THE POVERTY PREMIUM: A CUSTOMER PERSPECTIVE

EXECUTIVE SUMMARY

Authors: Sara Davies and Lorna Trend

NOVEMBER 2020

University of BRISTOL

The economic and social consequences of the Covid-19 pandemic have fallen hardest on those with low-incomes, and looks likely to throw many more into poverty. The poverty premium is when these households pay more for equivalent essential services and goods than wealthier ones. It occurs through the interaction of current market practices with the circumstances, needs, choices and constraints of lower-income households. This interaction can be compounded by factors such as digital or financial capability, as well as by geographical factors. However, by understanding why the poverty premium arises, we can begin to find ways to eliminate it.

ABOUT THIS STUDY

This three-stage, mixed-methods research study explored recent changes in the poverty premium landscape; to understand if the costs or types of premiums had changed over the last few years. Importantly, we did this through the lens of the low-income customer in order to hear first-hand how they experience these extra costs and to understand what would best help them to access goods and services at lower cost. This research was commissioned by Fair By Design[1] and Turn2Us[2].

- A review of the recent evidence about interventions designed to reduce or eradicate the poverty premium.
- A survey of 1,000 people living in low-income households[3] who had contacted Turn2Us for help, asking how they pay for services, and how well they were managing financially.
- Four focus groups with people in low-income households, examining a different dimension of poverty, such as age, financial difficulties, or having a young family.

KEY FNDINGS

The nature of the poverty premium has changed since 2016

The below table details the cost and incidence of the poverty premium in 2019, with comparison costs from our 2016[4] study. On average, in 2019 low-income households incur **£478** of extra costs through poverty premiums. This average was calculated by applying the nominal cost of each premium against the level of its incidence, assumed through the survey results. The equivalent figure for these premiums in 2016 was **£432**[5] , however, it should be noted that the *average amounts* of the premium, both overall and for each component, are not directly comparable - the survey methodologies between the two low income samples

[1] https://fairbydesign.com/fair-by-design-fund/

[2] Tun2Us is a national charity that helps people in financial hardship to gain access to welfare benefits, charitable grants and support services https://www.turn2us.org.uk/

[3] Low-income households were defined in the survey as those below 70% median income when equivalised for household size. This meant we could compare the findings with our earlier research which used the same definition.

[4] Davies, S, Finney, A and Hartfree, Y (2016) Paying to be poor - uncovering the scale and nature of the poverty premium. Bristol: Oak Foundation

[5] This figure includes only the particular premiums as detailed – others were included for the full 2016 poverty premium average of £490.

differed[6]. The *cost* of each component, as detailed in the table below, however, is comparable with those in 2016, as they were calculated on the same basis on both occasions.

A breakdown of the average poverty premium in 2019, with comparison costs for 2016

Premium	Households incurring premium 2019	Cost of poverty premium 2019	Average poverty premium 2019	*Cost of poverty premium (2016)*
	%	£ / year	£ / year	*£ / year*
		-	**£478**	-
Use of prepayment meters	**31**	**-**	**£28**	-
Prepayment meter - electricity	28	£29	£8	*£35*
Prepayment meter - gas	25	£29	£7	*£35*
On best prepayment meter tariff	10	£131	£13	*£227*
Non-standard billing methods			**£64**	-
Payment on receipt of bill - electricity	9	£54	£5	*£38*
Payment on receipt of bill - gas	8	£54	£4	*£38*
On best payment on receipt of bill tariff	5	£143	£7	*£43*
Home contents - monthly payments	29	£10	£3	*£9*
Car insurance - monthly payments	28	£161	£45	*£81*
Not switched to best fuel tariff	**53**	**£213**	**£113**	***£317***
Area-based premiums		**-**	**£133**	-
Home contents insurance - deprived area	44	£5	£2	*£14*
Car insurance - deprived area	44	£298	£131	*£74*
Insurance for individual items			**£23**	-
Household appliance insurance	8	£176	£14	*£132*
Mobile phone insurance	11	£81	£9	*£60*
Access to money			**£10**	-
Fee-charging ATM	35	£25	£9	*£25*
Pre-paid card fees	4	£33	£1	*£25*
Higher-cost credit	**28**		**£107**	-
Rent-to-own	2	£182	£4	*£315*
Short term loan*	4	£237	£9	*£120*
Home collected loan	4	£644	£26	*£540*
Pawnbroking loan	2	£152	£3	*£50*
Subprime personal loan	6	£557	£33	*£520*
Subprime credit card	12	£207	£25	*£194*
Mail order catalogues	10	£60	£6	*£178*
Christmas hamper scheme	1	£47	£0	*£47*

** short term (three month) loans were used as substitute for payday loans in 2016*

[6] In 2016 the survey was conducted by Ipsos Mori with a nationally representative sample of income households.

There has been a considerable change in the composition of the poverty premium since 2016 as well:

- In 2019, area-based premiums, particularly car insurance, were the largest contributor to the overall premium, with customers who live in a higher-risk area (20th percentile IMD area[7]) paying nearly £300 per year more on average, if they had insurance, than those who lived in a lower-risk area (50th percentile IMD). In 2016, this figure was only £74, which is a striking increase.

- The costs of the premiums related to energy costs, whether through switching or use of prepayment meters, have mostly reduced, with the exception of customers who pay on receipt of bill.

- The costs for use of High Cost Credit vary depending on the type of credit used, however, since 2016, the costs for buying goods on credit from a rent-to-own store, and using a mail order catalogue have dropped, but the costs of loan finance, whether subprime loans, short-term loans (payday substitute) and home-collected loans have all increased.

The experience of the poverty premium is diverse

As the poverty premium arises from a mix of market practices, structural circumstances, and behavioural factors, it is perhaps unsurprising that we found very varied experiences among different groups of people. Below we detail some of the notable differences between different types of low-income households, based on the data from both the survey of people who used Turn2Us. and from the four focus groups.

Those unemployed or in insecure work

Our survey data found that it was the respondents under 35 who were struggling, and were statistically the most likely to be falling behind on their commitments, or going without gas or electricity. They were significantly more likely to say that low income was negatively impacting on their life than older respondents (over 65). Qualitatively, this group may incur the poverty premiums that arise from participating in society; low-income households who need a car, perhaps to get them to work, and who could be paying far more than their peers in lower-risk areas. Debt charges were most common in those aged under 35, with nearly one quarter (23 per cent) suffering financially as a result of them.

Job loss was three times as common as redundancy among the households in our survey, suggesting a high level of insecure work. In the focus group, those in insecure work, resulting in irregular incomes, or who were unemployed, and faced delays in receipt of benefits, faced very constrained budgets, which could be a source of financial difficulty, and had implications for their ability to pay in the most cost-effective way.

Families with young children

Parents with dependent children were also trying to participate fully in most aspects of life and were particularly affected by the poverty premium in the insurance and credit sectors. This included the occasional use of credit for essentials like white goods, and sometimes for

[7] Index of Multiple Derivation; DCLG, 2015

social events like Christmas, as well as the use of appliance insurance, to ensure that they were covered if essential items were to break. However, this group was already doing all they could to minimise the energy-based premiums – switching levels were high, and parents spoke of monitoring heating costs very carefully.

Those in financial difficulty

Overall, those in poverty are at higher risk of falling into financial difficulty, and those who from the focus group of people who had sought advice for previous and ongoing financial difficulties tended to have the most consistently constrained budgets. The margin of error was often so tight that the risk of even small unexpected costs was a barrier to switching. This group were also hampered by poor credit ratings, impinging on their ability to access affordable credit, and to switch to the best deals.

Older people

It was in the need to be an active consumer in the energy and insurance sector – switching and negotiating a good deal – where the elderly were most disadvantaged; they were incurring premiums from a lack of participation in modern life. This disadvantage was related primarily to digital capacity. Some older consumers in our focus groups had developed good digital skills; however, this did not necessarily mean they were prepared to switch services online. While those in our survey who were over 65 – particularly those who were retired – were the least likely to be struggling, falling behind on their commitments, or going without gas or electricity, our focus groups found that this may be masking the fact that some are going without to manage to pay bills that are disproportionately high; some appeared to be reducing food costs and removing social activities like eating out in order to minimise costs.

Switching has a clear but limited role in poverty premium reduction

While the penalty for not being on the best energy tariffs was the biggest proportion of the poverty premium in 2016, and remains substantial in 2019, there remain barriers to switching for many of those in poverty. Issues of trust were key to the discussion around switching and revealed substantial dissatisfaction with the current consumer environment, whereby responsibility for getting a good deal falls to the consumer, regardless of their age, capacity, digital skills or ability to invest time in this area.

Firstly, there was a lack of trust in the stability of many of the newer energy companies, as the recent demise of a number of small providers was mentioned as a concern. Secondly, the fear of the unknown was an issue for those who hadn't switched before, and thirdly, some felt that the process of comparing prices and switching had produced only short-lived benefits, and that that they would end up on an expensive tariff again anyway. Across all groups, security was the biggest issue; fear of potential online fraud was a very real concern for many.

Conversely, there emerged a real wish for a relationship with service providers that went beyond the transactional, and a lot of criticism for the practise of increasing tariffs or prices, which resulted in existing 'loyal' customers paying more; trust was primary, and trust is built over time.

The challenges of negotiating a complex marketplace for older consumers or for those with a learning difficulty, health condition or other difficult situation, was overall deemed to be unfair and unrealistic. Even for participants without any particular limitations, the information required to determine the best deal was seen as complex and difficult to navigate. Nonetheless, particularly among those with young children, we found plenty who were prepared to switch to save money.

User-led solutions to help remove the poverty premium

Use of data to automate switching and entitlement to grants

- For those who are comfortable with switching, data sharing is less of a leap, and many could see a benefit in time and energy saved in automated switching. The use of data to facilitate entitlement to any grants or preferential tariffs was perceived to be of great benefit by a wider group.

Ending the 'loyalty' penalty

- Many focus group participants did not want to switch providers and felt it unfair that many companies penalised loyalty.

Flexible or personalised payment schedules

- Our research clearly shows that timings, methods and amounts of payments can play a causal role in some key poverty premiums. Allowing easy under- or over-payments would help low-income households to budget in a manner that helps them to avoid 'pinch points'.

Timely information and trusted intermediaries

- Many in the focus groups felt that lack of information was a huge barrier to getting the best deals:
    - Easy access to better information could make a difference to those focus group participants who were on expensive energy tariffs. Comparative information could help let people know what fair or reasonable costs would look like.
    - However, it is also important that information comes from a trusted source. Utility or telecom companies could signpost their customers to trusted sources of information, such as regulatory or government websites, to ensure that they are receiving any grants or support that they are entitled to. There was also felt to be capacity for social housing providers or local authorities to take a more active role in promoting clear information on energy and credit.

Addressing inadequate incomes: targeted support and preferential tariffs

- Inadequate income was the root cause of financial difficulties for many of our research participants. Consequently, our focus group participants felt that people on low incomes should receive targeted support (particularly related to energy costs and consumer credit), as well as expanding eligibility for grants.

POLICY IMPLICATIONS AND RECOMMENDATIONS

The policies, practices and innovations aimed at removing the poverty premium need to take account of the heterogeneity of poverty, and make sure that consideration is given to the impacts of different policies on different groups.

Regulators must play a key role in poverty premium reduction

The capacity for regulation to play a role in poverty premium reduction is demonstrable. Our updated calculations find that the Tariff Cap regulations implemented in 2016 and 2018 by Ofgem have reduced the domestic energy poverty premium. The findings also suggest that the Rent-to-Own price cap (2019) may have reduced the costs of buying goods in this way. *Widening the remit of regulatory caps, therefore, is an essential part of the poverty premium reduction strategy.*

In the domestic energy market, implementing a price cap on standing charges may be of real benefit to those who limit usage as a means to save money. For many retired, and single person households, the standing charge will form a substantial part of their energy costs.

In terms of the credit market, while use of mainstream credit cards and overdrafts does not necessarily produce a poverty premium, they are the most common forms of credit used by those on low incomes, and the high cost of these will be having a detrimental impact on their financial situation. The evidence suggests that the caps on the cost of credit, and on rent to own borrowing have had a broadly positive impact, although it is clear that capping costs is more effective in a comparatively simple market, such as gas and electricity provision, with less chance of costs being displaced elsewhere. *Nonetheless, without some form of cap on the cost of credit extending more widely to more forms of credit, then it appears unlikely that costs will reduce, and it will be difficult to reduce the substantive credit poverty premium.*

More broadly, the CMA needs to consider ways in which regulation may be effective (and needed) in ending the loyalty penalty. Although domestic energy provision was not part of the super complaint that is currently under scrutiny, our research found that the loyalty penalty was an issue in this sector, and is still to be fully addressed without a longer-term regulatory solution.

The FCA insurance market study explicitly recognises the need to address the 'price walk' that comes from renewing with the same insurance companies, yet it is the level of risk attached to living in an area of deprivation that it is the biggest constituent of the insurance poverty premium. *The FCA needs to consider what would be a fair risk pricing strategy within insurance.*

It is also evident that those who struggle with energy costs may well struggle to purchase white goods without credit, for example, and therefore a cross sector approach to understanding the particular vulnerabilities of poverty will produce the most benefit. Indeed, the cross-cutting nature of the poverty premium requires an approach that both understands and addresses the issues in a more comprehensive manner. The CMA should take forward previous scoping work on the poverty premium to accurately measure detriment across markets so the most effective interventions can be created, and to help easily recognise when one sector is treating low income customers unfairly.

Entitlement to fair tariffs or grants should be automatic

Our research has highlighted that many do not have the time, energy or, in some cases, the capability to ensure that they are on the best tariff, or that they have claimed any discount or rebate they may be eligible for. More of the responsibility needs to be placed on companies to ensure that they are giving the best value to the customer, whether that is letting them know that they are on an expensive tariff, and could switch to a cheaper one, or automatically giving them the warm homes discount (WHD). All energy providers should be able to give the WHD to eligible customers, and the provider should be able to identify those eligible through DWP data.

Improving access to frictionless switching

Group switching or auto enrolment could also play a role in reducing the parts of the poverty premium that arise from inertia. Evidence from the Big London Energy Switch[8], and Ofgem[9] finds that collective switching can increase the number of households on the best tariffs. There may be similar advantage for low income households through auto enrolment in basic home and contents insurance, perhaps as part of rental contract, or home contents insurance as a 'benefit' provided by other services, such as a current account or employer.

All customers should be able to pay flexibly without penalty

Low-income customers need to have more control over how and when they pay for goods or services, without penalty, and the ability to over- and under-pay easily will allow this. For example, a rent flexibility scheme[10] is currently being trialled to allow tenants of Optivo Housing Association to set up a personalised schedule of rent payments, accounting for known financial pressure points throughout the year. A greater range of businesses could give consideration to how similar schemes might work for their customers.

Understanding of the insurance needs of low-Income households needs to improve

Insurance can be understood as a 'hidden' poverty premium; while it constituted a substantial proportion of the overall premium, it was not perceived as such by the low-income customers we spoke to. While the recent regulation to prohibit selling extended warranties at the point of sale may reduce their usage, it is also clear that many take out these products because they offer the type of coverage required. As Aviva have produced a home contents cover that is designed specifically with the needs of low-income households in mind, a similar, and fair priced, product aimed at protecting white goods would reduce the poverty premium.

---

[8] https://www.londoncouncils.gov.uk/node/1648

[9] https://www.ofgem.gov.uk/ofgem-publications/156461

[10] https://www.responsible-credit.org.uk/trialling-supported-rent-flexibility-social-housing-tenants/

Increasing the availability of white goods could be of benefit

Enormous importance was placed on being able to access white goods, such as a reliable washing machine or cooker, at very short notice. Finding an easy way of distributing affordable white goods to those on low incomes, or increasing the availability and eligibility of grants to pay for them, would be of considerable benefit to low-income families

Improve access to affordable credit

While our findings highlight the limitations of credit, affordable or otherwise, to help those whose income is too low to support any type of borrowing, there was nonetheless scope for others to use lower cost credit when needed. Use of open banking to produce credit ratings, as done by companies such as Credit Kudos[11], for example, has the potential to reduce the credit poverty premium, and to help those whose credit file may not reflect their actual capacity to keep up with repayments. To avoid data sharing merely replicating existing inequalities, however, the findings of the data sharing review[12] by Fair4all finance need full consideration.

[11] https://www.creditkudos.com/

[12] https://fair4allfinance.org.uk/wp-content/uploads/2019/11/Project-summary-Data-Sharing-Review.pdf

University of BRISTOL

https://pfrc.blogs.bristol.ac.uk/