Kempson, 1994; Kempson and Whyley 1998; HM Treasury 1999; Office of Fair Trading 1999a; Speak and Graham, 2000).
- 4.10 Similarly, debt problems play an important part in the withdrawal of banking facilities (Kempson, 1994; Kempson and Whyley, 1998; 1999a; Burrows, 1999;). Indeed, research conducted for the National Consumer Council, found that, although banks all had a stated policy of being sympathetic to people facing financial difficulties, their practices often failed to match this (National Consumer Council, 1997).

Consumer credit

- 4.11 As might be expected, there is ample evidence to suggest that certain groups of people are excluded from mainstream credit because they are considered non-creditworthy. Many more decide not even to apply because they believe they will be turned down (Kempson et al., 1994; Rowlingson, 1994; Sterling, 1995; Ford and Rowlingson, 1996; Herbert and Kempson, 1996; Kempson, 1996; Burrows, 1999; Kempson and Whyley 1999a, 1996b; Speak and Graham, 2000).
- 4.12 As discussed in Section 3, there are two broad, but quite distinct, groups that are most affected. The first of these are people whose circumstances are such that they do not (and probably never will) score high enough on most score cards – for example, people who are not in work or have unstable work histories, especially if they have not lived long at any one address (Kempson et al 1994; Rowlingson, 1994; Sterling, 1995; Ford and Rowlingson, 1996; Herbert and Kempson 1996; Kempson, 1996; Burrows, 1999; Kempson and Whyley, 1999a; Speak and Graham, 2000).

- 4.13 The second group comprises people who have, in the past been considered credit worthy, but have (often through no fault of their own) got into serious financial difficulties (Kempson et al., 1994; National Consumer Council, 1997; Burrows, 1999; Kempson and Whyley, 2000).
- 4.14 Of course all lenders have a duty to be prudent in their lending – no one should argue otherwise. At the same time, there are, as we discuss in Section 5, serious consequences for those who live in a credit society but cannot gain access to mainstream credit. There is also concern about people who are unable to get access to credit as a result of a third party's debt rather than their own. This can particularly affect people following relationship breakdown.

Insurance

- 4.15 With insurance the risk assessment barrier is more related to affordability than it is to access per se. Recent developments have led to ever smaller risk pools, with the consequence that people who need insurance most – because they are at greatest risk of burglary, job loss or ill health – are the ones who end up having to pay most for their policies (Bayliss, 1977; Burchardt and Hills, 1998b; Whyley et al., 1998; Speak and Graham, 2000).
- 4.16 Research on mortgage payment protection insurance has identified a worrying development. Following criticisms that policies were being denied to people judged to be a high risk – such as self-employed people, and people with unstable work histories or a history of ill health – insurance companies reduced greatly the categories of people that they would not insure. Instead they were offered policies containing exclusions that meant that a claim was more likely to be disallowed (Kempson et al., 1999).

Racism

- 4.17 Two studies (Herbert and Kempson, 1996; Office of Fair Trading, 1999d) have specifically identified allegations that some financial service providers are racist. This takes two quite distinct forms. First, it has been alleged that staff working with the public are, on occasion, racist in their dealings with people from minority ethnic groups. Secondly, there have been allegations that banks and other credit companies are racist when it comes to credit granting. However, while there seems to be evidence to support that the first of these does occur, there is no clear evidence of the second. Indeed, the fact that people from some ethnic minorities are disproportionately in the lowest income groups may make it seem as if scorecards are racist (Herbert and Kempson, 1996; Office of Fair Trading, 1999d; HM Treasury, 1999a).

Marketing

- 4.18 Advances in information technology now allow financial service companies to target their promotional literature far more closely than had previously been the case. For most consumers this could well be a welcome development, cutting down the amount of unsolicited mail that they receive. It does, however, reduce greatly the extent to which consumers who are on the margins of financial services have any contact with financial services. In its vulnerable consumer survey, the Office of Fair Trading found that people on very low incomes or with no financial products were very unlikely to have had any sales approaches in the previous 14 months (Kempson and Whyley, 1999a; Office of Fair Trading, 1999c). Moreover, many of the people that would be considered financially excluded said that they would not even know how to go about getting financial products they might need (Whyley et al., 1998; Kempson and Whyley, 1999a).

Lack of appropriate products

- 4.19 Critics of financial service providers point to a ‘flight to quality’, whereby considerable effort is expended on developing ever more sophisticated products for the minority of customers who are considered most profitable (Leyshon and Thrift, 1993, 1994). Also, not only have there been no comparable efforts to create new products designed specifically for customers with the lowest incomes, but many of the products that best suited their needs have now been withdrawn. Examples include budgeting accounts that allowed people to spread the costs of their household commitments and indemnity home contents insurance policies that provided cover for second-hand replacement of stolen or damaged possessions (Whyley et al., 1998; Kempson and Whyley, 1999a). Indeed, it has been concluded that ‘*overall, the industry is thinking of products not people*’ (Bayliss, 1997).
- 4.20 There is widespread consensus that the great majority of current accounts are inappropriate to the budgeting needs of people living on very low incomes. Indeed, many surveys show that people lack current accounts for this reason. The key difficulties are their lack of transparency, the fact that it is possible to overdraw and the charges imposed for overdrawing. ‘Old fashioned’ bank accounts, with a pass book and a linked budgeting account for household bills, were far better suited to the budgeting needs of people on low incomes than ones with cash cards and direct debits (Kempson, 1994; National Consumer Council, 1995, 1997; Kempson and Whyley, 1998; Kempson and Whyley, 1999a; HM Treasury, 1999a; Office of Fair Trading, 1999a).
- 4.21 People on the margins of financial services often need to borrow small amounts for short periods of time – usually to make ends meet or buy essentials. They want to have an arrangement whereby the loan is repaid in fixed amounts each week. Mainstream credit suppliers do not have products that match these needs. Overdrafts and credit cards, if they could be acquired, are seen as a route into loss of financial control. Plus, banks and building societies find it uneconomic to make small short-term loans (Kempson et al., 1994; Rowlingson, 1994; Herbert and Kempson, 1996; Kempson, 1996; Kempson and Whyley, 1999a).
- 4.22 The main difficulty with basic savings accounts is the fact that minimum deposits may be needed to open an account with a building society, as some of the smaller ones have introduced quite large minimum deposits as a way of fending off carpet bagging. This is a particular barrier to people with only small amounts to invest (Vass, 1997; Kempson, 1998; Building Societies Association, 1999; Office of Fair Trading 1999a).
- 4.23 In fact, many people who are on the margins of financial services save regularly through life insurance policies. It is, however, now widely acknowledged that these are ill-suited to people with low and fluctuating incomes, as they have no flexibility or transparency. Many policies lapse in the first few years, and investors are unaware that they could fail to get back even the money they have paid in (Personal Investment Authority, 1996; Kempson and Whyley, 1999a; Office of Fair Trading, 1999a, 1999c; HM Treasury, 1999a).
- 4.24 As already noted, most home contents policies are poorly suited to the needs of low income consumers. High minimum sums insured, high excesses and a move away from indemnity insurance and catastrophe-only cover all act as barriers to the take-up of policies (Office of Fair Trading 1999a, 1999c; Whyley et al., 1998).
- 4.25 While other forms of private insurance – and those covering unemployment and ill health, in particular – cannot easily accommodate people who are most at risk of needing them. This could have far greater significance for exclusion when the majority of people take out cover of this kind (as opposed to a minority at present) and if there are further shifts towards the privatisation of welfare (Bennett, 1995;

Office of Fair Trading, 1996; Burchardt and Hills, 1997; Association of British Insurers, 1999a; Kempson et al., 1999)

- 4.26 As with life insurance, the main difficulty with private pensions is their inflexibility and lack of transparency. Many of those without a pension said that these two factors played an important part in their decision not to take one out (Pegram Walters Associates, 1995; Office of Fair Trading, 1997; Age Concern, 1998; Hedges, 1998; Rowlingson et al., 1999; Wood, 1999).
- 4.27 Finally, it has been noted by several studies that there is a lack of financial products that meet the Islamic teachings, which forbid the receipt or payment of interest (Burton, 1996; Herbert and Kempson, 1996; Kempson, 1998; HM Treasury, 1999a; Office of Fair Trading, 1999d).

Affordability

- 4.28 Affordability is a major obstacle to use of financial services among people with low disposable incomes. Not only do people on low incomes have little discretionary income for savings, insurance, credit or pensions, but it is also often the case that they pay more for financial services than others that are better off. Premiums for insurance are often higher (Whyley et al., 1998; Speak and Graham, 2000). The sources of credit to which they have access cost a great deal more (Kempson et al., 1994; Rowlingson, 1994; Sterling, 1995; Ford and Rowlingson, 1996; Herbert and Kempson, 1996; Kempson, 1996; Burrows, 1999; Kempson and Whyley, 1996b, 1999a; Speak and Graham, 2000). A survey of savings and investments for low-income consumers concluded that *'the less money you have to save and invest, the more likely you are to pay a premium for the industry's savings and investment products – if you have access to them at all.'* (Vass, 1997).
- 4.29 A related aspect of affordability, is the lack of options for people without a bank account to spread the costs of home contents insurance – a factor that was an important deterrent to people with low disposable incomes taking out a policy (Whyley et al., 1998).

Financial literacy

- 4.30 There is an extensive research literature on financial literacy, which shows that consumers, generally, often lack the information they need to make decisions about the purchase of financial products. While for most people this is a question of making informed choices about a range of products that are on offer, for a minority of people lack of knowledge is a barrier to the use of financial services at all. Here it is not just a matter of feeling confident about buying the right product, but more that they either do not know what sort of products are available or where to go to buy them (National Consumer Council, 1995, 1999; Herbert and Kempson, 1996; Bayliss, 1997; Personal Investment Authority, 1997; Vass, 1997; Hedges, 1998; Kempson, 1998; Kempson and Whyley, 1999a; Office of Fair Trading, 1999d).
- 4.31 Even among very young children it is possible to identify some important differences in financial literacy between those from low-income families and those whose families are wealthier. Children from low-income families have few opportunities to see the role that financial institutions can play in the management of money. They do not see their parents use non-cash methods of payment and some do not even see their parents using banks. If they have savings of their own, it is much more likely to be held in piggy banks or other informal ways than it is to be in a bank or building society account. In contrast, children from wealthier backgrounds have more opportunities to gain firsthand experience of banks and other financial institutions. They are able to watch their parents use them and are also much more likely to have an account of their own than their peers on lower incomes (Loumidis and Middleton, 2000).

- 4.32 It has been argued that the education system contributes to financial exclusion by its failure to prepare young people for dealing with financial matters (Building Societies Association, 1999a). Certainly the consumer survey undertaken by the Office of Fair Trading found that the level of education was strongly associated with the ownership of financial products (Office of Fair Trading, 1999c) as did a study of financial exclusion using the *Family Resources Survey*. Indeed, education remained significant even allowing for the lower incomes of people with only a basic school education (Kempson and Whyley, 1999a).
- 4.33 Access to information has been shown to be very unequal, and, perhaps more importantly, there are variations between localities that are a function of social class (Pratt et al., 1996a, 1996b; Thrift and Leyshon, 1997; Leyshon et al., 1998). This geographical dimension is important as there is widespread evidence that people often rely on relatives, friends and neighbours for information and advice about important decisions, which ‘creates a vicious circle among excluded groups’ (National Consumer Council, 1995).
- 4.34 It has also been concluded that much of the literature produced by financial service companies is not written in ‘plain’ English and has, in any case, been written as a public relations exercise and not to inform prospective purchasers (Pegram Walters Associates, 1995; Green et al., 1996; Wood, 1999).

Psychological barriers and mistrust of suppliers

- 4.35 Linked to a lack of knowledge is a widespread mistrust of financial services companies among people who are on the margins of financial services (Personal Investment Authority, 1997; Leyshon et al., 1998; Kempson and Whyley, 1999a).
- 4.36 Banks are seen as being disinterested in people living on low incomes, although building societies are sometimes seen in a more positive light (National Consumer Council, 1995; Herbert and Kempson, 1996; Pratt et al., 1996a, 1996b; Kempson and Whyley, 1999a; Kempson and Jones, 2000). A significant proportion of people on low incomes chose to save money by a range of informal means, simply because they thought that bank or building society staff would look askance at the small amounts they had to pay into their account (Kempson, 1998).
- 4.37 It is, perhaps, insurance companies that have the most negative image. There is, for example, a widespread belief among people who are financially excluded that insurance companies are often reluctant to pay when claims are made (National Consumer Council, 1995; Whyley et al., 1998; Kempson and Whyley 1999a; Office of Fair Trading, 1999d). Press coverage of the mis-selling of pensions and endowment policies has made many people wary of taking out a private pension. Also people who have little money to invest, are even more risk-averse than other consumers (Pegram Walters Associates, 1995; Age Concern, 1998; Hedges, 1998; Rowlingson et al., 1999; Wood, 1999).

Language and cultural factors

- 4.38 Several studies point to language and cultural barriers, especially for people from the Pakistani and Bangladeshi communities (FSA 2000). These cover: financial services generally (Kempson and Whyley, 1996b, 1999a; Office of Fair Trading, 1999d); banking (Herbert and Kempson, 1996; Kempson and Whyley, 1998); savings (Kempson, 1998); pensions (Burton, 1996; Kempson, 1998); and consumer credit (Herbert and Kempson, 1996). This is especially the case for first generation immigrants with poor levels of literacy in English and little prior experience of financial services. These language and cultural differences act as barriers in their own right, restrict levels of knowledge of financial services and fuel mistrust of UK financial service providers.

Impact of government policy and regulation

- 4.39 The final set of barriers to financial inclusion relate to government policy and regulation.
- 4.40 First, money laundering regulations have had the unintended effect of denying access to banking. It has been the practice of many banks and building societies to rely primarily on driving licences and passports as proof of identity and residence. This not only disadvantages people on low incomes, who frequently have neither (Building Societies Association, 1999a; Burrows, 1999; Kempson and Whyley, 1999a; HM Treasury, 1999a), but has also been interpreted as evidence of racism by ethnic minorities (Herbert and Kempson, 1996). Even widening the acceptable documents to include household bills disadvantages both women, who often do not have bills in their name but in their husbands,' and homeless people (Burrows, 1999).
- 4.41 The regulation of savings and investment product selling has also had the unintended consequence of restricting access. The level of training needed by sales staff and the time needed to conduct a full 'fact-find' has led to poor value for consumers who have only small amounts to invest (Personal Investment Authority, 1996; Burchardt and Hills, 1997; Vass, 1997; Office of Fair Trading, 1999a). It has also had an adverse effect on the economics of home service companies (Whyley et al., 1998; Kempson and Whyley, 1999a; Insurance Trends, 1999).
- 4.42 Social security regulations on means testing – both income and capital – also clearly play an important part in deterring people from taking out a pension, if they can afford to invest only small amounts (Hedges, 1998; Wood, 1999). Indeed, it has been argued that pension companies might be negligent if they sold a pension to someone who would later benefit little from it through means testing (Association of British Insurers, 1999a).
- 4.43 Finally, the fact that social security benefits are mainly collected in cash – in contrast to wages which are predominantly paid by automated cash transfer – has been shown to have a significant effect in encouraging people to be unbanked and in financial exclusion more generally. Statistical modelling has found that households reliant on means-tested benefits have a greatly reduced engagement with banking and with financial services generally than similar households with low incomes from other sources (Kempson and Whyley, 1996b, 1998, 1999a).

5 The consequences of financial exclusion

- 5.1 Financial exclusion is not a new problem, there has always been a group of people without access to a wide range of financial products and, in fact, it now affects a smaller proportion of households than used to be the case (Kempson, 1994; Whyley et al., 1998). However, the consequences of not having access to key financial products – a bank account, consumer credit, savings or insurance – are much more serious now than they were in the past. Being part of a small minority who are outside mainstream financial services creates a new set of difficulties. On the whole, the options for operating a household budget outside the mainstream financial services sector are far more costly and often unregulated. Moreover, where whole communities have limited access to financial products, the process becomes self-reinforcing and an important contributor to social exclusion more generally.

Banking facilities

- 5.2 Being without banking facilities has become increasingly problematic as the vast majority of people now make heavy use of a bank account and the facilities for automatic transactions that this provides. Lack of access to a bank account and banking facilities can make money management more complex and time-consuming, more costly and less secure. It is important to recognise that the consequences of being without banking facilities do not simply apply to those who have no current account at all. They can be equally relevant to people who have a basic bank or building society account, but are not given access to additional banking facilities such as direct debits, overdrafts and credit or debit cards. These consequences impact on three main areas of people's lives:

- handling cash and cheques;
- paying bills;
- access to short-term credit facilities and other financial products that require ownership of banking facilities.

Handling cash and cheques

- 5.3 One of the top priority needs for financial products that have been identified by financially excluded households is for an account to receive income and make payments. In addition, the same research has found that needing to cash or issue a cheque can be very problematic for people without a bank account (Kempson and Whyley, 1998; 1999a).
- 5.4 Accepting a job may be more difficult, as employers increasingly require workers to have their wages paid directly into a bank account. This is certainly perceived as a barrier to obtaining a job by financially excluded households (Burrows, 1999; Kempson and Whyley, 1999a; Speak and Graham, 2000).

- 5.5 Being without a bank account also means that people may lack a secure place to keep money until they are ready to spend it. Keeping cash at home makes people very vulnerable to burglary (Whyley et al., 1998; Kempson and Whyley, 1999a).
- 5.6 People without bank accounts also have problems if they receive or need to make a payment by cheque. Since the 1992 Cheque Act, most cheques are automatically crossed 'A/C payee only' so that only the person named on the cheque can cash them. People without banking facilities either had them made out in a relative's name, or paid them into a relative's account, so that the relative could give them the cash (Kempson and Whyley, 1998; 1999a). While few people have identified problems with this method of handling cheques, it is less secure and means they are heavily reliant on the honesty of a third party. Other people have to use one of the growing network of cheque cashers that have opened since the 1992 Act (Kempson and Whyley 1998; 1999). This service, while convenient, is relatively costly with typical fees ranging between 7% and 9% of the value of the cheque, plus a flat fee of around £2.
- 5.7 In addition, a surprising number of people have to 'buy' cheques when they need to make payments, usually from family or friends (Kempson and Whyley, 1998; Speak and Graham, 2000).
- 5.8 Finally, many people from minority ethnic groups remit money to their families overseas. Those without an account tend to use remittance or foreign exchange agents whose fees range from reasonable to almost extortionate (Herbert and Kempson, 1996; Kempson and Whyley, 1998).

Bill payment

- 5.9 While basic transactions can be costly and insecure for people without banking facilities, they are much less frequent than bill-payment. Payment of household bills now relies heavily on having access to a bank or building society account and the majority of households pay their bills in this way. In contrast, people without a current account employ a range of bill-payment methods, including paying in cash at a post office or a bank branch, using pay-as-you-go methods such as pre-payment meters or buying savings stamps (Kempson and Whyley, 1998).
- 5.10 Householders without a current account tend to manage bill payment in two main ways (Kempson and Whyley, 1998). Some set money aside towards quarterly bills, allocating a separate envelope or container for each bill, and then pay their bill in one go. Others prefer to spread annual or quarterly bills by making frequent cash payments on a weekly or fortnightly basis.
- 5.11 There are several consequences to having to pay bills in this way. First, keeping cash at home, or carrying cash to a post office or bank in order pay a bill, is insecure and research has highlighted examples of people losing all their bill money as a result of theft (Kempson and Whyley, 1999). There have also been examples of people losing savings stamps they had bought towards a bill and, as there is no separate record of this expenditure, people have no option but to start all over again. (Whyley et al., 1998).
- 5.12 Secondly, paying bills in cash can be very time-consuming and complex. The number of outlets for paying bills in cash has been decreasing and people have to travel further to settle them. This is particularly problematic for people who are making payments towards a number of different bills on a frequent basis who may end up making multiple journeys to a range of outlets.
- 5.13 Most important, however, is the fact that bill payment is much more expensive for people who pay in cash, particularly if they make frequent payments or use a pre-payment meter (Kempson and Whyley, 1998; Whyley and Kempson, 1998). While many utility companies absorb the costs of paying bills at post offices, others do not. The new network of PayPoint outlets, however, do not charge the customer.

- 5.14 Moreover, cash payment of bills excludes these people from discounted tariffs for energy, which are only available to those people paying by direct debit (Kempson and Whyley, 1998; Whyley and Kempson, 1998; Speak and Graham, 2000).
- 5.15 Kempson and Whyley (1998) found that being unable to pay bills by direct debit can add up to £46 a year to an average gas bill. In addition, people who make fortnightly cash payments towards their gas bills could incur handling charges of up to £24 a year, and those who pay weekly face charges amounting to £48 a year. Further, pre-payment meter customers could pay as much as £80 a year more for their gas on average levels of use.

Access to other financial products and services

- 5.16 A bank account can also act as a passport to a range of other financial products and services (Kempson and Whyley, 1998; Kempson and Whyley, 1999a). These include short-term credit facilities that are often provided alongside a bank account, such as an overdraft facility or credit card. Even credit facilities that are separate from bank accounts, such as personal loans or HP agreements, are based on score cards where not having a current account increases the chances of rejection. This means that access to mainstream credit facilities can be severely constrained for people who do not have access to a bank account. The consequences of this are explored further in the section on credit, below.
- 5.17 In addition, a number of other financial products and services require consumers to have access to a bank account. Many insurance policies, for example, are only available to people who can pay for them by cheque or direct debit (Whyley et al., 1998). Facilities for cash payment of insurance premiums are rare, except through the dwindling number of home service companies. It is even more unlikely that people can make frequent cash payments for a policy taken out with any of the mainstream insurance companies. In addition, an increasing range of products and services are now sold directly to consumers by telephone or even via the Internet (Leyshon et al., 1998). Access to these products is dependent on having either direct debit facilities, a credit or debit card, or sometimes both (Whyley et al., 1998; Kempson and Whyley, 1998; 1999a; Ludgate Public Affairs, 1999).

Credit facilities

- 5.18 People in general use credit facilities in two main ways. Short-term credit, such as an overdraft or credit card, is often used to smooth the peaks and troughs that occur in household budgets. While other types of credit, such as personal loans or hire purchase, are more commonly used to purchase larger items such as consumer durables or cars.
- 5.19 People who do not have access to these facilities, the ‘passport’ to which is often a bank or building society account, have to find other ways of making ends meet. As mentioned in Section 3, these people fall into two main groups. First, people with poor credit records or a history of bad debt, who are forced to turn to non-status lenders to fulfil their credit needs. Secondly, people living on low incomes who often have to look to alternative credit providers, such as moneylenders and pawnbrokers, to make ends meet. Both these groups of people are particularly vulnerable, as they have no option but to borrow from lenders operating outside the mainstream credit industry, some of whom are less scrupulous in their lending practices.

The consequences of borrowing from non-status lenders

- 5.20 As discussed in Section 3, the non-status lending market comprises financial institutions that cater specifically to people for whom mainstream lending practices are, more or less, suitable, but who do not have a good enough credit rating to gain access to them.

- 5.21 People who borrow from non-status lenders face two major consequences. The first is the higher price charged by these companies, to cover the additional risks associated with their customer base. Within the non-status market, the least respectable institutions, whose customers are often in the most serious financial difficulty, lend at much higher interest rates than the companies at the more respectable end of the market.
- 5.22 The second, and most serious, consequence is related to the customer's ability to repay the money they have borrowed. As loans from non-status lenders are frequently secured on the borrowers' property, the ultimate sanction for repayment default is the repossession of their home. More worryingly, there is concern that some less reputable institutions specifically target vulnerable people and encourage them to take out loans that they are unlikely to be able to repay. Typically this is equity lending, that is the loan decision is made on the basis of the level of equity against which the loan is secured and not on the likelihood of the borrower repaying the loan (Kempson and Whyley, forthcoming).

The consequences of borrowing from alternative credit providers

- 5.23 Households on a low income regularly help one another out at the end of the week or fortnight. Few, however, have someone they can turn to for larger sums in an emergency, such as an unexpectedly high bill. People in these circumstances often have little choice but to use moneylenders or pawnbrokers and, consequently, to pay their high charges (Kempson and Whyley, 1999a). Licensed moneylenders, for example, may charge APRs of between 100% and 500%, depending on the size and length of the loan (Rowlingson, 1994; Kempson and Whyley, 1999).
- 5.24 There are some groups of people to whom even licensed moneylenders are reluctant to lend, including lone parents, the long-term unemployed, hostel dwellers and people living in high crime areas (Rowlingson, 1994; Burrows, 1999; Speak and Graham, 2000). These groups are particularly prey to illegal or unlicensed moneylenders who operate outside any regulatory boundaries. Unlicensed moneylenders lend almost exclusively to people who need money to make ends meet, usually making weekly or fortnightly loans at very high rates of interest. As well as the high costs of this type of credit, there is evidence of very worrying practices among unlicensed moneylenders, such as aggressive and intimidating behaviour (Burrows, 1999; Kempson and Whyley, 1999).
- 5.25 In addition, people with limited access to credit often face difficulties accommodating 'lumpy' items of expenditure within a tight household budget, such as buying or replacing household goods and buying more expensive items of clothing (Kempson and Whyley, 1999a; Speak and Graham, 2000). Those lacking access to high street credit typically have two choices. Some use credit sources with very high charges. For example, a new washing machines which costs £280 cash will typically cost £470 if bought with a loan from a licensed moneylender, or £438 if bought from a mail order catalogue over 100 weeks (Speak and Graham, 2000). Others use credit through a third party – usually putting it in the name of a relative (Kempson and Whyley, 1999a).
- 5.26 As well as these difficulties, people without access to in-store consumer credit cannot take advantage of the interest-free repayment arrangements often available for larger consumer durables.

Insurance

- 5.27 In a society where private insurance is being used to protect individuals against a growing range of risks, lacking access to appropriate and affordable insurance products becomes increasingly problematic. The problems associated with financial exclusion currently relate only to particular types of insurance, such as home contents insurance, life insurance and mortgage payments protection insurance. The other types of insurance, such as health insurance and long-term care insurance are still relatively new and tend to be

used only by the more affluent groups in society. However, if existing patterns of insurance provision continue, and these newer types of insurance become more commonplace, insurance exclusion will increase. The full consequences of exclusion from these types of insurance provision are yet to be seen.

- 5.28 If some people in society are able to insure themselves against unforeseen events such as fire, burglary, loss of income due to ill health or job loss, and the need for long-term care, while others cannot obtain such cover the inequity this creates will further compound the effects of financial and, ultimately, social exclusion. The situation is worsened if those people who are most vulnerable to experiencing these events are also those who are unable to insure themselves against them. In the context of welfare reforms, which place a greater onus of responsibility on individuals to protect and provide for themselves through private insurance, there is even greater cause for concern. It is likely that a small, but extremely vulnerable group of people could be left without either state support or private insurance. Further, research indicates that the people who are most likely to be excluded from insurance products also tend to have the lowest incomes, and are without either savings or access to banking facilities that might provide them with short-term credit. Consequently, their strategies for coping with these unforeseen events are likely to be extremely constrained.
- 5.29 A number of research studies have highlighted the consequences of exclusion for people who are unable to gain access to insurance. People who are unable to obtain insurance are deprived of the peace of mind associated with knowing that they have a safety net, should they need one. For example, Whyley et al. (1998) found a small group of highly insurance conscious people who were unable to obtain home contents insurance because they lived in such high risk areas. The knowledge that they were at risk of being burgled but were unable to protect themselves against it was a source of constant anxiety for some (Whyley et al, 1998).
- 5.30 Other research has shown the heightened anxiety experienced by parents, should they fall ill or die, who have been unable to take out life insurance to provide for their children (Kempson and Whyley, 1999a). This was particularly the case for lone mothers who were no longer in contact with their children's fathers, who were acutely aware that their children could be left without anyone at all to care for them.
- 5.31 Should an individual experience a risk that they have not been able to insure against, their options vary according to their circumstances. At one extreme, if a parent without family protection insurance dies, unless they have been able to make other financial provision for their family, or there are relatives who can offer financial support, it is likely that the whole burden of future support will fall on the state (HM Treasury, 1999a).
- 5.32 The consequences of being without other types of private insurance, such as home contents insurance or mortgage payments protection insurance are less stark, but can be equally damaging. State support for mortgagors who suffer loss of income, or for people who experience a fire, flood or burglary, is increasingly limited. Mortgagors who are in receipt of Income Support or Job Seekers Allowance can receive payments to cover their mortgage interest, but this system was cut back in 1995. Currently, people who have taken out a mortgage prior to 1995 are not eligible to receive any payments at all for eight weeks, can get up to 50% of their mortgage interest for the following 18 weeks and, only then, are eligible to have their mortgage interest paid in full. Provision for post-1995 mortgagors is even less generous. They receive no assistance at all for nine months, and then receive their full eligible interest.
- 5.33 Uninsured people who suffer a fire, flood or burglary and who are unable to meet their losses from existing resources could, perhaps, apply for a Social Fund Crisis Loan. However, Social Fund Crisis Loans have strict eligibility criteria, are made on the basis of a system of priorities and the budget is capped both locally and nationally. Consequently, only 77% of Social Fund Crisis Loan decisions that were taken in 1998/9 resulted in a payment which was sometimes less than the applicant had requested (Department of Social Security Statistics, 1998/9).

- 5.34 Without either private insurance or state support, some people may be able to draw on existing resources such as their income or savings. Research has found that many mortgagors without mortgage payments protection insurance who suffered a loss of income due to redundancy or ill health were able to do this (Kempson et al., 1999). Around a third used savings they had put by, just over 1 in 10 used a redundancy payment, and 1 in 12 were able to cover their mortgage payments from earnings they had received in lieu of notice. Further, 1 in 20 cashed in other insurance policies to provide them with some additional income and one had sold his car in order to cover his mortgage repayments (Kempson et al., 1999).
- 5.35 The high proportion of low-income households and people with no savings among those without home contents insurance means that this is rarely an option for them (Whyley et al, 1998).
- 5.36 Some people who suffer losses as a result of an event that they have been unable to insure themselves against may be able to borrow from their friends or family. However, as people's social and family networks tend to comprise others with similar circumstances to their own, it is more likely to be an option among people from better-off households. For example, more than a third of people without mortgage payments protection insurance borrowed from informal sources while they were waiting for their entitlement to Income Support/Job Seekers Allowance mortgage interest payments to begin (Kempson et al., 1999). The same evidence suggests that the longer the waiting period is, the more people are likely to turn to friends and family for financial help. More than two in five post-1995 borrowers did this compared with just one in three pre-1995 mortgagors.
- 5.37 A small number of people without home contents insurance had been able to replace items that had been lost or damaged as a result of help from friends and family (Whyley et al., 1998). However, it was much more limited as few people knew of others who were in a position to offer financial help. Consequently, this strategy was only used to enable people to replace a few essential items, rather than cover all their losses.
- 5.38 In these circumstances, people are faced with two options. They could try borrowing to cover their losses, although many will have constrained access to credit. In addition, taking on credit commitments at a time when they are already vulnerable will be a risky strategy for some people as meeting the repayments could add to financial hardship. Finally, they may simply have to accept the fact that they cannot cover their losses and live with the consequences. These can, however, be severe.
- 5.39 Kempson et al. (1999) found that a third of people without mortgage payments protection insurance who were waiting for assistance from the state having suffered a loss of income had been unable to avoid mortgage arrears. By the time they qualified for help, the proportion had increased to 44%. A small number had had their homes repossessed. A further one in two were suffering financial difficulties.
- 5.40 Some people without home contents insurance who had suffered a fire, flood or burglary faced serious hardship (Whyley et al., 1998). One man had had to cut down on food and heating in order to replace cooking equipment that had been stolen. Another woman who had had consumer goods, jewellery, some of her children's toys and her Child Benefit book stolen felt she had never fully been able to regain her financial security.

Pensions

- 5.41 The obvious consequence of having made no, or inadequate, pension provision is the much greater risk of poverty and hardship in old age. Like other aspects of financial exclusion, however, the impact of exclusion from pensions is heightened because paying into private pension funds – either through an occupational scheme or with a personal pension – is increasingly becoming the norm. Recent figures suggest that approximately 83% of all employees are members of an occupational pension scheme or

have personal pensions (Budd and Campbell, 1998). A MORI survey found that, of all adults in the population, around 54% had made some private pension provision (MORI, undated). (See Section 3 for more detailed figures.) As a result, the consequences of being without a private pension do not just relate to the hardship suffered by individuals, but result from the growing inequality between current pensioners. These patterns of inequality are set to worsen if existing trends continue unchecked.

- 5.42 The Joseph Rowntree Foundation Inquiry into income and wealth found that it *'can no longer be assumed that all pensioners are poor... nor can it be assumed that there are no longer poor pensioners'* (Joseph Rowntree Foundation, 1995: p.28). While a significant proportion of younger pensioners were entering retirement with private pension provision, the research identified a 'substantial minority' who were heavily reliant on the social security system. The fact that this group is shrinking does nothing to alleviate the problem, as the reduction in the number of pensioners falling into this category has been accompanied by a striking increase in the extent of the inequality between them.
- 5.43 In fact, the research found that, despite a 30% increase in pensioners income between 1979 and 1989, pensioners were still disproportionately represented in the poorest half of the income distribution by the mid-1990s. This is because the overall growth in pensioner's incomes has masked the variety of experiences within the pensioner population. The distinction between those with private pension provision and those without is becoming ever more marked.
- 5.44 The disparity between the incomes of older and younger pensioners has grown as more people who have recently entered retirement have made private pension provision to supplement the state pension. In 1990-91 nearly two-thirds of people aged 75 or over were in the poorest three-tenths of the income distribution (Joseph Rowntree Foundation, 1995). However, inequalities between younger pensioners have also grown.
- 5.45 The Joseph Rowntree Foundation Inquiry found that, while fewer pensioners with private provision had lower incomes than those reliant on the state retirement pension, the 44% that had private pensions were not significantly better off than those without. By 1998/99, however, 55% of pensioners had private pension provision and their incomes were both higher and more dispersed than those without. Pensioners reliant on state provision, on the other hand, were more narrowly concentrated around the same real income level as had been the case ten years previously.
- 5.46 Those without any private pension provision are forced to rely totally on a state retirement pension linked to prices, rather than incomes, which may need to be topped up with means-tested social security benefits. This can be problematic for many older people, who are strongly resistant to claiming income-related benefits and who are prepared to face the stigma of doing so only as a last resort (see, for example, Finch and Elam, 1995). However, even the state retirement pension topped up with Income Support and other means-tested benefits is not intended to provide more than a basic minimum income that covers no more than essentials and has little leeway for unforeseen expenditure.
- 5.47 People who have made inadequate private pension provision, rather than none at all, also face a problem. People in these circumstances risk falling into the trap of having too small a pension on which to live comfortably, but too high an income from a private pension to qualify for state-benefits. As a consequence, they are little better off than those who have made no private pension provision at all. Also they must live with the knowledge that they have been penalised in old age for their thrift earlier on in life.
- 5.48 Pensioners who are unable to manage on the income they receive in retirement, like other financially excluded groups, face a very limited range of options. Those with private savings may be able to use them to supplement their income. However, evidence suggests that pensioners without private provision may also have been unable to accrue private savings (McKay, 1992). In addition, research shows that

many older people are extremely reluctant to run-down savings not least because it is very important to them to be able to leave a bequest to their family when they die (Rowlingson et al., 1999). Consequently, some prefer to endure hardship in their old age than deprive their family of an inheritance when they die.

- 5.49 Similarly, pensioners who are homeowners can supplement their income by selling their home and ‘trading down’ to a smaller property that is both cheaper to buy and to run. They can also take advantage of an equity release scheme, which would allow them to unlock some of their housing wealth. However, research has again found that some of the poorest pensioners are tenants and, therefore, must continue to pay rent long after homeowners have cleared their mortgages (McKay, 1992). In addition, many people were resistant to the idea of running down housing wealth, although some recognised that it might be necessary. Again, people wanted to leave their house for their family to inherit (Rowlingson et al., 1999). The same research showed even greater unease in relation to equity release schemes as people were not at all comfortable with the idea of a third party owning even part of their home while they still lived there.

Savings

- 5.50 The outcomes associated with not having savings are best viewed in two ways. First, the consequences of not having *formal* savings products and having to use informal methods. Secondly, the consequences of not having any savings at all.

Being without formal savings

- 5.51 Being without formal savings can be problematic in two respects. First, people who save by informal means rarely benefit from the interest rates and tax advantages that people using formal methods of saving enjoy. This is unlikely to be a major issue for most of the people involved, as the amounts of money they save are small. However, the inequity associated with people, who have the least amount of money to save, missing out on any of the benefits of doing so remains a cause for concern. Further, those who save in Rotating Savings and Credit Schemes (ROSCAS) or other informal associations often save quite significant amounts (Herbert and Kempson, 1994; Srinivasan, 1995; Sterling, 1995; Kempson, 1998).
- 5.52 The second potential problem is that informal savings are much less secure than formal savings facilities. People who keep cash at home are extremely vulnerable should they have a fire or burglary (Whyley et al., 1998; Kempson, 1998). Further, ROSCAS are unregulated and members rely totally on their trust in the ‘banker’ and the other members. While for the most part this is unproblematic, there have been cases where people have failed to get their turn of receiving the money put in. Moreover, because fairly large sums can be put into ROSCAS, members have commented that they are vulnerable when it is their turn to take the money as they have to carry large amounts of cash home (Kempson, 1998).

Being without savings altogether

- 5.53 The ultimate consequence of being completely without savings is the lack of the security and flexibility that most people have come to take for granted. Further, a lack of savings is particularly problematic when it is combined with restricted access to other financial products, as we have already seen.
- 5.54 In the absence of access to affordable credit, savings are the only means by which individuals can smooth the peaks and troughs in their household budget, cover unexpected expenditure or cope with emergencies. Further, without either savings or access to credit it is extremely difficult for people to purchase not just the consumer or luxury goods that the majority of people enjoy, but also basic household goods.

- 5.55 Without insurance cover, savings are the only real option available to meet the costs associated with unforeseen events, such as job loss, ill health, fire, flood or burglary, without resorting to the social security system or trying to obtain credit.
- 5.56 Similarly, savings are a particularly important resource for people to use to supplement their income in old age. For people without a private pension, savings could be the only thing that keeps them out of poverty.
- 5.57 Finally, research has shown that being without savings is a particular cause of concern among parents and, in particular, lone mothers. Some financially excluded people are acutely aware that they have no safety net to help them and their children through hard times or to give their children a ‘good start’ when they are older (Kempson and Whyley, 1999a). Equally, it is extremely important to parents to have money put aside to pay for children’s weddings, help them through higher education and, ultimately, leave as an inheritance (Rowlingson et al., 1999).
- 5.58 As with insurance, the consequences do not simply apply should people be in need of money but have no savings to draw on. The awareness that they did not have any financial security to act as a safety net can be an ongoing cause for concern.
- 5.59 However, as with pensions, there is a ‘savings trap’ that people who are only able to save very modest amounts may fall into should they need to claim social security benefits. The capital rules on most means-tested benefits mean that people with more than £3,000 in savings will only be entitled to a reduced amount of benefit or lose their benefit entitlement altogether. Consequently, some people with small amounts of money saved are no better off and, in fact, may be worse off than if they had no savings at all.

The impact on communities

- 5.60 The impact of financial exclusion is felt not only by those individuals and households who are directly excluded from financial services, but also by the wider communities in which they live.
- 5.61 First of all, the withdrawal of financial services from certain areas has been linked to deterioration of the built environment, limited economic growth and social problems (Leyshon and Thrift, 1994). For example, at the most basic level, the closure of an area’s only bank branch may lead to a decline in trade among local shops, as people go elsewhere to do their banking and shopping. But in addition, the lack of financial services in an area may deter small business start-up and inward investment. First evident in the USA, this process of decline has more recently been charted in the UK:

Holes are beginning to appear in the geography of retail financial services provision ... The emergence of these spaces of financial exclusion has important implications for uneven development ... for such spaces are associated with economic decline and attendant social problems such as poverty and deprivation.

(Leyshon and Thrift, 1995: p.313–14.)

- 5.62 Such uneven development often becomes entrenched because of the methods of risk assessment used within the financial services industry:

rich areas tend to get richer and poor areas poorer because of the way in which the financial system discriminates between people and communities on the basis of risk.

(Leyshon and Thrift, 1995: p.315.)

- 5.63 In turn (as mentioned in Section 2), the lack of ‘local knowledge’ among financial institutions about these areas can perpetuate a cycle of urban degeneration:

The loss of local information and knowledge may make financial institutions more cautious in their lending policy, because they will come to rely on national lending models, thus restricting the flow of new investment into the area.

(Marshall et al., 1999: p.9.)

- 5.64 Second, the fact that people who are financially excluded tend to be geographically concentrated in deprived neighbourhoods results in psychological barriers, such as mistrust of and resentment towards financial institutions, that are engendered in the community or neighbourhood as a whole (Kempson, 1997; Whyley et al., 1998; Kempson and Whyley, 1999; Speak and Graham, 2000). This means that some people not only have no experience of mainstream financial institutions themselves, but they also do not know anyone else who has. There is, then, no local base of information or knowledge about financial products or service providers.
- 5.65 In addition, the marketing strategies employed by financial institutions are often based on the same geographical information systems that determine access to products and services (Thrift and Leyshon, 1997; Leyshon et al., 1998). As a result, excluded households are isolated also from sales and promotional literature about products and services (Whyley et al., 1998; Kempson and Whyley, 1999a; Office of Fair Trading, 1999). All these processes are compounded as the number and complexity of financial products increase. Ultimately, the result is the ‘desertification’ (Thrift and Leyshon, 1997) of certain neighbourhoods and communities by mainstream financial services providers which is difficult, if not impossible, to reverse.

6 Financial exclusion in the United States

- 6.1 The problem of financial exclusion in the USA shares many of the features seen in the UK. This section therefore presents a brief overview of US research focusing particularly on exclusion from deposit accounts, mainstream consumer credit products, savings-oriented life insurance policies and pension accounts.¹ It covers the extent of financial exclusion, types of households excluded, the factors that cause them to be excluded, the adverse effects of exclusion and, finally, the main public- and private-sector responses to the problem.

The extent of financial exclusion

- 6.2 The most carefully constructed nationally-representative survey of household finances in the US is the Survey of Consumer Finances (SCF). The Board of Governors of the Federal Reserve System sponsors this survey, which is conducted every three years. The most recent survey, conducted in 1998, asked 4,309 families extensive questions about their assets and liabilities.² In January 2000, the *Federal Reserve Bulletin* published preliminary results from the survey (Kennickell et al., 2000). The 1998 data set will only be released to the public for additional analysis in February 2000. Consequently, most surveys have been based on the earlier, 1995, data.

Deposit accounts

- 6.3 In the US, commercial banks, savings banks, savings and loans and credit unions provide checking and savings accounts to the public. There is no post office savings system. Owners of checking or savings accounts (generically called ‘transaction accounts’ or deposit accounts) receive two services – a savings service and payment service. Payment services include the ability to deposit a cheque drawn on another bank, to receive electronic deposits, to write cheques, to withdraw cash from ATM machines, to use a debit card for retail purchases and to initiate electronic payments.
- 6.4 Table 6.1 shows that in 1998 about 9.5% of all families were without transaction accounts of any kind. This represents about ten million families. Interestingly, there was a marked decline in the percentage of families without deposit accounts between 1995 and 1998. In 1995, 12.5% of families were without such accounts.³

1 There is a large literature on the access that low-income and minority households have to mortgage credit. This section does not review that literature as, to do so fairly, would greatly extend the length of this survey. Moreover, the Urban Institute (1999) recently completed a study that covers much of this material.

2 A ‘family’ can consist of one adult individual living alone or an unmarried or married couple, as well as all other persons living in the household who are financially dependent on that person or those persons.

3 Data from a large 1994 household survey, the Panel Study of Income Dynamics conducted by the University of Michigan Survey Research Center, indicate that 20.2% of US households were without deposit accounts in that year (Hurst et al., 1998). No researchers have yet offered an explanation for why such a large difference exists across the two data sets.

Table 6.1: Percentage of families without deposit accounts

Family characteristic	1995 Survey %	1998 Survey %	Median value transaction accounts among households with accounts, 1998
<i>All families</i>	13.0	9.5	3,100
<i>Income (1998 US dollars)</i>			
Less than 10,000	40.8	38.1	500
10,000-24,999	17.7	13.5	1,300
25,000-49,999	6.6	4.2	2,500
50,000-99,999	1.3	0.7	6,000
100,000 and more	0.2	0.0	19,000
<i>Age of head (years)</i>			
Less than 35	19.6	15.4	1,500
35-44	12.8	9.5	2,800
45-54	11.2	6.5	4,500
55-64	11.6	6.1	4,100
65-74	8.7	5.9	5,600
75 or more	6.8	10.3	6,100
<i>Race or ethnicity of respondent</i>			
Non-white or Hispanic	31.9	24.2	1,500
White non-Hispanic	7.5	5.3	3,700
<i>Current work status of head</i>			
Working for someone else	10.4	7.3	2,700
Self-employed	8.5	4.6	6,300
Retired	13.4	12.8	5,000
Other, not working	41.9	30.9	1,000
<i>Housing status</i>			
Owner	5.0	3.8	5,000
Renter or other	27.6	20.8	1,100
<i>Percentiles of net worth</i>			
Lowest 25%	36.3	27.9	600
25-49.9	10.9	8.6	1,700
50-74.9	3.9	1.5	4,800
75-89.9	1.3	0.3	10,500
90-100	0.3	0.0	23,000

Source: 1998 Survey of Consumer Finances (Kennickell et al., 2000).

Table 6.2: Percentage of families with home-secured and instalment loans

Family characteristic	Home-secured %	Instalment %
<i>All families</i>	43.1	43.7
<i>Income (1998 US dollars)</i>		
Less than 10,000	8.3	25.7
10,000-24,999	21.3	34.4
25,000-49,999	43.7	50.0
50,000-99,999	71.0	55.0
100,000 and more	73.4	43.2
<i>Race or ethnicity of respondent</i>		
Non-white or Hispanic	30.7	41.6
White non-Hispanic	46.7	44.3

Source: 1998 Survey of Consumer Finances (Kennickell et al., 2000).

- 6.5 The socio-economic groups that were most likely to be without transaction accounts were consistent across the 1995 and 1998 surveys. Table 6.2 shows that families without deposit accounts were disproportionately likely to have low incomes, to be headed by a person younger than 35 years or older than 75 years, to be headed by an unemployed person, to have a non-white or Hispanic respondent and to be in the bottom 25% of the wealth distribution. In the 1995 survey, among families with incomes 80% or less of median household income, 24.2% were without transaction accounts (Hogarth and O'Donnell, 1999). Of those who did have accounts, they were much more likely to have a checking account than a savings account. While 27.9% were without checking accounts, 74.6% were without savings accounts.
- 6.6 Two studies, using different non-SCF data sets, have examined changes in individuals' account ownership over time. Hurst et al. (1998) found that of households with deposit accounts in 1989, 9% were without accounts in 1994. Of households without accounts in 1989, 6% had acquired one by 1994. Caskey (1997a), in a telephone survey of 900 families with household incomes of \$25,000 and below, found that 22.1% were without deposit accounts of any type. Of these, 70.7% reported that they had previously had a deposit account.
- 6.7 Families without deposit accounts are highly unlikely to own any other financial asset, with the exception of cash-value life insurance or employer-provided pension accounts. As Hogarth and O'Donnell (1999) report, using data from the 1995 SCE, among households without deposit accounts, only 1.4% had a certificate of deposit, and only 0.7% had a retirement account independent of an employer (an 'Individual Retirement Account' or 'Keogh' account). However, 34% reported that they had life insurance policy of some type.

Mainstream consumer credit

- 6.8 Households in the US typically use three types of credit: home-secured loans; installment loans; and revolving credit card loans. Home-secured loans are used to finance home purchases and to borrow against the equity in a family home.⁴ Instalment loans, which generally have fixed periodic payments over a fixed term, typically finance automobile purchases, higher education tuition, purchases of furniture and other consumer durables, and personal loans for unspecified purposes.
- 6.9 As in the UK, it is common for lenders to ‘score’ loan applicants using a statistical model that draws on computerised credit histories. Lenders typically classify the applicants in broad categories, such as A, B, C or D with further gradations indicated by plus and minus signs. Applicants in category A are labelled ‘prime’ borrowers, and ‘A–’ and ‘B’ applicants are labelled ‘subprime’. Those in C and D are frequently labelled ‘sub-subprime’. Over the past two decades, computerised databases and scoring methods have enabled lenders to classify loan applicants with greater accuracy. There has been a corresponding increase in the number of ‘mainstream’ lenders willing to extend credit to subprime applicants and even to the highest ranked sub-subprime applicants. Mainstream lenders include depository institutions and large non-bank financial institutions, such as mortgage companies and finance companies. Institutions extending credit to subprime borrowers charge a higher interest rate than prime borrowers pay since there is a greater default risk and a higher cost associated with the close monitoring that generally accompanies subprime loans.
- 6.10 The significant increase in subprime lending by large financial institutions has greatly increased the access of low-income households to mainstream credit. Nevertheless, as shown in Table 6.2, low-income households are substantially less likely to have home-secured loans than are other households and they are somewhat less likely to have instalment loans. In addition, the 1995 SCF found that 66.5% of households owned at least one major credit card (MasterCard, Visa, Optima, Discover) (Hogarth and O’Donnell, 1999). However, among low-income families (defined as families whose income is 80% or less of the median household income), 44.6% had a major credit card in 1995. Among low-income families without deposit accounts, only 7.7% owned a major credit card.
- 6.11 These basic descriptive data have two limitations. First, they do not indicate whether or not the lower incidence of credit to low-income households is caused by a lower level of loan applications from this group or by a higher level of loan denials. Secondly, they do not indicate the extent to which low-income or minority households, who do get credit, are confined to the higher-cost subprime or sub-subprime sectors.
- 6.12 The only credit market for which there have been careful studies of application rates and denials is the home mortgage market. This is because this is the only market with minimally sufficient data for researchers, and access to mortgage credit is particularly important for most families. Table 6.3, constructed from data from the Federal Financial Institutions Examination Council, shows that mortgage denial rates are higher for low-income households and households headed by racial or ethnic minorities. In response to the second issue, whether or not low-income and minority households are disproportionately represented in the higher-cost subprime market, available evidence (again, only from the mortgage market) supports a strong affirmative answer. A recent Federal Reserve study of mortgage lenders reported that subprime loans were disproportionately represented among low-income census tracts and among census tracts with high percentages of black or Hispanic families (Canner and Passmore, 1999).

4 Beyond their use in financing home purchases, home-secured loans are popular because the interest rates are comparatively low and because the federal government allows homeowners to deduct interest payments of home-secured loans from personal income in determining ‘taxable’ income.

Table 6.3: Disposition of 1998 applications for conventional home-purchase loans

Family characteristic	Percentage applications denied %	Cited reason for denial: credit-history %	Debt-to-income ratio %	Other, or information not available %
Income				
Less than 50% of MSA ^a median	45.5	43	19	38
50-79% of MSA median	30.4	44	16	40
80-99% of MSA median	21.6	41	16	43
100-119% of MSA median	16.6	39	16	45
120% or more of MSA median	10.0	33	15	52
Race or ethnicity of loan applicant				
White	26.0	50	13	37
Black	53.7	59	10	31
Hispanic	38.7	50	13	37

a MSA is the metropolitan statistical area.

Source: Website of the Federal Financial Institutions Examination Council (www.ffiec.gov).

Pensions and savings-oriented life insurance

- 6.13 Almost all adults received social security payments once they reach retirement age. The level of payments individuals receive depends on the contributions that they (and their spouse) made to the system over their working life. Consequently, retired people with higher working-year incomes receive higher social security benefits than do those with lower working-year incomes. But the working-income replacement rate is progressive. Social security will replace on average about 56% of a low income worker's salary, about 42% of a person with median wages, and about 25% of a person with high wages.
- 6.14 About 50% of families have individual or employment-based pensions in addition to social security (Kennickell et al., 2000). Broadly, employer-based pensions are of two types – defined-benefit and defined-contribution. Defined-benefit pensions typically provide an annuity income at retirement based on workers' salaries and years of service. Defined-contribution pensions are tax-exempt investment accounts from which a retired person can draw. The value of the account depends on the amount contributed during working years and the investment performance of the account. Typically, employees with defined-contribution accounts can choose among a variety of investment alternatives for their pensions. Among current employees with employer-based pensions, 79.4% have defined-contribution accounts, 42.9% have defined-benefit accounts and 22.3% have both. In addition to employer-based pensions, subject to some limitations, people can open their own pension accounts out of wage or self-employment income. These are defined-contribution accounts.
- 6.15 The SCF collects extensive information about households' defined-contribution accounts but not their defined-benefit accounts. This is because one can estimate the value of a defined-benefit account only by making strong assumptions about an employee's tenure on a job and future salary path. The lack of data on defined-benefit plans is probably not a serious problem given the substantially smaller share that this type of pension has, but the issue should be recognised.

Table 6.4: Ownership of defined-contribution retirement accounts and cash-value life insurance

Family characteristic	Retirement Accounts %	Median Value Retirement Account	Life Insurance %	Median Value Life Insurance
<i>All families</i>	48.8	24,000	29.6	7,300
<i>Income (1998 US dollars)</i>				
Less than 10,000	6.4	7,500	15.7	3,000
10,000-24,999	25.4	8,000	20.9	5,000
25,000-49,999	54.2	13,000	28.1	5,000
50,000-99,999	73.5	31,000	39.8	9,500
100,000 and more	88.6	93,000	50.1	18,000
<i>Race or ethnicity of respondent</i>				
Non-white or Hispanic	32.0	13,000	20.8	5,000
White non-Hispanic	53.7	26,000	32.1	7,500

Source: 1998 Survey of Consumer Finances (Kennickell et al., 2000).

- 6.16 Table 6.4 shows that low-income households are markedly less likely to have (defined-contribution) retirement accounts than are higher-income families. Households with non-white and Hispanic respondents are also much less likely to have retirement accounts. Moreover, even when they do have such accounts, the value of the accounts are substantially less than those of higher income and white households.
- 6.17 The SCF also collects data on the ownership of life insurance policies with a cash value.⁵ It focuses on these life insurance policies since they double as life insurance and as savings vehicles. Data from the 1998 SCF indicate that low-income households are less likely to own a cash-value life insurance policy than are higher income families. Families with non-white and Hispanic respondents were also less likely than other families to own a cash-value life insurance policy. As shown in Table 6.4, among the households who do have cash-value life insurance policies, low-income families and families with non-white or Hispanic respondents have policies with substantially lower values than other families.⁶

Causes of exclusion

Deposit accounts

- 6.18 Research strongly supports the conclusion that the major reason that families do not have deposit accounts is because they have almost no month-to-month financial savings, and therefore do not believe that they need deposit accounts. In 1996, a consulting firm working for the US Treasury Department surveyed a large sample of recipients of federal benefit cheques who did not have deposit accounts to

5 Insurance companies also sell 'term' life-insurance policies that have no cash value. There is no information on the ownership of these policies.

6 As Panko (1997) explains, many low-income households buy cash-value life insurance from door-to-door salespeople. This tends to be high-cost insurance with a small cash value. Frequently, the purchaser intends the death benefit to cover the cost of his or her funeral.

Table 6.5: Reasons why households do not have deposit accounts

A	
Reason/reasons given	Percentages giving this reason
Don't need account because we have no savings	53.3
Bank account fees are too high	23.1
Banks require too much money just to open an account	22.1
We want to keep our financial records private	21.6
Not comfortable dealing with banks	17.6
Banks won't let us open an account	9.5
No bank has convenient hours of location	8.5
B	
Problem fee/fees among those citing bank fees as a barrier	Percentages giving this reason
Monthly account maintenance fee	28.4
Bounced-cheque fees	18.5
Cheque-writing fees	12.9
ATM fees	11.0

Source: Caskey (1997a).

Table 6.6: Primary reasons why households do not have checking accounts

Reason	Percentages giving this reason
Do not write enough cheques to make it worthwhile	28.4
Do not like dealing with banks	18.5
Do not have enough money	12.9
Service charges are too high	11.0
Minimum balance is too high	8.6
Cannot manage or balance a checking account	7.2
Do not need/want an account	6.3
Credit problems	2.7
No bank has convenient hours or location	1.2
Other	3.1

Source: 1998 Survey of Consumer Finances (Kennickell et al., 2000).

inquire why they did not (Booz-Allen and Hamilton Shugoll Research, 1997). About half cited 'don't have enough money' as the primary reason.

- 6.19 In the same year, a survey of 900 low-income households obtained information on their use of financial services. Of those without accounts, 53% cited 'don't need an account because we have no savings' as a reason, making this the most frequent reason cited.⁷ (See Table 6.5.)
- 6.20 Unfortunately, the SCF does not ask people why they do not have a deposit account. Rather, it asks households without a checking account to give the primary reason why they do not have one. The most common reason cited is: 'do not write enough cheques to make it worthwhile'. 'Do not have enough money' is the third most common response (Table 6.6).

⁷ In the survey, respondents were allowed to give more than one reason.

6.21 In these surveys, other common responses for why people do not have deposit accounts include: ‘bank fees are too high’; ‘bank minimum balance requirements are too high’; ‘we want to keep our financial records private;’ and ‘we are not comfortable dealing with a bank.’ The first two reasons are closely related to people’s low level of financial savings, since depositors able to maintain a month-to-month balance of about \$500 or more rarely pay account maintenance fees and rarely write cheques that ‘bounce’ leading to non-sufficient funds fees. The desire to keep financial records private could arise because:

- a creditor might seize the savings of a delinquent debtor;
- a former spouse might pursue the savings of an individual behind on his child-support payments;
- welfare eligibility could be threatened by a substantial account balance or by a history of deposits from under-the-table earnings;
- an illegal immigrant might fear that a bank record would reveal his presence to the Immigration and Naturalization Service.

The formal surveys have not delved into these reasons but one qualitative study finds evidence of these concerns (Caskey, 1997b).

6.22 Less common reasons given for not having a deposit account include: ‘banks won’t let us open an account’ (presumably because the person has a history of writing bad cheques or a severely impaired credit record); and ‘no bank has convenient hours of location’. Interestingly, many journalists and community activists argued in the 1980s that the closing of bank branches, especially in low-income neighbourhoods, caused people to lose access to banks and close their deposit accounts. Survey data, however, do not support this factor as being significant on a national level (Caskey, 1997a; Stegman, 1999). UK research has reached a similar conclusion (Kempson and Whyley, 1998).

Prime credit from mainstream lenders

6.23 The main reason why people are excluded from prime loans from mainstream lenders is that they have impaired credit histories or, in some cases, no credit histories. Such traits commonly confine them to the subprime or sub-subprime credit markets.

6.24 A comparatively large percentage of low-income and minority households report a history of failing to fulfill payment obligations on time, heavy debt-payment burdens, bankruptcy or liens placed on their property. For example, FairIsaac Inc., one of the largest US credit scoring bureaus, reported that it examined loan application data from ‘tens of thousands’ of individuals applying for loans between July 1992 and December 1994 (Martell et al., 1997). In the FairIsaac credit scoring system, scores range from 0 to 240, with a higher score indicating a lower credit risk. A typical prime lender would require a score of about 200 or above. In its study, FairIsaac reported that 54% of loan applicants with household incomes in the lower half of the sample had scores below 200, but only 33% of loan applicants with higher incomes fell in this category. Similarly, the Freddie Mac Corporation (1999), a very large dealer in the secondary mortgage market, conducted a survey of 20,000 households with incomes under \$75,000. The survey focused on the households’ credit histories and financial behaviours. It classified a household as having a ‘bad’ credit record if the household reported that it had:

- been at least 90 days late on a payment in the previous two years;
- been 30 days late on a payment more than once in the previous two years;
- a record of bankruptcy or liens files on its property due to payment delinquencies.

Table 6.7: Incidences of impaired credit records

Family characteristic	Percentage with 'bad' credit records	Percentage with 'good' credit records	Percentage with insufficient information to classify
<i>All families</i>	30	57	13
<i>Income (1998 US dollars)</i>			
Less than 25,000	36	Data not reported	Data not reported
25,000–49,999	33	Data not reported	Data not reported
50,000–64,999	25	Data not reported	Data not reported
65,000–75,000	22	Data not reported	Data not reported
<i>Race or ethnicity of respondent</i>			
African-American	48	36	16
Hispanic	34	51	15
White	27	61	12

Source: Freddie Mac Corporation (1999).

Table 6.8: Indicators of credit burdens and credit payment difficulties

Family characteristic	Percentage with ratio of credit payments to family income above 40% (credit burden)	Percentage with a credit payment late 60 days or more in previous year (credit payment difficulties)
<i>All families</i>	12.7	8.1
<i>Income (1998 US dollars)</i>		
Less than 10,000	32.0	15.1
10,000–24,999	19.9	12.3
25,000–49,999	13.8	9.2
50,000–99,999	5.7	4.5
100,000 or more	2.1	1.5

Source: 1998 Survey of Consumer Finances (Kennickell et al., 2000).

- 6.25 Table 6.7 shows that, by these criteria, a substantially higher percentage of low-income households have bad credit records that would be likely to exclude them from prime loans than do higher-income households. In addition, substantially higher percentages of African-American and Hispanic respondents had bad credit records than did white respondents.
- 6.26 Similar results by income levels are reported from the Federal Reserve's 1998 household survey (Table 6.8). Results of a 1996 survey of low-income households provide further support for this conclusion. Among households using pawnshops, small-loan companies and rent-to-own shops, more than half had been contacted by bill collectors in the previous year (Caskey, 1997a). Finally, as shown in Table 6.4,

home mortgage lenders report that one of the main reasons they deny loans to applicants is because of impaired credit histories and high credit-to-income ratios.

- 6.27 Qualitative studies and formal household surveys have investigated why many low- and moderate-income individuals build up excessively heavy credit burdens, delay making or ignore scheduled payment commitments or declare bankruptcy (Caskey, 1997b; Freddie Mac, 1999). In brief, four explanations are common. First, people often point out that they have no financial savings, so any economic disruption, such as a health crisis in the family or a job termination, forces the family to put off non-essential expenditures, including debt service obligations. Secondly, many families attribute their credit service problems to external events (job loss, divorce, etc). Thirdly, families frequently report that they have trouble controlling their spending. Finally, some families believe that they lack the financial knowledge necessary to manage their money well.
- 6.28 In addition to impaired credit records, researchers have offered two other reasons for why many low-income families are excluded from the prime loans of mainstream lenders. First, some have argued that many low-income families may not be aware that they could qualify for a lower-cost prime loan. They turn to a higher cost subprime lender out of ignorance, and the subprime lender has no incentive to steer them to lower-cost prime lenders. Numerous newspaper accounts and advocates for people on low incomes report such incidences, but there have been no systematic studies of their statistical significance.
- 6.29 Secondly, researchers have hypothesised that many mainstream lenders discriminate against racial or ethnic minorities. Such discrimination could be based on ethnic or racial preferences. Alternatively, it might be ‘statistical’, meaning that there is no racial bias; the lender is simply responding to an observed correlation between race and default rates. Although almost everyone acknowledges that lenders practiced racial discrimination until the late 1960s, there is much disagreement among researchers about its significance since that time. The most careful studies concern mortgage lending since that is where the necessary data are available and because housing is fundamentally important to people. The Urban Institute (1999) reviews much of this research and concludes that racial and ethnic discrimination is still quite common in the housing industry, including the mortgage market. However, the evidence suggests that discrimination plays a secondary role compared to families’ financial situations in explaining their different access to prime credit.

Pensions and savings-oriented life insurance

- 6.30 We were unable to find any research since 1995 on why a disproportionate percentage of low-income households and households headed by minorities do not have pension accounts to supplement social security. However, other research suggests a number of possible explanations.
- 6.31 First, as noted earlier, social security replaces almost 60% of the income of a typical low-wage worker, so he or she has less need to supplement this.⁸ Secondly, it is likely that a disproportionate percentage of low-income workers work for small firms that do not offer pension benefits. These workers also have shorter average job tenures, so that they become eligible for employer-provided pensions less frequently. Thirdly, most employers require workers to contribute a small percentage of their current incomes toward a pension account. Low-income workers may be less able or willing to sacrifice current income for future income. Finally, pension savings are not taxed, but this brings less benefit to low-income households who pay lower marginal tax rates than do other households.
- 6.32 Likewise we were unable to find any post-1995 research on why a large share of low-income households and minority-headed households do not have cash-value life insurance. Undoubtedly, two explanations

⁸ Conventional wisdom is that most households will need about 65% of their pre-retirement annual income to live comfortably in retirement. However, low-income households, who are less likely to own their own homes, might need a higher percentage.

are important. First, for low-income families, government social support safety nets provide a larger share of employment income than they do for other families. This reduces the incentive to reduce current incomes in order to pay life insurance premiums for policies with long-term savings features.⁹ Second, a primary reason that households save using life insurance policies is that the accumulated savings are tax-advantaged. Any tax savings are likely to be far less significant to low-income households since they face lower marginal tax rates.

The consequences of exclusion

Deposit accounts

- 6.33 Most households without deposit accounts do not complain about inadequate access to savings facilities because they rarely have significant month-to-month savings. The main consequence for families without deposit accounts is that they need to arrange a means to satisfy their payment needs – cashing cheques and making long-distance payments. Available data, although far from satisfactory, suggest that about half of ‘unbanked’ households obtain payment services with little difficulty or cost (Caskey, 1997a, b). In most cases, they cash their paychecks at banks or credit unions that do not charge fees for this service. Often these are banks that have business relationships with the employers of the unbanked households or are community banks that cash government transfer cheques as a service to the community. In other cases, those without checking accounts cash their paychecks at grocery stores or other stores that provide this service in the hope that customers will spend some of the cash in the store. Some stores, as in the UK, even require that individuals cashing cheques spend a specified minimum amount in the stores. The households make long-distance payments mainly by money orders, which they can purchase at post office branches and a large range of commercial establishments.
- 6.34 People who are unbanked find it either somewhat costly or inconvenient to obtain payment services. Typically, they cash paychecks by paying a fee to a grocery store or commercial cheque-cashing outlet (CCO) for this privilege. CCOs, which first appeared in the 1930s, existed in just a few major cities in the early 1970s. Starting in the mid-1970s, they began to grow rapidly and became common in urban areas throughout the US by the mid-1990s.¹⁰ They cash paychecks and government support cheques for a fee (typically 2–4% of the face value of the cheque), sell money orders, transmit utility bill payments and sell other convenience items, such as pre-paid long-distance telephone calling cards.¹¹ This can be expensive. For example, a low-income household, making \$16,000 a year and that regularly uses a CCO to handle its payment services, might easily spend as much as \$400 of its income just for payment services.

Credit from mainstream lenders

- 6.35 Almost all households excluded from mainstream credit have alternative sources of credit, but these alternatives tend to be costly, inconvenient and have poor consumer protection. In the states where regulations permit lenders to charge annualised interest rates (APRs) of 200% or more, many individuals whose credit histories make them ineligible for prime and subprime credit, can still obtain small unsecured loans from small-loan finance companies and payday lenders. Such lenders cannot operate profitably in states with significantly more-restrictive usury ceilings (Caskey, 1997a).

9 Hubbard et al. (1995) argue, based on a detailed econometric study, that social safety nets discourage low-income households from saving.

10 Some CCOs are operated by large sophisticated companies, including one (ACE, America’s Cash Express) whose stock is widely held by the public.

11 As of 1999, 14 states set limits on the cheque-cashing fees that CCOs can charge. There are no federal fee ceilings. Most of the state fee-ceilings range from 1.1% to 3% for payroll and government cheques.

- 6.36 Payday lenders appeared in the late-1980s, when cheque-cashing outlets began to cash an individual's personal cheque under an agreement that the CCO would delay presenting the cheque for settlement until the person's next payday. Most payday lenders limit such loans to about \$300 with a maturity of two weeks or less. If a borrower does not have enough money in his deposit account to settle the cheque at the next payday, the lender will frequently permit him to renew the loan in exchange for a fee. Payday lenders commonly charge about a 20% fee for cashing the cheque, so APRs on the loans are often 500% or more. To reduce default rates, they often employ aggressive collection tactics (Caskey, 1997a). Over the past ten years, the payday loan industry has grown explosively. In 1999, thousands of CCOs were active payday lenders, but there were also at least a thousand business outlets that only do payday loans.¹²
- 6.37 Individuals unable to obtain unsecured consumer loans have three remaining alternatives: rent-to-own shops (called lease-purchase outlets in the UK); car-title lenders; and pawnshops. Rent-to-own shops (RTOs) provide implicit credit for purchases of household goods by structuring the purchase as a lease agreement with an option to obtain ownership at the end of the lease period.¹³ This method of providing consumer credit reduces the risk to the RTO. Because the RTO retains ownership of the leased household goods, if the lessor fails to make the scheduled payments, the RTO's costs of repossession are lower than that of a secured lender. In states where regulations permit it, consumers with bad credit histories who have clear title to a car can borrow from a car-title lender. In these transactions, the borrower leaves the title to the car in the possession of the lender and gives the lender right to transfer ownership of the car in case the borrower misses a scheduled loan payment. In a default, the lender transfers the title and repossesses what is now its property. Car-title loans tend to be for relatively small amounts (\$1,000 or less) and have maturities of one to three months. The final institutional credit alternative for individuals with bad credit records is a pawnshop. Since pawnbrokers lend only on the basis of the value of collateral left in the possession of the pawnbroker, they will lend to anyone who has suitable property to pledge. Typically, they lend about half the value of the collateral. Most loans have one- to three-month maturities. Over the past 20 years, the number of RTOs, car-title lenders and pawnshops has grown dramatically. There are several firms whose stock is publicly traded that are in the RTO or pawnbroking business.¹⁴
- 6.38 Although these alternative sources of credit are available to many individuals excluded from bank credit, they are costly. Implicit APRs on RTO lease/purchase agreements are generally 200% or more, as are the explicit interest rates on car-title loans. Pawnshop interest rates vary across the states due to differences in state regulations, but the majority of pawnshops are located in states that permit them to levy APRs of at least 150%. In addition, in the case of RTOs and car-title lenders, journalists have commonly reported that many of their customers have been victimised by particularly aggressive collection tactics. Some car-title borrowers who missed loan payments have lost their cars within a day of the first missed payment and have lost jobs because they could no longer drive to their employer.
- 6.39 In addition to these alternative institutional lenders, qualitative studies and household surveys (Bond and Townsend, 1996; Caskey, 1997a, 1997b) indicate that many households without access to traditional credit respond to periodic personal financial crises by working more hours to increase their incomes or by borrowing from friends or family. In interviews, most express a reluctance to approach family or friends because of embarrassment or concern that they will be rebuffed or chastised. Many also say in interviews that they respond to financial emergencies by 'doing without', meaning that for a

12 One large privately-held company (Dollar Financial), that operates CCOs making payday loans in several different states, has even begun to extend its operations to Canada and the UK.

13 The concept for US RTOs was apparently imported from the UK. In fact, until recently a UK firm, Thorn/EMI, owned the largest chain of RTO outlets in the US, but sold its US RTO subsidiary in 1997.

14 One pawnbroking firm, Cash America, is now a multinational, with pawnshops in the US, UK and Sweden. Its stock is traded on the New York Stock Exchange.

period of time they cut back on traditional household expenses such as food, transportation, clothing, etc. These measures have associated non-financial costs, but they are not easily quantified.

Pensions and savings-oriented life insurance

- 6.40 Individuals without pensions or savings-oriented life insurance policies face less financially secure retirements than do those with significant retirement savings. Almost all adults are covered by social security, and there is a less-generous government support programme (Supplemental Security Income, or SSI for short) for older low-income adults who are not covered by social security. But, SSI payments alone leave most recipients below the official poverty threshold. Social security for a low-wage worker replaces about 60% of his or her wage, but this is hardly a comfortable living. Workers hoping for comfortable retirements must supplement social security with pensions or other sources of income.¹⁵

Public and private-sector responses to the problem

Deposit accounts

- 6.41 Over the past three decades, many policies have been implemented or proposed to increase the share of households using banks and other mainstream financial institutions. Many of these policies have addressed the ownership of deposit accounts. Partly in response to a concern that the closing of bank branches in low-income neighbourhoods might exclude people from convenient access to bank services, the federal government introduced a ‘service’ test for banks through the Community Reinvestment Act (CRA). Under this legislation, originally introduced in 1977, but modified several times subsequently, federal bank regulatory agencies rate banks based primarily on their efforts and effectiveness at making mortgage loans to low-income households. Under the terms of the legislation, there is no direct sanction for banks that receive unsatisfactory ratings. But the regulatory agencies can take into account a bank’s rating when considering its request for a regulatory ruling, such as permission to merge with another bank. Since the late 1980s, the vast majority of banks have made efforts to ensure that they receive a ‘satisfactory’ or ‘outstanding’ CRA rating. Since one criterion that regulators use in assigning CRA ratings is a bank’s depository services to low-income communities, some banks maintain branches in low-income areas that they would otherwise close (Avery et al., 1997).
- 6.42 There are no reliable data on the impact that the CRA has had on bank branch closings. However, as surveys indicate that the location of depository institutions are not a significant barrier to account ownership, CRA legislation is unlikely to have had a detectable effect on a national basis on ownership of deposit accounts. It may, however, have had, a significant impact in particular low-income neighbourhoods.
- 6.43 ‘Basic’ or ‘lifeline’ bank account proposals have been a second policy initiative intended to address barriers to deposit account ownership. Under these proposals, which a few states but not the federal government have enacted into law, banks would be required to offer a low-cost checking account with a low minimum balance requirement.¹⁶ Although bank trade associations fought against such proposed laws, especially at the federal level, they called on banks to offer such accounts voluntarily. The majority of banks claim that they do.

15 Under the federal government’s definitions, 10.5% of adults older than 64 years lived in poverty in 1998. Were it not for government transfer payments, the poverty rate for this group would have been 48% (Current Population Survey, US Census Bureau).

16 In a January 13, 2000, press release, President Clinton proposed that the federal government enact legislation encouraging banks to create ‘First Accounts’ for people without deposit accounts. The President gave no details behind his proposal, but described the accounts as having very low minimum balance requirements and low fees.

- 6.44 There have been no formal studies of whether or not basic banking policies affect deposit account ownership, but there are good reasons to believe that the effect is very small (Doyle et al., 1999). Household surveys find that minimum balance requirements are cited by many as a barrier to account ownership, but they are typically fourth or fifth on a list of reasons. In addition, unless a bank were to reduce its ‘bounced cheque’ fees, a checking account could still be quite costly for a household that runs down its balance to near zero at the end of each pay period. Finally, several surveys of banks have found that banks do not publicise their basic banking accounts and frequently steer customers to more costly alternatives.
- 6.45 A third public policy measure seeks not to increase account ownership, but to reduce the cost of turning to alternatives. Advocates for the poor in many states have proposed legislation that would set ceilings on the fees that cheque-cashing outlets can charge. As of 1999, 14 states had adopted such fee ceilings, but in several cases the ceilings are higher than the free market rates so the ceilings are not binding.¹⁷
- 6.46 In 1996, the federal government enacted legislation requiring that all federal transfer payments be made electronically by 1999. The legislation was intended to save the government the cost of printing and mailing cheques. At the time the legislation was drafted, no one apparently realised that about 20% of the recipients of federal benefit payments did not have deposit accounts and therefore could not receive an electronic transfer of funds. The Department of Treasury was charged with implementing the legislation. After much discussion of alternatives, it decided to grant exemptions to anyone receiving a cheque who desired to continue doing so. Beginning in late 1999, the Treasury began to urge banks to create ‘electronic transfer accounts’, or ETAs for short. These accounts must accept electronic transfers from the federal government, have no minimum balance requirement, and permit the account owner to withdraw the funds using an ATM card. They need not offer any other features, but banks are permitted to charge the account holder only a \$3-a-month account maintenance fee. Some analysts have argued that these accounts may bring many of the unbanked into the banking system, but there are good grounds for scepticism (Stegman, 1999). The Treasury is only urging banks to create these accounts for recipients of government transfer payments, not low-income households generally. More importantly, given the highly restricted uses of these accounts, it is unclear whether or not the owner of an ETA account is truly the owner of a deposit account. One could argue that the ETA account is simply a means for transferring a government payment.
- 6.47 Analysts who believe that the primary barrier to deposit account ownership is a lack of month-to-month savings have proposed two public policy responses. First, they have advocated measures, such as enhancing the Earned Income Tax Credit, to raise the incomes of low-income households. Secondly, they have proposed expanding educational efforts intended to help lower-income households appreciate the value of financial savings and to budget expenditures effectively to achieve savings (Jacob et al., 2000). Unfortunately, there is no satisfactory research on the effect of such educational programmes on people’s savings behaviour or their use of deposit accounts.¹⁸

Credit from mainstream lenders

- 6.48 There have been three major policy responses to the exclusion of households from the credit of mainstream lenders. First, the CRA, as noted earlier, pressures banks to provide mortgage loans for low-income and minority households. Whatever the shortcomings of this Act, it has led many banks to initiate strong outreach efforts to identify low-income and minority households with acceptable credit risk profiles who are interested in becoming homeowners. Banks now actively compete with each other to book these loans since this is the primary criterion on which CRA ratings are based. Many banks

17 See Fox et al. (1997) for a list of the states and their cheque-cashing fee ceilings as of 1997.

18 In the case of pension plans, however, Bayer et al. (1996) find that employers are more likely to participate in employer pension programmes that require matching contributions from the employees if the employers provide basic financial planning seminars.

partner with not-for-profit low-income housing development agencies to generate such loan opportunities.

- 6.49 The second policy response to the exclusion of households from mainstream credit has been to regulate the loan policies of lenders in the alternative financial sector. In many states, advocates for the poor have pushed for legislation that would lower the interest rates and other fees charged by pawnbrokers, payday lenders, rent-to-own shops and car-title lenders. In a few cases they have been successful. More commonly, however, as the alternative financial sector has grown and as substantial corporations have replaced ‘mom and pop’ stores, the alternative lenders have become increasingly politically sophisticated and organised, and they have effectively lobbied states to raise or eliminate existing usury laws.
- 6.50 The third policy measure intended to increase the access of low-income households to mainstream credit is consumer education. For many years, government agencies at all levels and private-sector entities have offered ‘financial literacy’ programmes intended to communicate the importance of building savings, maintaining clean credit records, and addressing past credit problems.¹⁹ Some of these programmes are specifically targeted at low-income households. Unfortunately, as noted earlier, although there are many anecdotal accounts suggesting that such efforts can be effective, there are no rigorous academic studies measuring their effectiveness.

Pensions, savings-oriented life insurance and other savings products

- 6.51 For decades, numerous public policy analysts have commented on the inadequate savings that many low-income households have for retirement, education or a down payment on a home. One of the most influential books that made this point and offered a policy solution was *Assets and the poor: a new welfare policy* by Michael Sherraden (1991). He argued that tax incentives to encourage savings do not benefit low-income households; they pay little federal income tax. Moreover, he noted that many low-income households do not have access to employer pension plans and do not accumulate sufficient savings to make a down payment on a home. Sherraden proposed that the government create ‘Individual Development Accounts (IDAs)’, which would encourage low-income households to accumulate wealth by offering to match their savings for approved purposes. For example, for each dollar that a low-income household puts into a retirement account, the government might add a matching \$1.
- 6.52 Over the past decade, numerous not-for-profit community development groups have created small-scale IDA programmes, raising money from philanthropic foundations and government agencies to support the matching. They have created IDAs with very diverse rules and match rates. In 1998, the Center for Enterprise Development, an organisation that is a major advocate for IDAs, and Sherraden launched a major initiative to evaluate the impact of IDAs on people’s savings behaviour. At this point, no significant results are available, but their evaluation programme is well designed and should lead to reasonably reliable conclusions.²⁰ In the mean time, several state governments have started IDA programmes of their own. Most are fairly small scale and offer modest match rates.
- 6.53 Building on the idea of IDAs, President Clinton in his January 2000 State of the Union Address, proposed that the federal government create ‘Retirement Savings Accounts’ for low-income households.²¹ Under his plan, the federal government would match the retirement savings of low-income households at a rate that diminishes as household income increases. The government, for example, would provide a two-for-one match for the first \$200 invested by a couple earning \$25,000 or less. The match rate would phase out for couples earning between \$25,000 and \$80,000.

19 See Jacob et al. (2000) for an overview of these programmes.

20 The website of the Center for Enterprise Development (www.cfed.org) contains extensive information about IDAs and the ongoing evaluation programme.

21 The previous year, President Clinton proposed the creation of ‘Universal Savings Accounts,’ which were to have somewhat similar features. Congress never acted on this proposal.

Conclusions

- 6.54 A relatively high percentage of low-income and minority households do not use mainstream financial services. Two related factors are primarily responsible for this phenomenon. First, many low-income households have no, or almost no, month-to-month financial savings. Secondly, and partly as a result of this lack of a financial cushion, a disproportionate percentage of low-income and minority households cannot pass standard credit-risk screening procedures.
- 6.55 Exclusion from mainstream financial services can be costly. Annualised interest rates in the alternative financial sector are often as high as 200%, and a family that uses cheque-cashing outlets to convert its paychecks into cash can easily devote 3% of its income just to obtain this simple service. In recent years, several policy measures have been implemented in an effort to increase the percentage of low-income households using mainstream financial services. In many cases, however, these measures have not directly addressed the fundamental causes of financial exclusion, the measures have been quite limited in scale or scope, or the effectiveness of the measures has not been carefully assessed.

7 Overcoming financial exclusion

- 7.1 As earlier sections have shown, the causes of financial exclusion and barriers to inclusion are many and varied. Consequently, the solutions will not be straightforward. Equally, it is clear that there is a commitment, both from Government and from the industry itself, to finding ways of overcoming financial exclusion.
- 7.2 Financial services providers clearly have an important role to play, although not necessarily from commercial motivations, as many people both from the industry itself and outside it have commented.

while short-term profits may not benefit, companies with an eye to longer-term outcomes may do well to promote inclusionary practices within the industry.

(Association of British Insurers, 1999a: p.30.)

from the standpoint of society as a whole, the industry could either act as a brake on social exclusion, or as a contributor to it.

(Burchardt et al., 1999: p.5.)

- 7.3 But it would be wrong to assume that financial service providers can overcome financial exclusion alone. Central government, regulators, local authorities, other commercial organisations and not-for-profit organisations all have a part to play. The general consensus seems to be that partnerships – private/private; private/public; and private/not-for-profit – frequently offer the best way forward (Bayliss, 1997; Mayo, 1997; Rossiter and Kenway, 1997; Association of British Insurers, 1998a; Whyley et al., 1998; Building Societies Association, 1999a; Donovan and Palmer, 1999; HM Treasury, 1999; Kempson and Whyley, 1999a; Kempson and Jones, 2000).
- 7.4 Such partnerships are paramount in finding appropriate ways of delivering financial services that overcome the access problems currently faced by many of the financially excluded. They are also important in tackling financial literacy and the psychological barriers to using financial services. On the other hand, the financial services industry is likely to take the lead on the design of appropriate financial products. While responsibility for issues relating to regulation will rest with government.

Increasing access

- 7.5 There are a number of aspects to increasing access. As Section 4 shows, these include geographical access, access for people with disabilities, risk assessment and alleged racism.

Geographical access

- 7.6 Given the economics of the financial services sector, most providers that are committed to tackling financial exclusion believe that wider geographical access can only come about through a process of partnership.

- 7.7 Bank and building society branch closures are very emotive, but even without them, there will be people who are remote from a branch because they live in new or expanded communities. Although new branches are being opened, it seems unlikely that low-income communities on the edge of towns and cities will ever be a high priority for most banks or building societies. Consequently, they are looking to technology and partnerships with other organisations to widen access. For the present, technology (cash machines and telephone, internet, PC or digital TV banking) seems unlikely to offer a solution to the banking needs of people on the margins of financial services, as they want more control over their finances than these new forms of banking allow (Kempson and Jones, 2000).

Supermarkets

- 7.8 Earlier research had suggested that supermarkets could work with banks to improve access (Kempson, 1994; Leyshon et al., 1998). Experience has shown, however, that where supermarkets have moved into the provision of financial services they concentrated on attracting better-off consumers likely to buy a range of financial products. They have not been interested in tackling financial exclusion (Lynch and Haidar, 1997).

Post offices

- 7.9 The Post Office has emerged as a likely key player in increasing access to financial services, for a number of important reasons. First, it has over 19,000 outlets across the country, with a presence in just about every deprived community and also in many small rural ones. Secondly, people who make little or no use of financial services make extensive use of post offices to cash their pension or state benefits and to pay bills. If they lack a bank account, they may also use postal orders in place of cheques. Thirdly, Post Office Counters Limited (POCL) will face a major loss of income when, from 2003, pensions and benefits will be paid by ACT into an account. Consequently, one of the main strands of their future policy is to expand their role in the provision of financial services (Kempson, 1994; Leyshon & Thrift, 1994; Leyshon et al., 1998; HM Treasury, 1999a; Kempson and Jones, 2000; Speak and Graham, 2000).
- 7.10 Unlike the supermarkets, however, they will almost certainly be concerned to meet the banking needs of people who are currently unbanked. POCL already have agency agreements whereby they provide basic transactional banking services in England and Wales for Alliance and Leicester Giro, the Co-operative Bank and Lloyds TSB. Barclays Bank has just announced that it is starting a trial service in Cornwall and other major banks in England, Wales and Scotland, seem likely to do the same before long. At present the capacity of the Post Office is limited by the fact that transactions are all paper-based, but this will change when automation is completed. This should be the case by the end of 2001.
- 7.11 It is generally accepted that expanding the role of the Post Office will help tackle both financial and social exclusion. Not only will it increase access to financial services, but it will safeguard local post offices, and the shops in which many are based, in communities that, otherwise, have very few services within them. But there are reservations – most notably about whether the Post Office will end up as a monopoly supplier in many communities. This is a concern to the banks themselves and also to pressure groups such as the Campaign for Community Banking Services (Kempson and Jones, 2000).

Not-for-profit organisations

- 7.12 The third option is for not-for-profit organisations to play a role. Here there are various possibilities – credit unions, local exchange trading schemes and various forms of community bank have all been proposed.
- 7.13 The present government has given enthusiastic support to the development of the credit union movement in Britain as a means of tackling financial exclusion. In particular, credit unions are seen as

having an important role to play because they are open to low income groups, encourage small scale savings, provide low cost credit and can be a bridge to other financial services (HM Treasury, 1999b).

- 7.14 There is a small number of progressive credit unions that offer products which many people on the margins of financial services need, such as bill payment services, home contents insurance and mail order agency. On the whole, though, credit unions have been very slow to develop in Britain although provision in Northern Ireland is a good deal better. At present the movement covers less than 1% of the British population (HM Treasury, 1999b). In addition, research suggests that 40% of British community credit unions are not even at a basic level of economic viability (Jones, 1998).
- 7.15 It is clear, then, that credit unions need to undergo considerable change in order to become viable and sustainable financial services providers. The extensive body of research on credit unions is useful in identifying key factors for growth. Put simply, credit unions need to move towards a 'virtuous circle' of development – they have to attract more savings, which will lead to bigger loans, which will lead to higher income, bigger reserves, more members, more savings and so on (Jones, 1998).
- 7.16 But in order to achieve this 'virtuous circle', a number of conditions have to exist, or be fostered, within credit unions. In particular, they need strong leadership and professional management, a core group of active volunteers, effective organisation and promotional work, appropriate operational resources, IT infrastructure and appropriate IT skills among workers, the capacity to offer a range of high quality services and good business sense and planning skills (Conaty and Mayo, undated; Feloy and Payne, 1999; HM Treasury, 1999b).
- 7.17 In addition, research on the growth of Scottish credit unions identifies a number of other important factors. As well as requiring a high demand for loans from the outset, common bond areas need to have a mix of members who can save as well as borrow, that is, a mix of working and non-working members. Those involved in running credit unions should be aware of good practice in other credit unions and be willing to adopt this. Moreover, members need to retain ownership and responsibility for the credit union in order for it to flourish. Finally, the research identifies a 'cluster effect', where the proximity of credit unions in one area leads to considerable sharing of information and expertise (Donnelly and Kahn, 1999).
- 7.18 To help stimulate credit unions across the country the Treasury-led task force has recommended the setting up of a Credit Union Central Servicing Organisation. The logistics of achieving this are currently being examined. In addition, the regulation and legislative framework for credit unions has also come under government scrutiny with the intention of removing any barriers to credit union growth (see below).
- 7.19 Brought together, these factors could lead to the development of larger, more sustainable credit unions throughout the UK. In turn, this could mean a greater chance of partnerships with banks and other financial services providers, so that credit unions could offer a wider range of services (Turner, 1996; Conaty, 1997; HM Treasury, 1999b)
- 7.20 A major gap in our knowledge, however, is how far community credit unions are used by people who would otherwise be financially excluded. A survey of Birmingham credit unions shows that, while part-time workers and lone parents are over-represented among their members, unemployed people and pensioners are under-represented. African-Caribbeans are also over-represented, while Asians are under-represented. It also shows that many credit union members continue to use other sources of credit at the same time – especially mainstream sources such as mail order catalogues (31%), credit and store cards (33%) and overdrafts (24%). There was however, a reported decrease in the use of such sources since joining the credit union. Use of alternative credit suppliers was much lower – just 2% said that they borrowed from moneylenders or pawnbrokers – again there had been a decline in use since joining the credit union (Feloy and Payne, 1999).

Community banks

- 7.21 There has been increasing interest in the development of community banks in Britain, for the most part in response to the closure of bank and building society branches. The development of community banks in poorer areas, together with community reinvestment legislation similar to that in the USA, is seen as one way of tackling the geographical exclusion from financial services that affects many low-income households (Mayo, 1997).
- 7.22 In fact, recent research indicates that there is considerable support for community banks among groups such as the unemployed, lone parents, people with disabilities and very elderly people, who at present make little use of banking services. Banks, however, are more cautious and have indicated that, for the present, they only wish to participate in one-off experiments to test out a range of models. Two such experiments are currently underway – one in Portsmouth and one in Salford (see below)(Kempson and Jones, 2000).

Local exchange trading schemes (LETS)

- 7.23 It is argued that local exchange trading schemes (LETS) can improve the situation of people living on low incomes by (among other things) extending interest-free credit facilities through local trading activity (Pacione, 1998). They may also provide an accessible alternative financial mechanism for ‘getting what you need’ when money is short (Thorne, 1996).
- 7.24 In reality, though, research indicates that the ability of such schemes to provide credit is relatively minor (Williams, 1996a, 1996b). This is not least because empirical studies suggest that the benefits of LETS are not reaching the most marginalised social groups (Pacione, 1998). Moreover, very few offers are for goods and services that will fulfil basic needs (Stott and Hodges, 1996).
- 7.25 At most, then, LETS have a marginal role to play in tackling financial exclusion among low-income households.

Local government and housing associations

- 7.26 There is also growing interest in the role that social landlords – local authorities and housing associations – can play in widening access to financial services. The best example of this is the insured with rent schemes run by about half of local authorities and a growing number of housing associations. A typical local authority scheme involves the local authority acting as an intermediary for an insurance company, arranging policies and collecting the premium payments with rents. Some housing associations act in the same way, although many do not actually collect the premiums and so do little to overcome problems of geographical access (Whyley et al., 1998; HM Treasury, 1999; Kempson, 1999).
- 7.27 The Association of British Insurers has noted that take-up through these schemes has been disappointing, although they continue to grow both in number and in size (Association of British Insurers, 1999b; Kempson, 1999a). Nevertheless there is interest in finding other ways in which social landlords can help with the access problems related to the decline in home service insurance companies (Association of British Insurers, 1999a, 1999b)
- 7.28 Related developments have also occurred between local authorities and housing associations on the one hand and banks and building societies on the other, albeit on a much more experimental basis. In Salford, for example, a community bank has been set up by the city council, Barclays Bank, and a number of local organisations. While, in Portsmouth, a similar initiative has involved a local housing association, the local council and Lloyds TSB (Kempson and Jones, 2000).

- 7.29 Some building societies already have, or are in the process of establishing, strong links with local housing providers (Building Societies Association, 1999a). For example, the Cambridge Building Society and Cambridge Housing Society have launched an innovative savings and loans scheme. The housing association has deposited a lump sum with the building society as a loan guarantee fund for their tenants. All the housing association's tenants are eligible to open a savings account with the New Horizons Savings and Loans scheme, which is administered by the building society. There is no minimum deposit and the fund operates as a joint account covering all tenants and the loan guarantee fund and so qualifies for a higher rate of interest than individual tenants would get if they opened their own account. Moreover, once they have established a regular savings record, tenants can borrow a multiple of their savings without credit scoring (Newcombe, 1997).
- 7.30 Innovative schemes such as those described above need to be monitored and researched both to identify how far they meet the needs of people who are financially excluded and to document the practicalities of setting them up.

Accessibility for people with disabilities

- 7.31 Most disabilities are not, of themselves, necessarily sufficient to cause financial exclusion. They do however add to the barriers faced by people who disproportionately live on low incomes. As the Office of Fair Trading (1999a: p.43) has noted,

there remain a number of areas to which insufficient attention has yet been paid such as the more extensive provision of cash points suitable for the visually impaired, wheelchair access to bank branches and other aids for disabled consumers.

The Office of Fair Trading has also called for disability awareness training.

- 7.32 There are, however, two main areas where disabilities may lead more directly to financial exclusion. The code of practice on Part 3 of the Disability Discrimination Act states that '*insurers will be able to justify less favourable treatment only if it is based on actuarial or other statistical data or other information on which it is reasonable to rely*'. Yet, as the Office of Fair Trading notes in its *Vulnerable consumers* report (Office of Fair Trading, 1999a) there is anecdotal evidence that some insurers do discriminate against disabled people in ways that are not actuarially justified by differences in risk. The Office of Fair Trading (1999a: p.42) argues that,

while it is legitimate for insurers to discriminate on the basis of disability, they should make every effort to distinguish between serious and less serious conditions and apply relevant and up-to-date actuarial data when assessing the risk.

- 7.33 There is also evidence that over-zealous interpretation of insurance policy exclusions clauses may be discriminatory. Offering people who would previously have been denied a policy, by offering them one with clauses that makes it difficult to claim is merely 'shifting the goal posts' (Kempson et al., 1999).
- 7.34 Both these issues need to be monitored by the new National Disability Council and should be researched in more detail.
- 7.35 The other main area of more direct discrimination occurs with people with learning disabilities. Here there is no direct research, merely anecdotal evidence largely relating to current accounts. As financial products of all kinds become more complex and less transparent, people with learning disabilities are put at a real disadvantage. The simpler financial products, described below, may well be far more appropriate, but there is a need for more research to understand the full nature and extent of the problem.

Risk assessment

- 7.36 Developments in risk assessment have already widened access to many financial products. The real challenge now is to find risk reduction practices that will widen access still further (Association of British Insurers, 1999b).
- 7.37 For bank accounts, this would involve the design of a new type of account, midway between the present current and deposit accounts, that does not carry an overdraft facility and, therefore, does not need to be credit scored (see below). For insurance it is a matter of widening risk pools (Burchardt and Hills, 1997a), and the most common suggestion is for risk pooling through affinity groups (Association of British Insurers, 1998a; Leyson et al., 1998; Insurance Trends, 1999). One such example, is the insured with rent schemes that already exist for home contents insurance, where local authorities do not assess the individual risk of tenants but provide policies at the same rate to all. Such affinity groups can, therefore, bring risk-based insurance within the reach of even high risk groups, while the lower costs of such schemes offset the additional costs that would, otherwise, be incurred by people who are a lower risk (Insurance Trends, 1999). As a consequence, most local authority insured with rent schemes can offer all tenants home contents policies at a lower cost than they could otherwise get (Whyley et al., 1998).
- 7.38 Affinity groups do, however, have their limitations. They require a group that is large enough to give a spread of risk and provide economies of scale. As a rule of thumb, the insurance market requires 50 to 100 members for a risk-based product to be viable for all members, although this does not apply to savings-based group products. If the economies are not sufficiently large, then low-risk individuals could not be offered a policy at a competitive price. Secondly, a group product may not match the exact requirement of each group member. Thirdly, if affinity group insurance were to expand, some low risk individuals might have a choice of groups and be able to shop around, so reducing the cross-subsidisation (Insurance Trends, 1999).
- 7.39 Widened access to credit relates to how that risk is assessed as well as how it is managed. Alternative credit suppliers, such as weekly collected credit companies, do not use the credit scoring methods of other consumer credit companies. Instead they rely on acquiring new customers through personal recommendation, high levels of repeat business, starting with small initial loans of £100 or so and increasing the 'credit limit' with successive loans. Credit worthiness is thus judged on a combination of a customer's past repayment record and information gathered both formally and informally by the agent. Agents visit all clients weekly to collect repayments which both manages the risk of late payment and provides an opportunity to monitor clients' financial position (Rowlingson, 1994; Consumer Credit Association, 1999; Opinion Leader Research, 1999).
- 7.40 The cost of credit through these companies is, however, very high – partly because of the way that they conduct their business (Rowlingson, 1994; Kempson and Whyley, 2000). This has led to attempts to find cheaper ways of managing risk.
- 7.41 Credit unions manage the risk by requiring members to save before they can borrow any money, with a member's credit limit being linked to the amount that they have saved. In this way, potential borrowers are screened to exclude those with no disposable income. Secondly, the savings act as a form of security. Thirdly, the fact that a credit union is an affinity group increases members commitment to repaying their loans.
- 7.42 The Cambridge Housing Society has an arrangement with the Cambridge Building Society so that the money deposited by the housing association itself is used as collateral for loans to its tenants (Newcombe, 1997).

- 7.43 Finally, there have been recent calls for greater transparency in the credit scoring used by mainstream lenders (Ludgate Public Affairs, 1999; Unifi, 1999). It has been argued that the voluntary *Guide to credit scoring*, written in 1984, that is used by the UK credit industry, is in need of up-dating (Ludgate Public Affairs, 1999). There is growing concern about some sections of the subprime loans market, that cater for people with a history of bad debt who fail the credit scoring of mainstream lenders (Kempson and Whyley, 2000). At the time of writing, this is under review by the Department of Trade and Industry.

Racism

- 7.44 Alleged racism undoubtedly increases the alienation from financial services even if there is little evidence to suggest that risk assessment is racist. There are a number of ways of tackling this issue. These include attracting more staff from minority ethnic groups to work in financial service companies and especially in front-line jobs in areas of high concentrations of black and Asian people. At the same time, there is clearly a need for race awareness training of front-line staff (Herbert and Kempson, 1996; Office of Fair Trading, 1999a). Most financial service companies have systems in place that should ensure compliance with the Race Relations Act, 1976. But as the Office of Fair Trading recommends,

More effort should, however, be taken not only to ensure that such systems are effective but to communicate this fact to ethnic minority consumers.

(Office of Fair Trading, 1999a: p.51.)

- 7.45 The common requirement for a passport as proof of identity to open a bank or building society account is often construed by Asian people (Herbert and Kempson, 1996) as evidence of racism, as well as acting as a barrier to people who do not have one. This is discussed more fully below.
- 7.46 Finally, there is a need to review risk assessment procedures for both insurance and credit to see whether, as they become more precise in nature, they are effectively discriminating against certain ethnic groups.

Appropriate financial products

- 7.47 As the Association of British Insurers (1998) has noted,

A key challenge for the future will be to design innovative products which offer value for money to those not traditionally serviced by the industry.

- 7.48 The Personal Investment Authority's Consumer Panel, Office of Fair Trading, Policy Action Team 14 and others have identified a need for new financial products that are simple, transparent and flexible (Personal Investment Authority, 1997; HM treasury, 1999; Office of Fair Trading, 1999a). These include bank accounts, savings products and pensions.

Bank accounts

- 7.49 As we have seen in earlier sections, most current accounts are ill-suited to the needs of people on very low incomes, as they impede their ability to keep close control over their finances. What is needed instead is an account that does not carry an overdraft facility. It would, ideally, offer a small amount of leeway without penalties so that people can withdraw the last few pounds from their account from a cash machine that only issues £10 notes or to cover instances where accounts are overdrawn by small amounts for very short periods of time. It would have a cash card, for withdrawing money from cash machines but no cheque book. Ideally, it would also have a linked bill-payment account, into which agreed regular amounts could be paid from the current account and set towards a range of household

bills (National Consumer Council, 1995; Kempson and Whyley, 1998; HM Treasury, 1999a; Kempson and Whyley, 1999a).).

- 7.50 Encouragingly, banks and building societies have taken up this challenge. Recent press releases from the British Bankers Association and Committee of Scottish Clearing Bankers (22 September 1999) have announced that all the main banks have or are designing new accounts to fit this requirement. The Building Societies Association has, similarly, announced that many of its members are doing the same (Building Societies Association, 1999a).
- 7.51 Experience in the USA, however, suggests that research will be needed to discover how far these accounts actually meet the needs of people who are currently unbanked and what proportion of them choose to open a basic account.

Savings products

- 7.52 Here research has shown that what people who are on the margins of financial services most want is a product that encourages the discipline of saving small amounts regularly. They want to be able to gain access to that money when needed, but for withdrawals not to be too easy (Kempson, 1998; Association of British Insurers, 1999a; HM Treasury, 1999; Kempson and Whyley, 1999a).
- 7.53 Neither deposit accounts nor life insurance meets these requirements. Deposit accounts do not offer the discipline needed for deposits or withdrawals. Life insurance, on the other hand, is too inflexible and provides poor value for money for people who need flexibility (Vass, 1997; Kempson, 1998; Kempson and Whyley, 1999a).
- 7.54 ISAs (Individual Savings Accounts) were originally designed to encourage people with no savings to start putting money by. However, all the evidence suggests that, despite good intentions, they became so complex that they have, by and large, missed this target entirely (Building Societies Association, 1999b; MORI, undated). Indeed the Building Societies Association has concluded that ISAs are too complex to fulfil their intended hallmarks of *'simplicity, flexibility, accessibility and fairness'* and that *'There is a strong possibility that those who do not currently save will be deterred, rather than encouraged, by the complexity of the ISA'* (Building Societies Association, 1999b).
- 7.55 The Association of British Insurers is currently designing a new savings product which it believes will better meet the needs identified by non-savers (HM Treasury, 1999a).

Pensions

- 7.56 People who currently lack a personal pension want one that: is low-cost, but will provide a guaranteed retirement income; is easy to understand; and is sufficiently portable and flexible to accommodate an insecure pattern of work that involves frequent job changes and periods of unemployment. For women, it needs to accommodate longer periods out of the labour market (Hedges, 1998; Kempson and Whyley, 1999a; Wood, 1999).
- 7.57 This is quite a tall order, but the Stakeholder Pension is designed to meet these needs. Research has shown that people in the target group are well-disposed towards the basic principles of the Stakeholder Pension. Although there are doubts about whether the amounts they could afford to put into a personal pension would be sufficient to provide an adequate retirement income that would not be seriously eroded by means-testing (Wood, 1999). This has led pension companies to argue that an effectively benchmarked product, like the Stakeholder Pension, should be more lightly regulated (see below) in order to cut the costs of provision and so maximise the contributions made by pension-holders.

Affordability

- 7.58 In many ways, affordability is addressed by many of the other issues covered in this section. For example, insurance policies through affinity groups offer economies of scale; they can reduce the administrative costs of provision, the costs of marketing and the collection of premiums or contributions. Also they can enable policy holders to spread the cost of their premiums. Likewise, cheaper credit can be offered through credit unions and arrangements between building societies and social landlords.
- 7.59 Simpler financial products should also be cheaper for consumers. Basic bank accounts require no credit scoring and do not carry the risk of financial penalties. Indemnity or catastrophe-only home contents insurance will also be cheaper than new for old comprehensive policies. Simple benchmarked investment products should therefore, require less regulation of the sales process, so reducing the costs.
- 7.60 The key, however, lies in providing products that are not just cheap but are also good value for money (Association of British Insurers, 1999a, 1999b;).

Financial literacy and combating psychological barriers

- 7.61 Providing simple products through appropriate delivery channels will not, however, be sufficient to ensure their take-up. There are considerable psychological barriers among people on the margins of financial services that also need to be overcome. As noted in earlier Chapters, there is a widespread belief that financial services are irrelevant to someone on a low income. In part, this is because, with many competing demands on their budget, people with low disposable incomes tend to put insurance, savings and pensions fairly low down on their list. But it is more than that. A lack of appropriate financial products and restricted access have fuelled a mistrust of financial service companies and created a belief that they have no interest in meeting the needs of people on low incomes. This mistrust means that even redesigned products are likely to be viewed with a considerable degree of scepticism.
- 7.62 Concerns such as these have led a number of commentators to identify a need for better information, written in 'plain' English and provided by a credible, unbiased source (see, for example, National Consumer Council, 1995, 1999; Pegram Walters Associates, 1995; Personal Investment Authority 1997; Vass, 1997; Association of British Insurers, 1999a). Such information is required to inform consumers about the products available and the FSA's plans to provide comparative information will be a big step in the right direction.
- 7.63 In addition, though, there is a need for information to build up trust and better relations between financial service providers and people who make little use of financial services (Pegram Walters Associates, 1995; Bayliss, 1997; Association of British Insurers, 1999a; HM Treasury, 1999a; Kempson and Whyley, 1999).
- 7.64 A number of research studies have also identified a need for a free, independent advice service to help people with decision-making about financial products. Some have gone further and suggested that such a service might be funded by a levy on financial service providers (see for example, National Consumer Council, 1995; Vass, 1997, Burchardt and Hills, 1998a; Hedges, 1998). Other research, however, has found that people on the margins of financial services are more interested in receiving explanations than getting advice, largely because they do not believe that advice can ever be truly independent (National Consumer Council, 1999; Wood, 1999).

7.65 Finally, as the Building Societies Association (1999a) notes, the problems with literacy and numeracy skills have been well-documented and, consequently,

the apparently weak education system in the UK makes a contribution to the presence of financial exclusion.

7.66 The national numeracy strategy could address these issues in schools and the work of the Personal Finance Education Group is also making an impact. But there is a need for adult education that it seems is not being met (Schagen and Lines, 1996).

7.67 The FSA has a remit to improve consumer information, advice and education and has consulted on how best to fulfil this function. The Authority has also embarked upon a programme of research in this area, which is wide-ranging. The particular contribution of this report is, however, to focus on the needs of people who are considered financially excluded. There is, however, little research to draw upon that looks in detail at the very basic needs that this group has in terms of both knowledge and trust and, in particular, at how these needs are best met.

Regulation

7.68 There are key areas where regulation, or its interpretation, can play a part in financial inclusion.

7.69 With bank accounts, there is a need for greater latitude in the range of identity documents that are acceptable to open an account. Discussions between the Treasury and the banking industry have paved the way for this to happen and, in future, far fewer people should find themselves unable to open an account for lack of suitable proof of identity (HM Treasury, 1999a).

7.70 For savings, pensions and other investment products there is a need for simpler, more appropriate regulation for some of the new products. Such regulation should protect low-income consumers but not price them out of the market. Past mis-selling has resulted in greater regulation, which, it is argued, has placed a disproportionate burden on products with low premium or contribution rates (Personal Investment Authority, 1997; Vass, 1997; Association of British Insurers, 1999a; Pearl Assurance, 1999). Instead, simple benchmarked products should need much lighter regulation as the opportunities for mis-selling should be greatly reduced. Based on research it has commissioned on Stakeholder Pensions, one company has argued for an 'explanation sale' that would cut costs by reducing the amount of information that currently needs to be collected by their sales staff (Pearl Assurance, 1999).

7.71 Also important, from a standpoint of financial inclusion, is the level of regulation required by fledgling not-for-profit organisations, such as credit unions, rotating savings and credit associations in minority ethnic communities and the proposed community banks. Indeed, the community bank initiatives in Portsmouth and Salford were delayed by the complexities of ensuring regulatory compliance with the FSA (Kempson and Jones, 2000). Again, the need is for regulation that widens access, while providing vulnerable consumers with an adequate level of protection.

7.72 Some would argue that, as not-for-profit organisations, they should not be subject to the same level of regulation as commercial organisations. Others, however, maintain that consumers need the same level of protection whoever they deal with and that regulation should relate to products as much as to suppliers. So simple products should be regulated in much the same way whether they are provided by a credit union or by an insurance company.

7.73 The Government has recently introduced measures designed to lift some of the restrictions in the Credit Union Act 1979, in order to encourage growth of credit unions. At the same time, there is a perceived

need for a system of more effective regulation, not least to ensure depositor confidence. This includes, for example, having a viable share protection scheme for members (HM Treasury, 1999b).

- 7.74 So far, we have looked at the impact of current regulation. There have, however, been calls for new legislation to tackle the problems of financial exclusion. For the most part, these have drawn upon the example of the US Community Reinvestment Act (see Section 6); (see, for example, Leyshon and Thrift, 1994; Leyshon and Thrift, 1995). However, recent developments, including the apparent interest of the financial services sector to find ways of tackling financial exclusion, have led to a greater emphasis on allowing time to assess these voluntary steps before deciding whether and in what form legislation is needed.
- 7.75 In particular, there have been calls for a strengthening of the voluntary codes of practice issued by trade associations, which form an important element of the way the financial services industry is regulated. As regards banking, it has been suggested that the code should include universal access to a basic bank account as well as a social audit of the impact of bank closures (Mayo and Mullineux, undated; Unifi, 1999; Donovan and Palmer, 1999).
- 7.76 The Co-operative Bank has gone further and commissioned research to identify key indicators on which it will report annually. Two of these are especially relevant in the debate on financial inclusion:
- The number of accounts provided to low-income households.
 - The number of Co-operative Bank employees working in areas of deprivation.

They have also made a commitment to assessing the social impact before taking the decision to close a branch (Co-operative Bank, 1998).

- 7.77 Others have identified ways in which the insurance industry codes of practice should be strengthened. In a review of financial services and financial exclusion, Burchardt and Hills (1998a) have identified scope for new or revised codes covering provisions for maintaining risk pools, universal low-cost provision and access to facilities and services, while the Office of Fair Trading (1999a: p.45) has recommended a strengthening of the safeguards for disabled people:

These codes and guidance should require the actuarial information on which decisions are based to be reliable and up-to-date. Self-regulation could only be strengthened if the DRC (now the National Disability Council) were given explicit powers to challenge, on an industry-wide basis, such actuarial information and the interpretation placed upon it.

- 7.78 Finally, a number of studies have approached financial inclusion legislation from a consumer perspective and questioned whether or not compulsion is the best way to ensure universal coverage of pensions. On the whole, however, it has been concluded that compulsion is not the best way forward (Age Concern, 1998; Association of British Insurers, 1998a; Insurance Trends, 1998a).

Monitoring financial exclusion

- 7.79 As the above shows, many steps are already being taken that should begin to tackle the problem of financial exclusion. There is, however, a need to monitor these to see how far they achieve financial inclusion and identify what other steps need to be taken.

- 7.80 A wide-ranging report, *Monitoring poverty and social exclusion 1999* (Howarth et al., 1999), proposes 46 different indicators of social exclusion, three of which relate to financial exclusion:
- The proportion of pensioners with no private income.
 - The proportion of households without a bank or building society account.
 - The proportion of households without home contents insurance.
- 7.81 Policy Action Team 14 has set out a more detailed set of milestones covering the period from 2000 to 2005 and recommended that there should be an annual report to see how far these have been met (HM Treasury, 1999a). These milestones include:
- By the end of 2000:*
- An increase in the number of banks offering basic accounts.
 - A further reduction in the proportion of households with no access to a bank account.
 - A substantial decline in the refusal of bank accounts because of non-standard identity documentation.
 - An increase in the number and take-up of insured with rent schemes, promoted by the DETR, Housing Corporation and Local Government Association working together.
 - Passage of credit union de-regulation measures and development of a regulatory framework for credit unions by the FSA.
- By the end of 2003:*
- Post offices to be automated and offering wider access to bank accounts.
 - Increased access to bank services by alternative delivery channels.
 - First wave of benefit recipients getting payment of benefits and pensions by ACT.
 - Credit unions' Central Services Organisation to be operational.
 - Substantial increase in coverage and take-up of insured with rent schemes.
 - Enhanced Social Fund operation to widen access to affordable credit.
- By the end of 2005:*
- All benefits paid by ACT.
 - Low-income households' usage of banking and insurance to be at similar levels to other social groups.
 - Substantial increase in credit union membership among low-income groups.

- 7.82 These milestones are, however, aggregate, industry-wide ones. Others advocate something much closer to the disclosure provisions of the US Community Reinvestment Act. At the same time it is recognised that the Community Reinvestment Act would not be easily transposed to the UK, where the structure of banking is very different – with far fewer local banks and building societies. On balance, there seems to be a preference for voluntary disclosure in the first instance, with the possibility of legislation kept in reserve (Kaur et al., undated; Mayo and Mullineux, undated; Donovan and Palmer, 1999).
- 7.83 A report from the New Economics Foundation (Mayo and Mullineux, undated) has set out in detail how such a scheme might work for banking. It has suggested that disclosure should preferably be voluntary, industry-wide and included within the Banking and Building Society Codes. Such disclosure should be:
- Appropriate to the current market.
 - Include a baseline of comparative data.
 - Be affordable.
 - Build on existing IT systems.
 - Extend to all relevant financial institutions, that is new entrants as well as traditional suppliers.
- 7.84 It is proposed that disclosure should be by postcode for low- to moderate-income neighbourhoods, as defined in the *Index of Local Living Conditions*. It should include volume of business and level of rejections for loans, mortgages, overdrafts, credit cards, leasing and factoring, bill-payment credits and invoice discounting. Regulatory options range from ‘self certification, with investigation on an exception basis’ to ‘more intensive regular scrutiny’. Community reinvestment ratings could be published annually by the Treasury, or listed in the Bank of England’s *Quarterly Bulletin*. It is, however, proposed that, to encourage current responses by banks, no sanctions should be considered unless there is no progress using a voluntary approach (Mayo and Mullineux, undated).
- 7.85 As well as monitoring progress in combating the current causes of exclusion, there is a need to be vigilant for new forms of exclusion, especially those that could arise through further privatisation of welfare or as unintended consequences of new regulation intended to protect consumers of financial services (Burchardt and Hills, 1997; HM Treasury, 1999a).
- 7.86 Finally, there is a need to monitor whether financial exclusion is replaced by marginalisation. In other words, that people are being offered products and methods of delivery that either fail to meet their needs (as was the case when mortgage payment protection policies became more widely available) or fail to integrate them into the mainstream of financial services (Pratt et al., 1996a, 1996b).

References

- Age Concern (1998). *Age concern debate of the age*. London: Age Concern.
- Association of British Insurers (1998a). *New ambitions for our country: a new contract for welfare*. London: Association of British Insurers.
- Association of British Insurers (1998b). *Response to stakeholder pensions from the ABI – a consultation document*. London: Association of British Insurers.
- Association of British Insurers (1998c). *16 million interested in Individual Savings Accounts*. (Press release.)
- Association of British Insurers (1999a). Financial exclusion – an ABI analysis of the background and issues to aid industry discussion. (Unpublished.)
- Association of British Insurers (1999b). Response by the Association of British Insurers to the Financial Services Policy Action Team. (Unpublished.)
- Avery, R. et al. (1997). Changes in the distribution of banking offices. *Federal Reserve Bulletin*, September: 707–25.
- Barker, A. (1995). Credit unions – rural initiatives. (Unpublished.)
- Barker, J. (Undated). What does the consumer want? An analysis of recent consumer research. (Unpublished.)
- Bayliss, V. (1997). *Financial services and the changing world of work*. Rep. No. Discussion paper 4. London: RSA.
- Bayer, P. et al., (1996). The effects of financial education in the workplace: evidence from a survey of employers. (Unpublished manuscript, June.)
- Bennett, F. (1995). *Security at risk*. London: National Association of Citizens Advice Bureaux.
- Bond, P. and Townsend, R. (1996). Formal and informal financing in a Chicago ethnic neighborhood, Federal Reserve Bank of Chicago. *Economic Perspectives*, July/August: 3–27.
- Booz-Allen and Hamilton Shugoll Research (1997). Mandatory EFT demographic study. A report prepared for the U.S. Department of Treasury, September 15.
- Budd, A. and Campbell, N. (1998). *The roles of the public and private sectors in the UK pension system*. London: HM Treasury.

- Building Societies Association (1996a). Financial inclusion: the building society contribution. (Unpublished.)
- Building Societies Association (1996b). A long way to go on ISA awareness. (Press release.)
- Burchardt, T. and Hills, J. (1997). *Private welfare insurance and social security: Pushing the boundaries*. York: York Publishing Services.
- Burchardt, T. and Hills, J. (1998a). Financial services and social exclusion. *Insurance Trends*, 18: 1–10
- Burchardt, T. and Hills, J. (1998b). From public to private: the case of mortgage payment protection insurance in Great Britain. *Housing Studies* 13: 311–23.
- Burchardt, T., Le Grand, J. and Piachaud, D. (1999). Measuring social exclusion in Britain 1991–1995. *Social Policy and Administration*, 33: 227–44.
- Burrows, B. (1999). *Living in a homeless hostel: You wouldn't credit it!* Glasgow: Money Advice.
- Burton, D. (1996). Ethnicity and consumer financial behaviour: a case study of British Asians in the pensions market. *International Journal of Bank Marketing*, 14: 21–31.
- Canner, G. and Passmore, W. (1997). The role of specialised lenders in extending mortgages to lower-income and minority households. *Federal Reserve Bulletin*, November: 709–23.
- Caskey, J.P. (1997a). *Lower income American, higher cost financial services*. Madison, WI: Filene Research Institute.
- Caskey, J.P. (1997b). *Beyond cash-and-carry: financial savings, financial services, and low-income households in two communities*. A report for the Consumer Federation of America, December.
- Clarke, H. and Parker, G. (1997). Attitudes and behaviour towards purchasing long-term care insurance. *Insurance Trends*, 15: 1–6.
- Co-operative Bank (1998). *The partnership report*. London: Co-operative bank.
- Conaty, P. (1997). New mutuality in practice. In J. Rossiter (Ed.), *Financial exclusion: can mutuality fill the gap?*, pp. 27–30. London: New Policy Institute.
- Conaty, P. and Mayo, E. (undated). *A commitment to people and place: the case for community development credit unions*. London: New Economics Foundation.
- Consumer Credit Association (1999). Combating financial exclusion: the role of the home credit industry. Submission prepared by the Consumer Credit Association to Treasury Policy Action Team 14. (Unpublished.)
- Department of Social Security (1999a). *Opportunity for all – tackling poverty and social exclusion*. London: Department of Social Security.
- Department of Social Security (1999b). *Social Security statistics 1999*. London: Department of Social Security.

- Disney, R., Grundy, E. and Johnson, P. (1997). *The dynamics of retirement: analyses of the retirement surveys*. London: Department of Social Security.
- Donnelly, R. and Kahn, H. (1999). *A report into the rapid growth of credit unions in Scotland*. Edinburgh: Royal Bank of Scotland / Heriot-Watt University.
- Donovan, N. and Palmer, G. (1999). *Meaningful choices*. London: New Policy Institute.
- Doyle, J.J. et al. (1999). How effective is lifeline banking in assisting the unbanked? Federal Reserve Bank of New York. *Current Issues in Economics and Finance*, 4 (6):1–6.
- Feloy, M. and Payne, D. (1999). *People, communities and credit unions*. Birmingham: Birmingham Credit Union Development Agency Limited.
- Finch, H. and Elam, G. (1995). *Managing money in later life*. Rep. No. DSS Research Report 38. London: HMSO.
- Ford, J. and Rowlingson, K. (1996). Low-income households and credit: exclusion, preference and inclusion. *Environment and Planning A*, 28: 1345–60.
- Ford, J. and Kempson, E. (1997). *Bridging the gap? Safety-nets for mortgage borrowers*. York: Centre for Housing Policy.
- Fox, J.A. et al. (1997). *The high cost of banking at the corner check casher: check cashing outlet fees and payday loans*. A report issued by the Consumer Federation of America, September.
- Freddie Mac Corporation (1999). Executive summary: Freddie Mac National Consumer Credit survey. Posted on the Freddie Mac web site (www.freddiemac.com), September.
- FSA (2000). *Better informed consumers: assessing the implications for consumer education of research by BMRB*. London: Financial Services Authority.
- Green, C., Zurbrugg, R. and Karlsen, H. (1996). *A licence to operate: education initiatives and the financial services*. Manchester: Manchester School of Management, UMIST.
- Hedges, A. (1998). *Pensions and retirement planning*. London: Department of Social Security.
- Herbert, A. and Kempson, E. (1996). *Credit use and ethnic minorities*. London: Policy Studies Institute.
- HM Treasury (1999a). *Access to financial services*. London: HM Treasury.
- HM Treasury (1999b). *Credit unions of the future*. London: HM Treasury.
- Hogarth, J.M. and O'Donnell K.H. (1999). Banking relationships of lower-income families and the government trend toward electronic payment. *Federal Reserve Bulletin*, July: 459–73.
- Howarth, C., Kenway, P., Palmer, G. and Miorelli, R. (1999). *Monitoring poverty and social exclusion 1999*. York: York Publishing Services.
- Hubbard, G. et al. (1995). Precautionary saving and social insurance. *Journal of Political Economy*, 103(2): 360–99.

- Hurst, E. et al. (1998). Wealth dynamics of American families, 1984–94. *Brookings Papers on Economic activity*, 1:267–337.
- Insurance Trends (1998a). Compulsory insurance – is it the answer? *Insurance Trends*, 17:1–120.
- Insurance Trends (1998b). Home service insurance companies: customer profiles and perceptions. *Insurance Trends*, 19:15–27.
- Insurance Trends (1999). Are affiliation group policies the answer to welfare reform? *Insurance Trends*, 20:1–8.
- Jacob, K. et al. (2000). *Tools for survival: an analysis of financial literacy programs for lower-income families*. A report issued by the Woodstock Institute, January. Chicago: Woodstock Institute.
- Jones, P. (1998). *Towards sustainable credit union development*. Manchester: Association of British Credit Unions Ltd.
- Joseph Rowntree Foundation (1995). *Inquiry into income and wealth*. York: Joseph Rowntree Foundation.
- Joseph Rowntree Foundation (1998). *Income and wealth: the latest evidence*. York: Joseph Rowntree Foundation.
- Kaur, S., Lingayah, S. and Mayo, E. (undated). *Financial exclusion in London*. London: New Economics Foundation.
- Kempson, E. (1994). *Outside the banking system*. Rep. No. 6 Social Security Advisory Committee Research Paper. London: HMSO.
- Kempson, E. (1996). *Life on a low income*. York: York Publishing Services.
- Kempson, E. (1997). Understanding financial exclusion. (Unpublished.)
- Kempson, E. (1998). *Savings and low income and ethnic minority households*. London: Personal Investment Authority.
- Kempson, E. (1999a). Insured with rent schemes. *Insurance Trends*, 23: 1–13.
- Kempson, E. (1999b). Safety nets for mortgagors. *Insurance Trends*, 22: 24–31.
- Kempson, E., Bryson, A. and Rowlingson, K. (1994). *Hard Times?* London: Policy Studies Institute.
- Kempson, E., Ford, J. and Quilgars, D. (1999). *Unsafe safety-nets*. York: Centre for Housing Policy, University of York.
- Kempson, E. and Jones, T. (2000). *Banking without branches*. London: British Bankers Association.
- Kempson, E. and Whyley, C. (1998). *Access to current accounts*. London: British Bankers Association.
- Kempson, E. and Whyley, C. (1999a). *Kept out or opted out? Understanding and combating financial exclusion*. Bristol: Policy Press.

- Kempson, E. and Whyley, C. (1999b). Understanding and combating financial exclusion. *Insurance Trends*, **21**: 18–22.
- Kempson, E. and Whyley, C. (2000). *Extortionate credit in the UK*. London: Department of Trade and Industry.
- Kennickell, A. et al. (2000). Recent changes in US family finances: results from the survey of consumer finances. *Federal Reserve Bulletin*, January: 2–29.
- Lee, R. (1996). Moral money? LETS and the social construction of local economic geographies in south east England. *Environment and Planning A*, **28**: 1377–94.
- Leyshon, A. and Thrift, N. (1993). The restructuring of the UK financial services industry in the 1990s: a reversal of fortune? *Journal of Rural Studies*, **9**: 223–41.
- Leyshon, A. and Thrift, N. (1994). Access to financial services and financial infrastructure withdrawal: problems and policies. *Area*, **26**: 268–75.
- Leyshon, A. and Thrift, N. (1995). Geographies of financial exclusion: financial abandonment in Britain and the United States. *Transactions of the Institute of British Geographers, New Series*, **20**: 312–41.
- Leyshon, A. and Thrift, N. (1996a). Financial exclusion and the shifting boundaries of the financial system. *Environment and Planning A*, **28**: 1150–6.
- Leyshon, A. and Thrift, N. (1996b). *Money/Space: geographies of monetary transformation*. London: Routledge.
- Leyshon, A., Thrift, N. and Pratt, J. (1998). Reading financial services: texts, consumers and financial literacy. *Environment and Planning D: Society and Space*, **16**: 29–55.
- Loudimis, J. and Middleton, S. (2000). *A cycle of disadvantage? Financial exclusion in childhood*. London: Financial Services Authority.
- Ludgate Public Affairs (1999). *Tackling social exclusion in financial services*. London: Ludgate Public Affairs.
- Lynch, M. and Haidar, L. (1998). UK report. In J. Evers and U. Reifner (Eds). *The social responsibility of credit institutions in the EU*. Baden Baden: Nomos verlagsgesellschaft.
- Marshall, J. N., Willis, R., Raybould, S., Richardson, R. and Coombes, M. (1999). *The contribution of British building societies to financial exclusion*. London: Building Societies Association.
- Martell, J. et al. (1997). *The effectiveness of scoring on low- to moderate-income and high-minority area populations*. A report issued by Fair, Isaac and Company, Incorporated, August.
- Mayo, E. (1997). Policy responses to financial exclusion. In J. Rossiter (Ed.), *Financial exclusion: can mutuality fill the gap?*, pp. 17–20. London: New Policy Institute.
- Mayo, E., Fisher, T., Conaty, P., Doling, J. and Mullineux, A. (1998). *Small is bankable: community reinvestment in the UK*. York: Joseph Rowntree Foundation.

- Mayo, E. and Mullineux, A. (undated). *Show and tell: a Community Reinvestment Act for the UK?* London: New Economics Foundation.
- McKay, S. (1992). *Pensioners assets*. London: Policy Studies Institute.
- McKillop, D., Ferguson, C. and Nesbitt, D. (1995). The competitive position of credit unions in the United Kingdom: a sectoral analysis. *Local Economy*, 10: 48–64.
- McKillop, D., Ferguson, C. and Nesbitt, D. (1995). Paired difference analysis of size economies in UK credit unions. *Applied Economics*, 27: 529–37.
- MORI (undated). Pension Plans Survey. (Press release.)
- MORI (undated). Individual savings account (Press release.)
- National Consumer Council (1995). *Financial services and low-income consumers*. London: National Consumer Council.
- National Consumer Council (1997). *In the banks bad books: how the banking code of practice works for customers in hardship*. London: National Consumer Council.
- National Consumer Council (1999). *Consumer concerns 1999: consumers views of advice and information on financial services*. London: National Consumer Council.
- NatWest (1998a). *Low earners want more help to provide for retirement*. (Press release.)
- NatWest (1998b). *Biggest pensions underclass is women*. (Press release.)
- NatWest (1998c). *Natwest pensions index*. Bristol: National Westminster Life Assurance Limited.
- NatWest (1999). *Education is the key to success of stakeholder pensions*. (Press release.)
- Newcombe, R. (1997). Social banking: the example of New Horizons. In J. Rossiter (Ed.), *Financial exclusion: can mutuality fill the gap?*, pp. 31–34. London: New Policy Institute.
- NOP (undated). *NOP research on pension provision*. (Press release.)
- Northern Ireland Executive (1999). *The first new TSN annual report*. Belfast: Northern Ireland executive.
- Office of Fair Trading (1996). *Health insurance*. London: Office of Fair Trading.
- Office of Fair Trading (1997). *Report of the Director General's inquiry into pensions*. London: Office of Fair Trading.
- Office of Fair Trading (1998). *Health Insurance*. Rep. No. OFT 230. London: Office of Fair Trading.
- Office of Fair Trading (1999a). *Vulnerable consumers and financial services*. Rep. No. OFT 255. London: Office of Fair Trading.
- Office of Fair Trading (1999b). *Job insecurity for the vulnerable: is it increasing?* Rep. No. OFT 255c. London: Office of Fair Trading.

- Office of Fair Trading (1999c). *The consumer survey*. Rep. No. OFT 255d. London: Office of Fair Trading.
- Office of Fair Trading (1999d). *Qualitative research into ethnic minorities and financial services*. Rep. No. OFT 255e. London: Office of Fair Trading.
- Opinion Leader Research (1999). *Home credit: bridging the gap in understanding*. London: Opinion Leader Research.
- Pacione, M. (1998). Towards a community economy: an examination of local exchange trading systems in West Glasgow. *Urban Geography*, **19**: 211–31.
- Panko, R. (1997). Home delivery. *Best's Review*, **98**: 60.
- Pearl Assurance (1999). *Partnership in pensions*. Peterborough: Pearl Assurance.
- Paterson, R.J. (1998). Community banking initiative: why RSLs should get involved. Portsmouth: Portsmouth Housing Association.
- Pegram Walters Associates (1995). *Pensions publicity qualitative research: a final report*. Rep. No. PWA 3817. London: Pegram Walters Associates.
- Personal Investment Authority (1996). *Consumer panel report 1996*. London: Personal Investment Authority.
- Personal Investment Authority (1997). *Consumer panel report*. London: Personal Investment Authority.
- Pratt, J., Leyshon, A. and Thrift, N. (1996a). Financial exclusion in the 1990s: the changing geography of UK retail financial services. (Working paper.)
- Pratt, J., Leyshon, A. and Thrift, N. (1996b). Financial exclusion in the 1990s. II: geographies of financial exclusion. (Working paper.)
- Rogaly, B., Fisher, T. and Mayo, E. (1999). *Poverty, social exclusion and microfinance in Britain*. London: Oxfam GB.
- Rossiter, J. (1997). *Financial exclusion: can mutuality fill the gap?* London: New Policy Institute.
- Rowlingson, K. (1994). *Moneylenders and their customers*. London: Policy Studies Institute.
- Rowlingson, K., Whyley, C. and Warren, T. (1999). *Wealth in Britain – a lifecycle perspective*. London: Policy Studies Institute.
- Schagen, S. and Lines, A. (1996). *Financial literacy in adult life*. Berkshire: National Foundation for Educational Research.
- Scottish Office (1999). *Social inclusion – opening the door to a better Scotland*. From website: Scottish Office, www.scotland.gov.uk/library/documents-w7/sima-oo.htm
- Social Exclusion Unit (1998). *Bringing Britain together: a natural strategy for neighbourhood renewal*. London: Social Exclusion Unit.

- Sherraden, M. (1991). *Assets and the poor: a new American welfare policy*. Armonk, NY: M.E. Sharpe.
- Speak, S. and Graham, S. (2000). *Service not included: social implications of private sector service restructuring in marginalized neighbourhoods*. Bristol: Policy Press.
- Srinivasan, S. (1995). ROSCAs among South Asians in Oxford. In S.Ardener and S. Burman (Eds.), *Money-go-round*, pp. 199–208. Oxford: Berg.
- Sterling, L. (1995). Partners: the social organisation of rotating savings and credit societies among exile Jamaicans. *Sociology*, **29**: 653–66.
- Stegman, MA. (1999). *Savings for the poor: the hidden benefits of electronic banking*. Washington DC: Brookings Institution Press.
- Stott, M. and Hodges, J. (1996). Local exchange and trading schemes: never knowingly undersold? *Local Economy*, pp.266–8.
- Thomas, A. (1998). *Within reason: access to services for blind and partially sighted people*. Rep. No. Campaign Report 5. London: Royal National Institute for the Blind.
- Thorne, L. (1996). Local exchange trading systems in the United Kingdom: a case of re-embedding? *Environment and Planning A*, **28**: 1361–76.
- Thrift, N. and Leyshon, A. (1997). Financial Desertification. In J.Rossiter (Ed.), *Financial exclusion: can mutuality fill the gap?*, pp. 11–16. London: New Policy Institute.
- Turner, W. J. (1996). Credit unions and banks: turning problems into opportunities in personal banking. *International Journal of Bank Marketing*, **14**: 30–40.
- UNIFI (1999). Financial exclusion. (Unpublished.)
- Urban Institute (1999). *What we know about mortgage lending discrimination in America*. A report issued by the US Department of Housing and Urban Development, September. Washington, DC: US Department of Housing and Urban Development.
- Vass, J. (1997). *Savings and investments for low-income consumers*. London: National Consumer Council.
- Welsh Office (1999). *Building an inclusive Wales*. Cardiff: Welsh Office.
- Whyley, C. and Kempson, E. (1998). *The needs of frequent payers and pre-payment customers in a competitive gas market*. London: Gas Consumers Council.
- Whyley, C. and Kempson, E. Access to current accounts in Scotland. Edinburgh: Royal Bank of Scotland. (Unpublished.)
- Whyley, C., McCormick, J. and Kempson, E. (1998). *Paying for peace of mind*. London: Policy Studies Institute.
- Williams, C. C. (1996a). Local exchange and trading systems: a new source of work and credit for the poor and unemployed? *Environment and Planning A*, **28**: 1395–415.

Williams, C. C. (1996b). An appraisal of local exchange and trading systems in the United Kingdom. *Local Economy*, pp.259–66.

Wood, C. (1999). *Pensions for all*. London: Pearl Assurance.

Yorkshire Bank (1999). *The penny drops for UK savers*. (Press release.)