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Brian Pomeroy
CBE

Chair, Financial
Inclusion Taskforce

Paper Author



**Sukhvinder Kaur-
Stubbs**

Board member,
Consumer Focus
Chairperson



Alan Cook CBE
Managing Director,
Post Office Ltd

Panellist



Antony Elliot
Founder, FairBanking

Panellist

The debate

Introduction

This paper offers a thematic summary of discussions from our fourth event, which was held on 10th February 2010. Our paper author, Brian Pomeroy CBE, set out his views in a discussion paper which you can download from www.focusonfinance.org.uk

Brian's paper highlighted many of the issues around the additional amount that low-income consumers have to pay for financial services, which contributes to the 'poverty premium'.

Antony Elliott from FairBanking and Alan Cook CBE from the Post Office were given the opportunity to respond to Brian's paper before the discussion was opened up to the floor. The debate took place under the Chatham House Rule and quotes relate only to the author and panellists.

This final debate was part of a series of seminars which explore some of the issues to arise from the economic downturn from a consumer's perspective. The debates will be used to inform policy development for Consumer Focus.

The Poverty Premium

“Giving people an opportunity to benefit from a bank account is an important part of the remedy for the poverty premium. Historically there have been strong barriers to people on low incomes opening bank accounts. Banks did not welcome this particular customer group which they did not see as profitable. Formal barriers included the need to show types of ID, such as a passport and driving licence, that many poor people simply did not possess.”

Brian Pomeroy, Paper Author

Low income groups sometimes find it hard to open a bank account as they are not viewed as the most profitable consumers. Practical barriers to less affluent people opening bank accounts include requirements to present types of identification, such as a passport and driving licence, which many low income consumers do not have.

There are currently 1.75m adults without access to a transactional bank account - this in itself causes disadvantages. For example, those without a bank account often have difficulties securing employment as many employers require salaries and wages to be paid directly into a bank account.

Some employers are willing to pay salaries with a cheque, but this, in itself, creates a new problem – employees then pay (substantial) additional fees to have these cheques cashed. Another problem is security - money is more vulnerable to theft or loss. Thus, those without bank accounts suffer even greater financial insecurity.

Utility companies often incentivise the use of direct debits for bill payments - direct debits reduce the chances of outstanding bills. Those without bank accounts often pay more for utilities such as gas and electricity as they cannot take advantage of the many discounts available for paying bills via direct debit. Some individuals with very limited finances are also wary of using direct debits, even when they are available, because of the lack of control and the risk of charges.

The less affluent are often subjected to higher rates of credit as the risk profiles for those on lower incomes are often more complex. The benefits of remedying financial exclusion need to be built into a future economic model.

In essence, the poverty premium in financial services exists through both a lack of access and the incurring of higher charges. This seminar was an opportunity to discuss some of these issues in more detail and debate the way forward.

Providing financially inclusive services

Participants at the seminar were in agreement that information about suitable products for those on lower incomes is not always readily available. Many financially excluded people do not see any benefits to having a bank account. This is, in part, due to a mistrust of banking and sometimes through a fear of losing full control over their finances if they moved away from managing their finances in cash.

Some people lucky enough to have a bank account are sometimes cautious to use direct debits as they fear incurring large penalties. Others may be driven away from opening a bank account because of the risk of high fees. Basic bank accounts are presently free but do not have overdraft facilities. With these and other current accounts, consumers are often charged high fees for unauthorised borrowing. Participants at the seminar discussed the possibility of bank accounts which charged nominal up-front monthly fees in return for avoiding unexpected or large penalties for using an unauthorised overdraft. If there was no longer the risk of punitive fees for unauthorised borrowing, some consumers might be more willing to open a current account.

While bringing people into banking is a first line of defence against the poverty premium, this does not mean that everyone must have a bank account. But it does mean that anyone who wants to enjoy the advantages of being banked should have the opportunity to do so.

Knowledge is vital to deciding whether opening a bank account is the right option in the given circumstance. Messages and information about financial services must be easy to understand and accessible as a lack of knowledge is one of the main features of financial exclusion.

Seminar participants acknowledged that information penetration is difficult to achieve in some areas of the market – some people fail to read paper or electronic statements and notices, and some do not like to receive information by text message for data confidentiality reasons.

There are now fewer barriers to obtaining a bank account and the goal was reached in 2009 to halve the number of people without a bank account. However, despite this achievement by banks, government and many other agencies, barriers to banking continue to exist, as there are still a large number of adults in households without access to a transactional bank account. In addition, there remains an issue about the extent to which accounts which have been

opened are being used. It is not enough that financially excluded individuals open basic bank accounts, they must also be used as transactional accounts for inclusion to be achieved.

Widening Inclusion and the role of the Post Office

“It is important to promote financial inclusion whilst at the same time ensuring that companies are still able to make a profit.”

Alan Cook

“It is worth remembering that prior to the economic downturn many people would have said the banking sector was not serving everyone.”

Antony Elliot, Fair Banking

The Post Office was seen as having significant potential to contribute towards financial inclusion through the expansion of the Post Office Card Account (POCA) and the provision of other financial services. A strong consensus emerged at the seminar that the functionality of the POCA could be expanded so that it becomes a fully transactional bank account. This, many argued, would instantly give unbanked holders of the POCA access to basic financial services. Whilst such a move would be welcomed by many, careful consideration must be paid to the underlying business model. Alan Cook argued that the Post Office must be sustainable in the long run and any products or services it offers must be financed properly. The costs of upgrading POCA in terms of providing an infrastructure, such as IT and call centre costs, must be taken into consideration as it is unlikely that a fully transactional version of POCA would be self financing.

The impetus for such a change would have to come from the Government as the POCA is a product designed and offered on behalf of the Department for Work and Pensions (DWP). However, if the Post Office were to offer its own bank account, this would not require the approval of the DWP.

There will always be a section of society who view mainstream commercial banks as a hostile, unattractive place and who will prefer traditional, trusted outlets such as third sector community financial institutions such as the Post Office. A lot of POCA holders do not differentiate between a POCA and a bank account. If providers enhance the functionality on an account, it is essential that they make customers aware of the benefits of this development.

It was also noted by participants that the Post Office is often seen as a trusted national brand and especially low income consumers feel

comfortable when using services at the Post Office. Most low income consumers are risk averse as they do not have disposable funds and so tend to be cautious with the little they have. The Post Office also has significant advantages for some older people, who value face-to-face transactions and may have to grapple with financial capability issues.

There are huge costs to both central and local government of handling the consequences of financial exclusion. Recognition of the importance of social cohesion should be built into the economic model. Those on low incomes incur extra costs in their every day lives because they are financially excluded and tend to have bad debts and irregular cash flow. There is an overall cost to having a community which is constantly struggling financially. These costs manifest themselves in social problems including theft and substance abuse for example. The Post Office has the potential to be one of the main solutions to tackling financial exclusion. There was support at the seminar for the Post Office to develop the POCA as a means of promoting financial inclusion.

Can banks act for the common good?

Although there was support for developing the POCA, it was acknowledged that other ways of delivering financial inclusion need to be considered. Further progress in tackling financial exclusion is dependent upon developing a multi-faceted approach. More must be done to encourage banks to continue to offer basic bank accounts when customers ask for them and to keep up their efforts to reduce barriers to exclusion. At the same time there must be recognition among policymakers that there is a limit to what the banks alone can do in this field - there is substantial scope for the wider community to play a role in providing an adequate service. Credit unions, for example, have played an important role in providing affordable credit services to the financially excluded.

There is a persistent question of where to direct people who cannot get a bank account. It was suggested at the seminar that a way must be found to make the social fund work so that people never turn to loan sharks or other high risk forms of credit. There are also health benefits of improving financial inclusion - money matters affect people's overall sense of well-being and anxiety and depression levels can be significantly reduced if successful methods are put in place to remedy financial exclusion.

This might mean stimulating additional sources

of banking services and working through trusted intermediaries such as local authorities, housing associations, advice services and third sector organisations to inform and support people who want to become financially included by opening bank accounts. A key solution would be to design suitable products for low income consumers, for example accounts with low penalty charges and precautionary measures put in place to prevent consumers from incurring penalties if they go overdrawn or miss a payment. Although some customers do not want to receive details of their balance by text message, text alerts could play a role in informing people about new products and the features of their bank accounts. Financial services providers should be responsible for looking at new ways to use technology to design products that are cost-effective and therefore give banks a strong commercial incentive to serve low-income consumers.

Research should be carried out to see if there is scope for new forms of social enterprise that could emerge to provide community banking services. It is acceptable for such initiatives to have an element of profit involved, as this may help low income consumers to develop a stronger sense of financial awareness in the long term. An element of profit seeking may be essential to avoid stiff penalties such as unauthorised overdraft charges.

Identifying sources of profit for providers is crucial for the creation of financially viable solutions. This is the only way to entice key commercial providers to cater for poorer consumers and alternatives are necessary in order to promote competition in the low income consumer market. At present, there is a 10% default rate which is far too high. If pricing was more transparent in the banking sector, it would enhance competition and might broaden demand to include lower income consumers.

Summary

There was a consensus among both the panellists and guests at the event that greater effort should be placed on tackling financial exclusion and its causes. The Post Office was perceived as a viable option for leading the provision of services to those who often miss out on the best products as they are part of the lowest income brackets in society. The functionality of the Post Office Card Account could be expanded, but consideration should be made to the costs involved as any additional functionality must be financially sustainable in the long term.

A theme that was revisited from the third event in the series was whether banks should have the freedom to design products that are most profitable or should be mandated to create provide

products that are more socially inclusive. All participants agreed that it was both in our social and economic interests to broaden financial inclusion as much as possible.

The utilitarian principle that banking and the provision of financial services should be for the common good was high on the agenda. When banks fall into difficult times, they are rescued by governments, and therefore taxpayers. The same argument should apply to certain individuals who struggle financially despite their best efforts. Identifying how a system such as this could work in practice with minimum abuse requires a diverse approach from all layers of government, communities and both public and private sectors.

You can listen to an exclusive podcast from the fourth debate at:

www.focusonfinance.org.uk/debate4.html