

New  
**Philanthropy**  
Capital

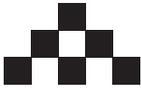
# Short changed

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## **Financial exclusion**

A guide for donors and funders



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## **Financial exclusion**

A guide for donors and funders

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# Summary

Two million adults in the UK do not have access to a bank account. At least three million people cannot get mainstream credit. And half of the poorest households have no home contents insurance. This is the reality of financial exclusion.

Financial exclusion hurts individuals, disrupts families and burdens society. It makes living on a low income more expensive, unstable and stressful than it otherwise would be, and acts as a barrier to personal development and economic progress.

For example, without a bank account, people cannot get the discounted prices that come from paying for gas and electricity by direct debit. Without insurance or savings, it can be impossible to recover from a flood or burglary. And debt problems can lead to mental health issues, family breakdown or homelessness.

Financial exclusion has a range of different causes. On the demand side, these include a lack of trust in financial institutions and low skills. On the supply side, causes include the way that financial products are designed and marketed. An underlying driver of exclusion is poverty—a problem that makes particular groups less able to pay, but also more expensive to serve. For instance, poorer people often want to borrow small amounts with flexible repayments, and they may have higher default rates than middle-income borrowers.

Over several years, the government has defined the field and led the way in tackling financial exclusion. Much of this has been done in partnership with charities—particularly those providing debt advice. But there is another party that is unavoidably involved in financial exclusion, whether tackling the problem or worsening it—the financial services industry.

Both government and the industry have put some money and energy into improving access to financial products, helping to solve debt crises, and helping people to

manage their finances better. In some areas, the situation is improving. For example, the number of people without bank accounts has fallen sharply in recent years. Yet financial exclusion in its various forms remains a significant problem, and other areas, such as insurance, have been relatively neglected. Levels of government and industry funding are low relative to need.

Third sector organisations are playing a useful role in promoting financial inclusion, both delivering services using government and industry funding, and taking action where the government and the industry are absent. Private donations can help to broaden the range of services that charities offer, increasing their quality and allowing innovation.

Nevertheless, financial exclusion is a multifaceted and fast-moving issue, and it can be a tricky field for donors to navigate. This is partly because it is not the target of a well-defined or unified sector. Instead, there is a fairly broad mix of charities with an interest in money problems. The need is great, but there is not always an obvious funding option. In some areas, tackling financial exclusion requires more 'engaged' donors who are willing to roll their sleeves up and get involved.

Most charities in this area are concerned with the demand side of financial inclusion—improving financial skills and confidence, and helping people with debt problems. Far fewer are concerned with the supply side of financial inclusion—providing accessible financial products or campaigning for broader change.

New Philanthropy Capital (NPC) has identified the following priorities for donors. In each area, more funding is needed to allow charities to widen or deepen their efforts. By supporting charities in these areas, philanthropists can make a real difference to the millions of people who are financially excluded in the UK today.

## Improving financial capability and tackling crisis

People need financial skills, knowledge and confidence to make the most of their money and to prevent future trouble. Funding is needed to support new, creative forms of financial education that engage families and reach financially excluded groups.

Charities also play a key role in helping people through what is often a consequence of financial exclusion: problem debt, or over-indebtedness. Debt advice can help people to manage a crisis, easing stress and anxiety and even avoiding bankruptcy or homelessness. However, people access advice when they are already in a lot of trouble, so funding should encourage more preventative advice that reaches people earlier. Funding could also support greater efficiency by mixing delivery methods.

## Improving the design and delivery of financial products

Bank accounts help people to store money safely and pay for things conveniently. Savings and credit help people to smooth expenditure. And savings, credit and insurance help people to cope in a crisis.

Yet many people find that the products available do not meet their needs, or else they come at a very high price. Other people are refused mainstream products and turn instead to the expensive sub-prime market.

A priority for donors interested in alternative provision of financial products is building the capacity of third sector lenders, which sometimes struggle to balance sustainability and reaching excluded people. There is also a need for research into issues such as the impact of lending.

## Improving the market

Increased competition and technological improvements have led to more sophisticated products and risk management. This has helped low-risk customers but has made life tougher for those who are perceived to be high risk.

Financial capability and suitable products are important, but their success is shaped by the regulatory and institutional context in which financial services are delivered. Lobbying and campaigning on topics such as the future of post offices, regulation of credit markets and reform of the Social Fund could help address financial exclusion.

## Conclusion

Despite recent progress, financial exclusion remains a serious problem. By supporting charities in this field, donors can help the millions of people who are financially excluded solve personal financial crises and make the most of their money.



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# Contents

<b>Introduction</b>	<b>5</b>	<b>5. Affordable credit</b>	<b>65</b>
The purpose of this report	5	The problem	66
Scope and content	6	Commercial sub-prime credit	67
Structure	6	Government action	71
Research process	7	Industry action	73
About NPC	7	Third sector activity	73
		Third sector lenders	73
		What is the role of donors?	81
<b>1. The basics</b>	<b>9</b>	<b>6. Savings</b>	<b>85</b>
What is financial exclusion?	9	Savings and financial exclusion	85
Why does it matter?	10	Saving options	87
Future trends	12	Government action	89
Who is financially excluded?	12	What is the role of donors?	93
What causes financial exclusion?	13	<b>7. Insurance</b>	<b>97</b>
How can financial exclusion be tackled?	15	What is insurance exclusion?	97
Government response	18	Why does it matter?	97
Conclusion	21	Who is affected?	98
		Causes of insurance exclusion	98
<b>2. Charities and donors</b>	<b>23</b>	Government action	100
The charity sector	23	Industry action	101
Charitable activity	24	Charitable activity	102
The funding situation	28	What is the role of donors?	103
Donors and financial exclusion	29	<b>8. Over-indebtedness</b>	<b>105</b>
What works?	29	Over-indebtedness and financial exclusion	105
What should donors fund?	33	Why does it matter?	106
Choosing organisations to support	37	Causes of over-indebtedness	107
Conclusion	37	Solving over-indebtedness	107
		Government response	109
<b>3. Financial capability</b>	<b>39</b>	Industry response	110
Financial capability and financial inclusion	39	The charitable debt advice sector	111
Tackling poor financial capability	41	What is the role of donors?	113
What does good financial education look like?	45	<b>9. A final word</b>	<b>117</b>
Government and industry action	48	<b>Appendices</b>	<b>119</b>
Charitable activity	50	Appendix 1: Industry funding for financial inclusion	119
What is the role of donors?	52	Appendix 2: Charitable funding for financial inclusion	120
		Appendix 3: Improving financial capability—the size of the sector	121
<b>4. Banking</b>	<b>55</b>	Appendix 4: Third sector lenders—the size of the sector	121
Banking exclusion	55	Appendix 5: Glossary of terms	122
Government and industry action	58	<b>Acknowledgements</b>	<b>123</b>
Solutions	59	<b>References</b>	<b>127</b>
Charitable activity	60		
What is the role of donors?	62		



# Introduction

## Derek's story<sup>11</sup>

Derek is married with two children. He suffers from learning difficulties but has three jobs and works long hours to provide for his family.

One Christmas, someone knocked on Derek's door offering to take a family portrait. Derek signed up without realising that the product was bundled with a loan from a home credit company, or that the total charge was over £2,000. All he knew was that he had to pay a manageable weekly amount.

When the agent turned up on Derek's doorstep in the following months, she often came with tempting goods, especially around the time of his children's birthdays. She offered cash loans to help him purchase them.

As time went on, Derek borrowed from a variety of doorstep lenders, each one requiring small, weekly repayments. He began to borrow from one provider to pay another. He was afraid of answering the door, especially one week when his family only had £26 to pay for food and bills. Derek ended up giving it all to the agent.

Eventually, Derek visited the money adviser at his local Moneyline, a not-for-profit lending organisation. The adviser worked out a budget, negotiated repayment agreements with Derek's creditors, and provided him with a loan to pay off the three creditors that were charging him the highest rates of interest.

## Joel's story<sup>8</sup>

Joel is a migrant from Brazil. He works full time for a hotel, as well as cleaning an office on weekday mornings and cleaning Wembley Stadium at the weekends. He hopes to save enough money to return one day to his wife and two daughters in Brazil.

When he arrived in the UK two years ago, Joel's passport was retained by the immigration authorities. As an undocumented migrant, he was unable to open a bank account. Nevertheless, his employers insisted on paying him electronically, so Joel started to use his flatmate Arturo's bank account to receive his wages.

One morning, when Joel returned from his nightshift at Wembley Stadium, he was shocked to find that Arturo had disappeared, taking £1,700 of Joel's savings with him. Two weeks later, Joel was evicted as he could not afford to pay his rent. He was devastated and desperate. With no other choice, Joel found another friend whose bank account he could use to receive his wages.

## Janet's story<sup>3</sup>

Soon after Janet left work to have her fifth child, her husband lost his job. The couple got so behind with their bills that they were almost evicted, but to make ends meet, Janet took out another loan.

Janet used to go for days without food, telling her children that she had already eaten. Her marriage hit rock bottom, and she could not bear to be in the same room as her husband.

Janet went to see her doctor because she was crying all the time and felt like she was not functioning. In the waiting room, she picked up an *'Are you in Debt?'* leaflet from a local charity. The doctor prescribed her anti-depressants, then Janet went home and called the charity.

A debt counsellor visited Janet the next day. They went over all the paperwork together, and the counsellor phoned all Janet's creditors to ask them to freeze all interest and charges. A week later, Janet had a budget of what to pay and when. *'It included a realistic amount to pay off our debts and we still had money to put food on the table and a small amount for savings—it was unreal.'*

## The purpose of this report

For millions of Britain's poorest people, making ends meet on a low income is not easy. But as Derek, Joel and Janet's stories show, financial exclusion can make living on a low income even harder.

Financial exclusion has many different manifestations. People can be excluded from one or many different products, through choice or because of access problems. Some people do not have the necessary documentation or credit history. Some are discriminated against on the basis of income, age or disability. Others simply have few financial skills and a poor understanding of financial services.

Financial exclusion has harmful consequences. It exacerbates poverty and can lead to serious debt problems, homelessness or even mental health issues. Certain vulnerable groups are particularly likely to be financially excluded, as this is an issue that is closely linked with problems such as disability, offending and domestic violence.

But for many people, financial exclusion can be overcome or even avoided. With the right support, people can make the most of the financial services available to them and make the most of their money.

This report helps donors to think about the role that they can play in tackling financial exclusion. It looks at the opportunities for private philanthropy and how these fit in with government funding. It helps donors to think about what makes an effective financial exclusion organisation, and shows donors what they can achieve with their money.

## Scope and content

NPC takes a broad definition of financial exclusion, referring to the situation of people who cannot or do not access and use appropriate financial products and services. The problem may lie with the products and services themselves, and the market in which they operate; or it may lie with the person's financial capability and personal financial situation.

On this latter point, NPC has found that financial exclusion not only exacerbates poverty, but also can be caused by having to live on a very low income. The issue of poverty is therefore central to financial exclusion and crops up throughout this report. Most of the charities highlighted provide their services to the poor. However, poverty is also an issue far broader than financial exclusion, so this report has no detailed critique of how charities can tackle poverty more generally. It will be the subject of a future NPC report.

This report covers England, Scotland and Wales, but not Northern Ireland.

## Structure

This report looks at the different issues facing financially excluded people. It considers the ways that charities are meeting their needs and the role that private philanthropy can play in improving their lives, ultimately promoting financial inclusion.

**Chapters 1 to 2** set the scene of financial exclusion and provide a detailed overview of the field. These chapters include a framework for thinking about the problem and consider how it can be solved.

Donors who require only a broad overview of how to tackle financial exclusion may choose to stop reading after Chapter 2.

**Chapters 3 to 8** cover six of the main issues in the financial exclusion sector. These chapters ask the following key questions:

- What is the issue?
- Why should donors care about it?
- What are charities doing about it?
- What can donors fund?

These chapters focus on the contribution that charities are making to solve each financial exclusion issue.

## Chapter 1: The basics

This introductory chapter provides an account of financial exclusion, focusing on its causes and impact. It introduces a four-fold framework for thinking about which factors create financial exclusion, and therefore how financial exclusion might be solved:

- the design and delivery of financial products and services;
- the financial services market;
- financial capability; and
- poverty.

The first two factors can be thought of as a problem of supply; the second two as a problem of demand.

This chapter then considers the role of the government in tackling financial exclusion.

## Chapter 2: Charities and donors

This chapter looks at how charities are approaching financial exclusion. It then considers the specific role that donors can play, and highlights questions that should be asked when allocating private funding.

## Chapter 3: Financial capability

This is the first issue covered, as poor skills, inadequate information and even low confidence are common causes of financial exclusion. Not everyone who lacks financial capability is financially excluded—many people on high incomes are not good at managing their money. But poor financial capability matters most to those who are excluded because they have the fewest resources to cope with the consequences of bad decisions.

Financial capability is a cross-cutting issue, playing a part in all the other issues that follow. It overlaps with the demand-side factors of the four-fold framework above.

## Chapters 4 to 7: Financial products

The report then looks at the four basic financial services that form the foundation of financial inclusion: **banking, affordable credit, savings** and **insurance**. These chapters all consider the two supply-side factors of the four-fold framework above.

### Chapter 8: Over-indebtedness

The final issue considered is over-indebtedness, or problem debt. This is not strictly a component of financial exclusion: many financially included people also have problems with their borrowing. However, it is a common consequence of financial exclusion and the struggle to manage on a low income with inadequate financial products.

### Research process

This project took around 18 months to complete. We conducted detailed desk research and consulted more than 30 experts, including civil servants, academics, grant-makers and charities. We also benefited from an advisory group made up of ten of these experts (see Acknowledgements). We identified

around 100 key charities and visited around 40 of them. We analysed several of these charities in detail to produce a first batch of six charity recommendations for donors, released at the same time as this report. Some of the experts we met during the early stages of our research then acted as consultative readers before we produced the final document.

### About NPC

NPC is a charity that helps donors understand how to make the greatest difference to people's lives. We provide independent research and tailored advice on the most effective and rewarding ways to support charities.

Our research guides donors—individuals, foundations and businesses—on how to support causes such as education, cancer treatment and mental health. As well as identifying the areas of greatest need, we highlight organisations that could use donations to best effect, and the results that these donations might achieve.

We keep a list of charity recommendations and regularly update it as the situation changes. The list is available on our website at [www.philanthropycapital.org](http://www.philanthropycapital.org).



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# The basics

Financial exclusion may not be a familiar term for some donors. Yet its manifestations—be it struggling to open a bank account, to get insurance or to access appropriate credit—are the sorts of problems that many people living on a low income will have experienced at some time in their lives. It does not need much reflection to realise that access to financial products and services is critical to people’s ability to acquire, manage and make the most of their money. But the precise nature and scale of financial exclusion is not widely understood.

## What is financial exclusion?

Financial exclusion describes the situation of people who **cannot or do not access and use appropriate financial products and services.**

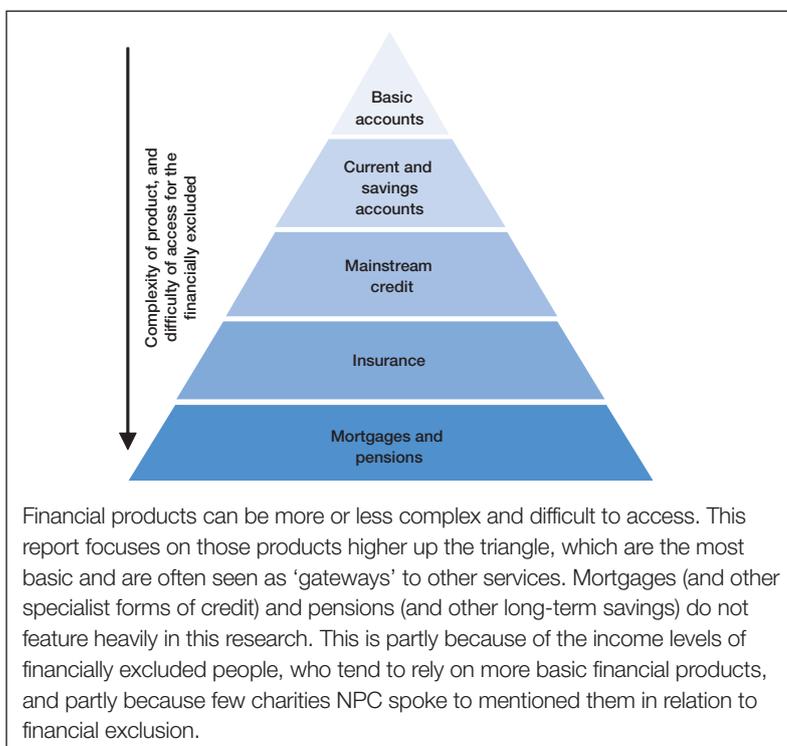
The term came to prominence in the late 1990s as part of the debate around poverty and social exclusion.

Historically, efforts to analyse poverty have focused heavily on incomes—how much cash (and other resources) individuals or households have coming in. Financial exclusion is partly about looking at the other side of the ledger: the costs that individuals, households and communities bear. Poor people pay more for many of their financial services than those on middle incomes—certainly in relative terms, and sometimes in absolute terms.

A key challenge with financial exclusion is that the term is very broad and could, theoretically, apply to exclusion from many different products and services (see Figure 1). It could also apply to people at many different income levels. In practice, it is used to refer to people on low incomes who:

- **Lack bank accounts**—people may not have them at all, or have them but do not use them.
- **Lack affordable credit**—mainstream credit may be unavailable or restricted. Some people cannot get any credit at all (at least legally). Others rely on lenders in the non-mainstream, or sub-prime, market. Critics often single out home credit (also known as doorstep lending)—a large legal industry that delivers cash to people’s doorsteps. Repayment is flexible, but costs are high—it costs £65 to borrow £100 from the biggest home credit company.
- **Lack savings and insurance**—people often do not have access to formal savings products. Different kinds of insurance may

Figure 1: A hierarchy of financial products



be unavailable or unaffordable. These areas have been relatively neglected in thinking about financial exclusion until recently.

A partial cause of financial exclusion is lack of **financial capability**: the knowledge, ability and confidence to make sensible financial decisions and manage money well. Poor financial capability can also be a consequence of exclusion, for example, if someone does not receive information or marketing from banks.

One very visible possible consequence of financial exclusion is **over-indebtedness.** Though not actually a defining feature of financial



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Financial exclusion makes living on a low income more expensive, unstable and stressful.

Table 1: How many people are financially excluded?

Component of financial exclusion	Prevalence of exclusion
Not being <b>financially capable</b>	The Financial Services Authority (FSA) 2006 baseline survey of financial capability in the UK found that 1.5 million people are falling behind with bills or credit commitments, and another 3 million face a 'constant struggle' to keep up. <sup>12</sup>
Not having and using a <b>bank account</b>	Two million adults in the UK do not have access to a transactional bank account, according to the latest Family Resources Survey (2005/2006). One in nine of the poorest households does not have an account. <sup>13</sup>
Not using mainstream, <b>affordable credit</b> , and using expensive sub-prime credit	In 2005, researchers at the University of Bristol conservatively estimated that more than three million people living in the poorest UK households are excluded from the mainstream credit market. A similar number use expensive sub-prime credit, such as doorstep loans and pawnbrokers. <sup>14</sup> Note, some people use both mainstream credit and sub-prime credit; others use neither.
Not building up <b>savings</b>	The 2005/2006 Family Resources Survey found that 28% of households have no savings, rising to 43% for households earning less than £300 per week. <sup>15</sup> The 2006 FSA baseline survey suggested that the numbers of people without savings may be even higher, finding that 43% of all households have no savings at all, with a further 15% only having savings of less than half of one month's income. <sup>15</sup>
Not having <b>insurance</b>	Half of the poorest households have no home contents insurance, compared to only a fifth of those on average incomes. <sup>16</sup>
Being <b>over-indebted</b>	7% of households are at least two months behind on at least one credit or bill payment. <sup>17</sup> An average of 292 people are declared bankrupt or insolvent every day. <sup>18</sup>

exclusion, NPC includes it in the scope of this research because it is a focus for many charities in the field. Over-indebtedness can also play a part in causing financial exclusion, for example, if it damages someone's credit rating.

There is no typical profile of a financially excluded person. One example might be a woman without much money who lives in social housing, only uses cash, pays as she goes in all things (from her mobile phone to gas and electricity) and who, faced with her boiler breaking down or paying for the funeral of a relative, ends up borrowing from a home credit company or even an illegal loan shark.

Another example is of an older man on a basic state pension who is not aware that he is eligible for more benefits, whose local bank branch and post office have recently shut down, and who cannot afford to drive because his car insurance increased on his 75th birthday.

### Why does it matter?

As Table 1 shows, financial exclusion is a problem on a large scale. It matters because its direct and indirect costs hurt individuals, disrupt families and burden society. In particular, it makes living on a low income more expensive, unstable and stressful than it otherwise would be. It also marginalises people, acting as a barrier to their personal development, their inclusion in society and their economic progress.

Table 2 spells out the benefits of financial inclusion and the costs of exclusion in relation to specific products and services. But there are several costs that crop up in more than one area.

Not having or using the right financial products makes living on a low income more **expensive**. For example, without affordable credit, loans from high-cost lenders divert significant proportions of people's income to repayments. Without a bank account, people cannot get the discounted prices associated with payment by direct debit. The **Family Welfare Association** and **Save the Children** estimate that poor families pay on average a £1,000 annual 'poverty premium'—9% of their income—for goods and services such as credit, gas, electricity and banking. This is because they cannot access the deals that higher income households enjoy.<sup>19</sup> One report has found that low-income consumers pay on average £129 a month in interest—11% of their income—servicing high-cost borrowing. For lone parents, the figure was 19%.<sup>20</sup>

Not having or using appropriate products makes living on a low income more **unstable** because, with low take-up of savings and insurance, underlying objectives like security, income smoothing, managing risks and asset accumulation are hard to achieve. For those who lack contents insurance or savings, there is reduced flexibility or security in the face of expected events (such as birthdays) or unexpected events (for example, flooding

can cause an irrevocable loss of wealth that can catastrophically interrupt a person's life). Individuals who operate day-to-day using cash are more vulnerable to theft; and without debt advice, problems can escalate, with a range of consequences—from having goods repossessed to bankruptcy and homelessness.

Not having or using the right products makes life more **stressful** for those living on a low income, partly because of the consequences of the expense and instability already mentioned. The Legal Services Research Centre—the research division of the Legal Services Commission—found that 89% of debt advice clients interviewed reported worrying about their money problems 'most' or 'all' of the time.<sup>21</sup> Around three in five clients reported having received treatment, medication or counselling as a result, and 45% of clients stated that debt problems had a negative effect on relationships with partners.

Financial exclusion **marginalises** people and acts as a **barrier** in their lives. For example,



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without motor insurance, it is illegal to drive. Without a bank account, it is more difficult to find work or at least to get paid, because employers now overwhelmingly pay salaries and wages electronically.<sup>22</sup> This may be a factor that keeps people on low incomes employed in the informal economy.

**Table 2: The benefits of financial inclusion**

Financial service	Why it is needed	Consequences of financial exclusion in this area
<b>Money guidance and education</b>	To enable people to make the most of their money, using financial products and services well.	People do not make the most of their money.
<b>Bank account</b>	To store, save and access money safely. To make electronic payments by direct debit, standing order and, where accounts have them, debit cards. Some goods can only be bought over the internet or phone. Others, such as satellite TV, are only available by direct debit. Some goods and services, including gas and electricity, are cheaper when paid for electronically. It is a gateway to other services: bank account holders can build up a credit rating, learn about finance, and are exposed to marketing. Some accounts are a direct gateway to credit, via overdrafts.	Managing money can be more complicated, take longer, and be less secure. People miss out on the discounts that come with paying by direct debit for services like gas and electricity. It is harder to get a job, because most employers pay wages electronically. People are forced to rely on cheque cashers. People do not get opportunities to access other services. It is harder to build up assets.
<b>Affordable credit</b>	To smooth consumption when income or expenditure varies (eg, at Christmas or birthdays), and to smooth consumption over a lifetime. To meet emergency needs. To develop assets.	Reduces opportunities (such as school trips and training). People have to go without, or rely on expensive or illegal lenders. It is harder to acquire assets or become a homeowner.
<b>Savings</b>	To smooth consumption when income or expenditure varies (eg, at Christmas or birthdays), and to smooth consumption over a lifetime. To meet emergency needs. To develop assets. To increase confidence and sense of security.	People have to turn to credit in emergencies and to smooth expenditure. Reduces opportunities (such as school trips and training). It is hard to acquire assets or investments, or to become a homeowner.
<b>Insurance</b>	To replace assets lost in the event of a crisis such as a fire or burglary; to be able to drive; to be protected when travelling.	People are at risk of serious losses.
<b>Debt advice</b>	To help people manage a crisis.	People can suffer stress and anxiety over unmanageable debt. It can lead to ill health and relationship breakdown. People can lose assets and even go bankrupt.

Poor access to financial services is one way that disadvantage is transmitted and sustained in communities.

Financial services are becoming more sophisticated. Commentators are talking about *'the end of cash'*.

In addition to these effects on individuals, there are consequences for communities and society. For example, where money is spent servicing interest repayments, borrowers have less income to spend locally. This may translate into lower support for local businesses and the loss of a *'multiplier effect'*, albeit offset to some extent if the initial loan is spent locally and if lenders employ local people.<sup>23</sup>

To the extent that financial exclusion contributes to expense, instability and stress, it is associated with factors such as higher unemployment,<sup>24</sup> greater use of benefits<sup>25</sup> and ill health<sup>26</sup>—the costs of which have not been quantified to NPC's knowledge. It is also possible to identify links to crime, particularly through illegal lending, which is associated with drugs and prostitution.<sup>6</sup>

Finally, financial exclusion can be intergenerational. Financial behaviour is strongly influenced by parents, families and friends, so poor access to financial services is one way that disadvantage is transmitted and sustained in communities.

### Future trends

Both the numbers affected and the consequences of being financially excluded look set to grow—because of cyclical factors, because of changes in social policy and, most fundamentally, because of long-term trends.

#### Cyclical factors

Economic conditions at the time of writing—particularly the *'credit crunch'*—seem likely to reduce the access of those on low incomes to mainstream loans as banks take a tougher attitude to risk. One City analyst that NPC has spoken to suggests that home credit, previously thought of as a mature market possibly in decline, is set to grow strongly off the back of this.<sup>27</sup> There is also evidence of rising problem debt among people higher up the income scale, reflected in emerging data on mortgage repossession orders.<sup>28</sup>

#### Social policy

Several changes are putting more responsibility for managing money on the shoulders of individuals. These changes increase the costs and risks of being excluded. For instance:

- The government is seeking to expand direct payments and individual budgets for the purchase of social care by elderly and disabled people, following a pilot that ended in December 2007. Some of the individuals involved are very vulnerable and may lack financial capability. The risk is that a policy designed to increase their choice may damage their welfare if they cannot protect, manage and spend their money well.

- Similarly with a different development—the reform of Housing Benefit through the introduction of Local Housing Allowances. Here, the government has been piloting paying rent direct to tenants rather than to landlords. The idea is to give individuals control of their housing payments so they can shop around for a better deal. In principle it seems like a good idea to devolve responsibility, but there are risks of people not being able to manage the money or it going astray. Again, this risks marginalising people who lack financial capability.

#### Long-term trends

One factor that may increase financial exclusion is the decline of the final salary pension scheme alongside pressure on the state pension. People need to be better at long-term planning to make provision for their old age.

Another factor is the changing technology of financial services, which are becoming more sophisticated, for example, with the introduction of internet banking and risk-based pricing of credit and insurance. Commentators talk about *'the end of cash'*.<sup>29</sup> Some important forms of payment, such as cheques, are already being phased out, potentially marginalising those who cannot adapt quickly.

### Who is financially excluded?

Information here is incomplete. However, we do know that most financially excluded households are on low incomes and have few assets. Half of people without bank accounts are single, a fifth are lone parents, and 40% are of working age but do not work, mainly because of childcare responsibilities.<sup>25</sup>

Financial exclusion is closely linked to a number of other important social issues, such as homelessness, mental health problems and domestic violence. By tackling financial exclusion, donors will also help to tackle many other interlinking issues, and in doing so gain leverage from their investment. Particular groups are highlighted in case studies and boxes throughout the report.

Vulnerable groups that are particularly likely to be financially excluded include:

**Social housing tenants:** Around 60% of *'unbanked'* households rent social housing accommodation from a local authority or housing association.<sup>25</sup> Not having a bank account also underlines the risks associated with paying Local Housing Allowances direct to tenants.

**Prisoners and ex-offenders:** The Legal Services Research Centre found that 40% of prisoners report having no financial products at all.<sup>21</sup> This group has a wide range of financial inclusion needs, such as access to products,

debt advice, and increased financial capability. (See also Box 37.)

**Older people:** Help the Aged has provided evidence to the Treasury Select Committee showing that financial exclusion increases with age: 7% of 50 to 59 year olds do not have access to a bank account, increasing to 12% of over 85s.<sup>30</sup> (See also Box 7 and Box 8.)

**Migrants and refugees:** There is a lack of hard data on the financial exclusion of migrants and refugees, but several factors put them at risk, including not understanding UK financial services, language barriers, document problems, and incomplete or non-existent credit history.<sup>31</sup>

**Ethnic minorities:** Some minority ethnic groups—particularly Afro-Caribbean, Pakistani and Bangladeshi households—make limited use of financial products due to language barriers, religious beliefs and lack of knowledge.<sup>32</sup> (See also Box 12 and Box 20.)

**People with a disability or long-term illness:** Causality here is hard to unpick, but disability often goes hand in hand with unstable income, poverty and debt, all of which put people at risk of financial exclusion. Mental health problems can be a cause and a consequence of financial exclusion: 43% of people have experienced stress or illness due to money worries.<sup>33</sup> (See also Box 36.)

**Victims of domestic violence:** Financial exclusion is a frequent feature of domestic violence. Victims escaping violent partners may need help setting up new financial identities. They may have low levels of financial capability if their abuser has kept a tight control on finances. Some victims are also heavily in debt, due to their abuser taking out loans in their name. (See also Box 4.)

**Young people not in education, employment or training (NEET):** These young people tend to have particularly low levels of financial capability. Budgeting skills and general financial management may be important for these young people to make the transition to the next stage in their lives. (See also Box 15.)

Financial exclusion also has a very important geographic dimension. Half of those with no financial products live in one of the 50 most deprived districts and boroughs in England and Wales.<sup>34</sup> People who are disadvantaged and living in rural areas can be more cut off than those living in urban areas: they are likely to live further from basic services such as banks and cash machines, and there are obvious accessibility problems for people who do not have their own transport.<sup>35</sup>

Finally, it is worth noting that financial exclusion is dynamic. For some it is acute: a temporary problem that arises as part of normal transitions through work and life, such as illness, family breakdown or job loss. For others, financial exclusion is chronic: arising in relation to

### Box 1: Debt and financial exclusion

In the early 1990s, Andrew took out a secured loan of £10,000 with a sub-prime lender. After 14 years, he had paid back three times that in monthly instalments, never missing a payment. Only then did he realise that he had only been paying back interest, and still owed £12,000 on what was supposed to be a 15-year loan. Andrew is now retired on the grounds of ill health, and is unlikely ever to be able to pay the outstanding amount.<sup>37</sup>

Jane borrowed £300 from an illegal loan shark in Birmingham, and was told she would have to repay a total of £680 at £20 per week. When she missed a repayment, the lender added on £300 to the amount she owed. Eventually, after Jane had repaid £780 and still owed hundreds more, the lender was arrested.<sup>6</sup>

A Citizens Advice Bureau in Shropshire reported that Frances, a 61-year-old widow living on a farm, sought advice about her debt problems. That year, Frances had had to cope with her husband's death, the foot and mouth epidemic, a nephew's suicide, her daughter's marriage break-up and her father being diagnosed as terminally ill. During this period she felt unable to pay any of her commitments due to her state of mind. When she finally sought advice from the bureau, she brought with her a large carrier bag of unopened mail. The bureau reported that Frances needed several interviews and advice sessions before she felt able to start coping with her debts in a practical way.<sup>38</sup>

long-term unemployment or from growing up in a financially excluded household where the problem is transmitted between generations. Donors may wish to distinguish between temporary and chronic exclusion: arguably the latter matters more than the former because it damages people's life chances.

### What causes financial exclusion?

Financial exclusion has multiple components, and any of its manifestations can have a number of headline causes. For instance, Box 1 highlights some different causes of over-indebtedness. Also:

- People who do not have bank accounts will often have had problems with proving their identity or residency—both requirements under money laundering regulations. Some do not feel at home in banks, and prefer operating in cash because it helps them to budget and keep in control of which creditors to prioritise. Perhaps they have been stung by a large fee for missing a direct debit. Others prefer banking face-to-face, but do not live near a branch. And some have language or literacy problems.
- People who do not access credit at affordable prices may be unable to use mainstream bank loans, overdrafts or credit cards because they have a bad credit history. Others, like migrants, may have no credit history at all. A third group might be able to access mainstream credit, but it does not suit them: they want small sums, not large bank loans; they need to be able to miss the odd payment but cannot afford bank penalties; they need cash, not a credit card.

“I have to be very careful about my spending... money can't buy you happiness but it offers you peace of mind.”<sup>8</sup>

The most obvious insight that these examples provide is that financial exclusion is a complicated phenomenon—it is not easy to point to a single dominant feature.

One way to make sense of it is to note that it is partly a problem of supply (the financial products and services available) and partly a problem of demand (the choices and behaviour of the consumers of financial services). But there are also supply and demand problems on a broader scale: exclusion is partly a problem of the way the financial services market is structured and regulated, and partly a problem of insufficient income.

These perspectives are not mutually exclusive but collectively help to account for the way in which different factors come together to create exclusion. Figure 2 highlights a framework for bringing them together.

Figure 2: The causes of financial exclusion

	Micro	Macro
Supply (institutions)	Product design and delivery	The way the financial services market works
Demand (individuals)	Financial capability	Poverty

‘Micro’ explanations

On the supply side, there is a problem of **design and delivery**. Mainstream financial products are built for people on regular, stable, moderate incomes. This is apparent in the minimum sums that can be borrowed from a bank or the minimum cover on an insurance policy: both can be higher than those on low incomes might want. It is also apparent in bank fees. The UK ostensibly has a free banking system with no monthly charges for current accounts. Instead, banks generate significant funding from penalty charges and fees for unauthorised overdrafts and missed direct debits. This system may penalise those least able to bear the costs. A different design with a small charge for an account and lower fees might suit some financially excluded people better. It remains to be seen if this will emerge as a consequence of recent legal challenges to bank charges.

On the demand side, there is a problem of **financial capability**—people’s skills, knowledge and confidence. Some people do not have a bank account because they do not like banks or have only got the skills to operate in cash. Some choose not to save or take out insurance because they misunderstand the benefits. Others are bad at budgeting or do not know where to find debt advice.

Both these perspectives offer part of the explanation of financial exclusion. But they do not tell the whole story. In particular, they are open to the objection that they do not make explicit the structural factors shaping exclusion.

‘Macro’ explanations

On the supply side, the design of financial products and their marketing and distribution are shaped by another factor: the choices of financial services institutions and the regulatory and institutional framework in which they operate. As a shorthand, this is described here as a problem of the **financial services market**.

Financial exclusion arises from the way the financial services market works. Increased competition and technological improvements mean that the market focuses on, first, identifying and serving the most commercially attractive customers, and second, searching for cheaper delivery channels. Better pricing and segmentation of risk have helped those who are low risk, but they have made life more difficult for those who are (or are perceived to be) higher risk. Credit scoring has become based on automated assessments of socio-economic factors, rather than personal relationships and trust. Innovations like internet banking have increased access for some, but they leave other people behind (including some older people, people with disabilities, and the poor). Technology is expensive and can be hard to access.

In their strongest form, these institutional explanations for exclusion comprise a complaint about lack of social justice: commentators highlight profit-making institutions ‘actively excluding’ loss-making low-income customers and not providing products and services that they want and need.

But the role of financial institutions in creating exclusion can be more inadvertent than this. For instance, by framing an offer to wealthier customers, and reducing branches and marketing in poorer areas, psychological barriers are reinforced among poorer customers that mainstream products are not for them, and they exclude themselves.

On the demand side, the choices individuals make reflect not only their decisions but the options open to them. The exercise of financial capability has to be seen in the context of **poverty**.

Poverty has compound effects: on the one hand, it reduces the cash available to buy products and services; on the other hand, it increases the cost of delivering products and services. For example, many people on very low incomes live in the most deprived areas and are most vulnerable to crime. This drives up the cost of insurance.

In 2005/2006, around 13 million people—a fifth of the UK population—were living in relative poverty (on less than £108 a week for a single adult). This was an increase of 750,000 on the previous year, following six years of improvements.<sup>36</sup>

There are psychological barriers among some poorer people that mainstream products are not for them.

## How can financial exclusion be tackled?

The four factors highlighted above—design, capability, the market and poverty—recur throughout financial exclusion. By separating them out, the framework (Figure 2) also highlights the different ways of tackling it.

### Supply-side solutions

#### Improving the design and delivery of financial products

If financial exclusion is understood as a problem of the design and delivery of financial products, its solutions lie here too. Identity requirements should be understood by staff and customers. More flexible bank accounts need to be developed and marketed. Flexible low-cost credit needs to be made available. And insurance needs to be made more affordable and accessible. All this leads to solutions based on supporting alternative provision of financial services, new product development, increased competition, practical support accessing bank accounts and cheaper credit.



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#### Improving the way the financial services market works

Changing the broad regulatory and economic system might seem a daunting task. But change could be encouraged by campaigning for better regulation to ensure financial products are available more widely, for example, considering access issues or 'fair' treatment of low-income customers.

### Box 2: Are financial services market or social goods?

A recurrent debate in this report is the role of financial service providers and the wider market in excluding people.

Campaigners sometimes complain that banks put profits over inclusion and ignore their supposed social obligation to serve the whole community.

A slightly different case is also sometimes made, namely that banks are missing out on valuable customers. Here the complaint is that banks are ignoring the business case for targeting financially excluded people.

Donors thinking about these issues should beware. These arguments risk confusing what is really at stake.

Financial services are currently treated as market goods in the UK. That is, they are (mainly) created and sold by profit-making firms. The implication of this is simple. Unprofitable customers do not get the chance to benefit from those goods and services. Firms aim to exclude loss-making customers, and in most areas of life, we accept this is reasonable. Policy-makers do not concern themselves overly with people who are, say, 'iPod' excluded.

How then might financial services be different? This goes to the heart of why policy-makers care about financial exclusion. Financial services differ because, arguably, they are in some cases social goods rather than market goods. What campaigners are really saying is that some products are so fundamental to taking part in society that they need to be available to everyone. Precisely where to draw the line on this is uncertain, but it certainly seems to describe bank accounts, given their significance in accessing many other aspects of modern life and their use in social policy such as delivering benefits.

If certain financial services are social goods, arguments about their supply are best made to government, not to banks. Only government can guarantee equity of access—either by regulation or subsidy.

What about the business case argument—complaints that banks are excluding people who are in fact potentially profitable? Firms have strong incentives to sell to customers, so the premise of this view is that there has been a 'market failure' in developing or selling new or existing products. Perhaps this failure is lack of information about low-income customers, or reputational risk (for example, where a new loan product involves higher than normal interest rates). The role of campaigners here is to show that this is the case and, if necessary, to establish alternative provision.

It is important not to confuse the different arguments for tackling financial exclusion. If the problem is that an excluded group could be profitably served with existing or new products and services, it can be solved by establishing a business. If the problem is that an excluded group cannot be served profitably, but the good or service is important to taking part in society, a business response will not do. A case for someone to pay for it needs to be made—usually to government.

Donors can intervene either to prevent financial exclusion or in reaction to its consequences.

Both the design of products and the functioning of the financial services market raise fundamental questions about the role of banks and the extent to which tackling financial exclusion means making markets work on their own terms, or reshaping them. These are discussed in Box 2.

**Demand-side solutions**

**Improving people’s financial capability**

This includes education to build people’s knowledge and skills, such as budgeting and planning. It might mean giving practical support to access products, for instance, by accompanying an unconfident person to a bank. Improving financial capability also includes broader money guidance, which is personalised advice on maximising financial well-being. This might include help on how and where to save or how to find the best deal on gas and electricity.

Solutions based on skills, knowledge and confidence are open to the objection that they cannot be the main cause of financial exclusion, as low capability affects many people who are financially included. But poor capability certainly has more serious consequences for people who are excluded since, with less of a cushion, they are more affected by the consequences of bad decisions. Moreover, people on middle incomes are insulated to some extent from low capability by their circumstances—though their actual skills may be no better, they have more money to cover expenses, and are more likely to

have savings or be covered by good employer benefits.

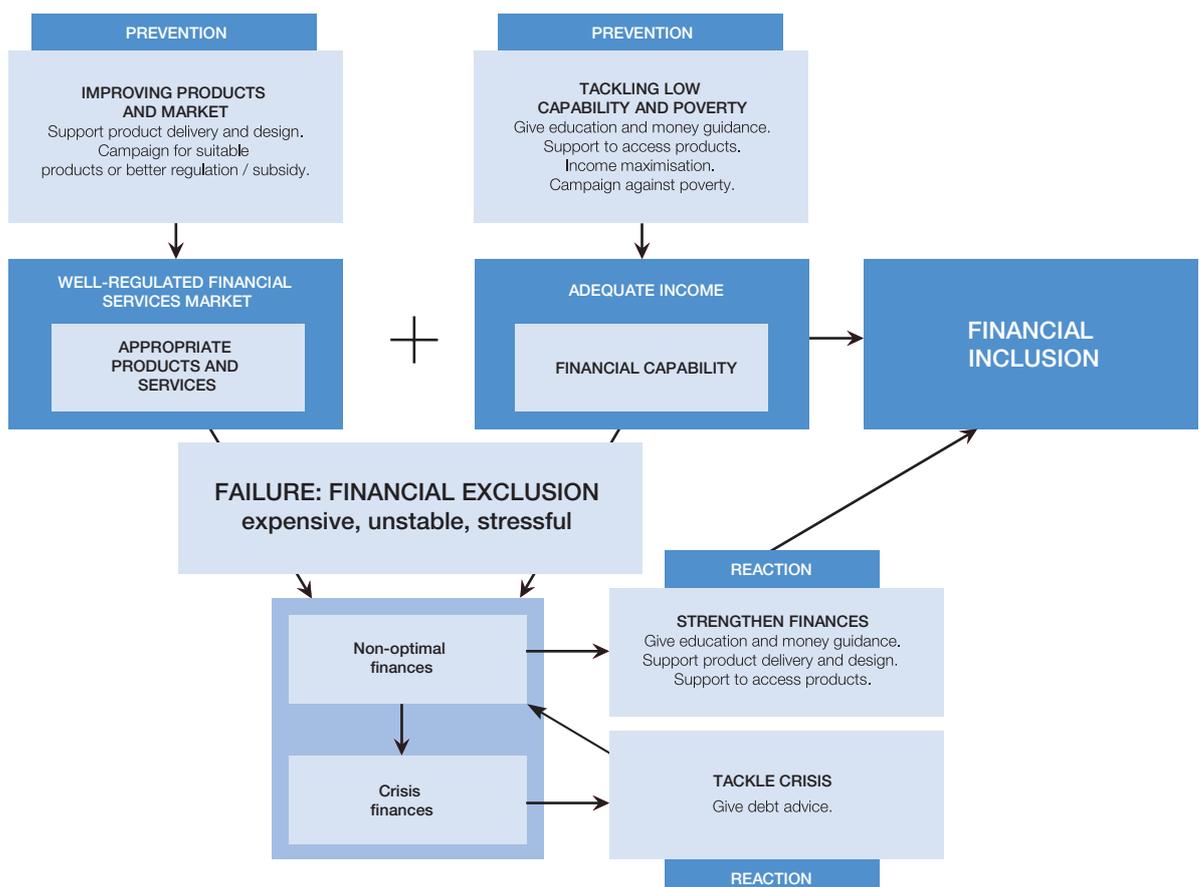
A key point to bear in mind is that financial habits are learned and reinforced by social groups. People living in a cash economy may face little peer pressure to open a bank account, to take out insurance or to save formally. By contrast, and as behavioural economists have pointed out,<sup>39</sup> many middle-income consumers are exposed to ‘default’ circumstances that lead to becoming included without thinking about it actively. For example, parents might open accounts for their children or banks might cross-sell to graduates. These pressures and ‘defaults’ are often missing in poorer communities.

**Tackling poverty**

Many campaigners see the answer to financial exclusion in higher benefit levels and more effective job brokerage and childcare systems: these lead to solutions based on lobbying government and campaigning to the public, but also to local initiatives (such as income maximisation advice to increase take-up of benefits).

In general, this research does not focus very much on insufficient income as a cause of financial exclusion, although it does focus on charities that are (overwhelmingly) providing services to the poor. Most organisations working on broad areas of poverty do not really label themselves as focused on financial exclusion or money management. This project

Figure 3: The path to financial inclusion



has considered financial exclusion in relation to better consumption: that is, helping people access appropriate tools to make the most of what they have. The (very valid) need to look at income (ie, increasing ‘what they have’) will be treated in a future NPC report.

### From financial exclusion to inclusion

How can these different approaches be brought together? NPC’s judgement is that they are complementary. Tackling financial exclusion needs work on both the supply and demand sides, at both macro and micro levels.

Figure 3 sets out a model for how they might fit together. To be financially included, people need on the one hand to be able to access and make the most of suitable products, including appropriate bank accounts, credit and insurance; and on the other hand, to have sufficient information, skills and advice to handle their finances well. This helps them to optimise their finances. For this to happen, institutions need to be interested in them as customers and dedicate effort to serving their needs. Product suitability and institutional support are more likely to occur when customers are better off—for example, having maximised their incomes—rather than when they are poor.

Figure 3 also adds a new area, setting out what happens if any of this is missing. Exclusion results in finances being non-optimal and, periodically, in crisis.

Donors can intervene either to prevent financial exclusion or in reaction to its consequences.

Activities to prevent exclusion are shown along the top of the diagram. Donors can intervene on the supply side: improving product design and delivery, and improving the market. Or they can intervene on the demand side: tackling poverty and improving people’s financial capability.

To react to the effects of financial exclusion, donors can fund the activities highlighted in the bottom right of the diagram. These tend to be on the demand side, and some of them look similar to the activities preventing exclusion. For those whose finances are not in crisis but could be in better shape, donors can improve financial capability, much in the same way as they might intervene to stop financial exclusion emerging. For those in crisis, donors can support a new intervention not talked about so far: debt advice.

Figure 3 is a simplification, but it does tell us a number of useful things. In particular:

- Financial inclusion has several components: to solve an individual’s problems, more than one component may need to be addressed.
- Most of the interventions mentioned can be used both to prevent financial exclusion and in reaction to financial exclusion. A

### Box 3: Government policy on financial exclusion

The term financial exclusion has in a sense come from the top down in the UK. It began to be popularised in Britain in the late 1990s by the Labour government as part of its programme to tackle poverty.

The first manifestation of government interest in the area dates back to 1999, when the Social Exclusion Unit set up a Policy Action Team (PAT 14) to look at increasing access to financial services. But there was fairly limited activity off the back of PAT 14’s findings until 2004. The Spending Review that year set out a commitment to tackle financial exclusion in three priority areas:

- access to banking;
- access to affordable credit; and
- access to free face-to-face debt advice.

A Financial Inclusion Taskforce was established to monitor progress, undertake research and advise government action.

The government also announced a Financial Inclusion Fund to support initiatives to tackle financial exclusion. Between 2004 and 2007, the fund had a £120m budget, most of which has been spent through charities and third sector lenders (not-for-profit financial institutions—see affordable credit chapter). Different parts of the fund were administered by various government departments. For instance:

- £47.5m went into increasing the supply of free, face-to-face debt advice—the reactive intervention shown at the bottom of Figure 3.
- £6m was used by the Legal Services Commission to pilot methods of outreach debt advice.
- There was a £36m Growth Fund for third sector lenders, plus £6m to invest in the skills and capacity of staff and volunteers of third sector lenders.
- £5.4m was spent on the ‘now let’s talk money’ campaign, which is trying to reduce access barriers to mainstream financial products and services.
- The Financial Inclusion Taskforce has a £3m budget, used primarily to conduct research and increase the knowledge base on financial exclusion.

Four years on from the fund’s launch, the government has reported positively on its impact and confirmed that it is going to be extended to 2011. The government says it will continue to support banking, affordable credit and debt advice, as well as expanding initiatives into insurance, savings and financial capability. The later chapters of this report discuss government action in specific areas in more detail.



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key exception is lobbying, which generally attempts to be preventative by changing the financial services system. Debt advice is also an exception because it is generally a reaction to the effects of financial exclusion rather than a way of preventing it in the first place.

- Most of the activity involves working directly with the individuals affected. Campaigning and product design are the main approaches that address the problem at a systemic level.

## Government response

The framework in Figure 3 describes some of the different ways in which financial exclusion can be tackled. Donors thinking about the issue need to know what is happening in each area already, to consider whether there is a space for private capital.

Broadly speaking, for many of the interventions set out above, the government is playing a significant role as a funder, often supporting charitable work. It also plays a role as a

regulator and, through its wider policies, tackles problems like poverty.

But policy in this area is far from perfect, and activity to tackle financial exclusion, including funding for charitable work, remains vastly outweighed by need.

The government's dedicated pot of money for financial inclusion, the Financial Inclusion Fund, had a budget of £120m over its first three years and £135m for the period 2008–2011. Box 3 gives the detail of how this money has been spent. In broad terms, it has mainly been divided between funding face-to-face debt advice and funding third sector lending. This sounds like a lot of money and, in a tight budget round, a generous settlement.

But relative to the size of the problem, it is modest—for example, relative to the sums spent by financial services providers on reaching their target groups, or when broken down into funding per financially excluded person.

Moreover, the apparent increase in funding is in fact a cut in real terms. This is because the original fund was back-loaded (ie, most of it was not spent until the second and third years). As charities like **Citizens Advice** have pointed out, on yearly spending, the new £135m represents a decrease, and will not be enough to maintain all the work the government has begun. This comes at a time when external factors like the credit crunch might be expected to increase demand for services.

All this means that there is certainly space for donors to play a financial role.

There may also be a role in shaping policy and innovation. A common complaint about government activity in this area is that it has been too fragmented. Though the Treasury has been in the lead, no single department has ownership of financial exclusion. Respected scrutineers like the Treasury Select Committee have argued that the money could have been used in a more joined-up way.<sup>40</sup> NPC has certainly been struck by the relative dearth of activity that brings together the different approaches to tackling financial exclusion.

Of course, a lot of government activity that impacts upon financial exclusion has occurred in policy areas not necessarily labelled with that term. The following gives a brief summary of government action other than the Financial Inclusion Fund, in each of the areas of the framework set out in Figure 3 above.

Donors might be struck by the range and complexity of policies and initiatives that touch on financial exclusion. This highlights the breadth of the problem and, as suggested above, the number of systems it involves. But philanthropists should not allow this to put them off.

## Supply-side solutions

### Improving the design and delivery of financial products

Activity to deliver more appropriate products has been fairly substantial. This is most easily understood by looking at products individually. The majority of activity has been focused on bank accounts, credit and saving.

On bank accounts, the government's most well-known initiative has been to establish a 'shared goal' with the banking industry to halve the number of people without accounts. The government is helping to achieve this in two ways: firstly, it has made benefit payments electronic rather than by cash or cheque; secondly, it has required banks to provide a 'no-frills' basic bank account, and to co-fund a more limited Post Office Card Account.

On credit, the government is itself a provider through the Social Fund. This is an £800m interest-free loans and grants fund delivered through Jobcentre Plus offices to help people on low incomes. However, the fund is widely thought to be inadequate and badly administered.

In addition to the Financial Inclusion Fund, there has been some support for third sector lenders from elsewhere, especially local and regional government. Regional Development Agencies have been involved in developing region- and city-wide partnerships to tackle financial exclusion. Councils have been instrumental in establishing and supporting third sector lenders and, often, in supporting models of lending that introduce other kinds of support like advice.

On savings, the government has recently introduced two initiatives: the Child Trust Fund and the Saving Gateway. The former gives a small cash asset to all children born after 1 September 2002. The latter is not yet up and running but will offer 'match savings' for eight million people on low incomes.

On insurance, there has been relatively little action.

Taking the whole of the government's activity on products, the picture is a mixed one. It has made progress in some important areas, but there remain large gaps in both geographical coverage and social reach of appropriate products. This is explored in more detail in later chapters.

### Improving the way the financial services market works

The government has made some important changes to the wider regulatory and economic environment but has generally preferred voluntarism and self-regulation to legislation.

For instance, although the government has put some pressure on banks to make accounts available to less profitable customers, it

has rejected a 'universal service obligation' on banks to provide accounts. Basic bank accounts go part of the way to delivering a 'right to banking', but campaigners argue that they are not an adequate substitute.

Similarly, the government has rejected calls for a UK equivalent of the US Community Reinvestment Act, legislation that requires banks to disclose how much money they are lending in poor areas. This is one of the factors behind a historically vibrant third sector lending system in the US.

There have been some developments strengthening consumer rights. In 2006, the Consumer Credit Act made numerous changes to the way credit is regulated, including toughening the licensing regime for lenders, extending protection to all consumer credit and replacing the previous 'extortionate credit' test (allowing courts, in certain circumstances, to set aside credit agreements) with a test based on unfairness.

In 2005, the Competition Commission investigated the high-cost home credit industry and found that it was uncompetitive. It has recommended and implemented various remedies to increase competition.

But critics argue that a more typical story is that of Farepak, the Christmas hamper savings scheme that collapsed in 2006. The government put pressure on the hamper industry to increase protection to savers only after disaster had struck. The industry has now agreed to hold savings in independent trust accounts where they are protected.

Overall, government activity on the wider economic and regulatory system has been informed by its desire not to be heavy-handed or to damage the UK financial services industry.

## Demand-side solutions

### Improving people's financial capability

Efforts to improve capability have been a recent area of activity. Education and advice aimed at strengthening people's skills and abilities before they suffer the consequences of exclusion are two areas that are growing from a low base.

The government has sought to strengthen financial education in schools through the Personal, Social and Health Education syllabus. Personal finance has also been given a bigger role in 'functional maths'.

The financial regulator, the Financial Services Authority, has been tasked with leading the National Strategy for Financial Capability, with a £17m budget in 2007/2008. Finally, there is a major new development in government plans to develop a free money guidance service. This is in light of the conclusions of the Thoresen Review, which was established to look at the case for a 'generic' advice service for those whom the



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market will not support (see Box 11 in financial capability chapter).

Overall there has been some progress in improving financial capability, but NPC questions whether the scale of activity is enough. First, although activity on broader capability is welcome, there are strong pressures on people that make it hard for them to manage their money well. For example, financial services are complex and consumerism is strong. Government spending relative to these pressures is modest. Second, much government activity is not focused primarily on financially excluded people, but is focused instead on the public as a whole. There is a risk of excluded groups being left out of broader activities.

### Tackling crisis

Efforts to tackle crisis using debt advice have a fuller history. The government has long been a major funder of debt work, both centrally (through Legal Aid and the Department for Business, Enterprise and Regulatory Reform) and locally through councils. Councils also provide some advice directly.

The Financial Inclusion Fund focused on face-to-face advice. Elsewhere, the government funds telephone-based advice services delivered by organisations like National Debtline, which is run by the **Money Advice Trust**.

Notwithstanding government's efforts, there remain big demands on debt advice capacity, especially face-to-face services. These may grow with an economic downturn.

### Tackling poverty

The Labour government has made a series of changes aimed at reducing child and pensioner poverty. The most notable of these include the development of the Pension, Child and Working Tax Credits and higher levels of some key benefits including Child Benefit.

The government has also presided over a reduction in unemployment, partly helped by the New Deal programmes and increased childcare, which has contributed to higher incomes among poor families.

Until recently, there have been significant falls in poverty levels. However, the data for 2006 shows that progress has stalled. Moreover, government is almost certainly set to miss its target to reduce child poverty by half by 2010. Unfavoured groups, especially adults of working age without children, have seen a slight rise in poverty.<sup>36</sup>

As noted above, for reason of scope, poverty is not a key focus of this research. However, as with the other drivers of financial exclusion, there remains a lot of need.

## Conclusion

Financial exclusion is a problem that, on first encounter, might appear rather arcane. But its consequences for disadvantaged individuals are very real and could be set to grow. Many of the UK's most vulnerable groups are financially excluded. Though the causes of the problem are not susceptible to quick fixes, the broad areas where activity is needed are clear.

While the government is working across the range of areas to make progress on financial exclusion, its activity is neither at a scale nor a degree of comprehensiveness that is significant enough to solve the problem. In a sense this is unsurprising. It is a relatively new area of policy. However, this highlights further the need for donors and the fact that solutions to the problem do not lie in one sector alone.

The next chapter examines the shape of the voluntary sector that is tackling financial exclusion. It looks in detail at options for donors who are interested in making a difference in this area.



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# Charities and donors

The previous chapter showed that tackling financial exclusion requires a range of approaches. The nature and activity of charities in the field partly reflects government priorities, with a focus on building financial capability and expanding debt advice. There is some work to improve the design and delivery of financial products, particularly by third sector lenders. And some charities are campaigning and lobbying for reform of the wider financial market.

The relative youth of the sector is a challenge for both charities and donors. Good practice is not always well developed, and it is not always clear which interventions work.

Donors interested in tackling financial exclusion can make a substantial difference by strengthening the work that is already happening. NPC's funding priorities include making financial education and debt advice work better, and building the capacity of third sector lenders.

There is also significant need for donors who are prepared to roll their sleeves up and get involved in shaping the kind of work being undertaken to tackle financial exclusion. In particular, solutions to many problems on product design are unlikely to lie in one sector alone, and may rely on partnerships being brokered across organisational and sector boundaries. Donors with financial expertise and contacts could help to deliver a step change here.

Donors also have a big role to play in supporting lobbying work, which by its very nature is unlikely ever to attract much statutory funding.

## The charity sector

For most issues, donors thinking about allocating their funding are well-advised to consider the shape of the overall charitable sector that has developed to tackle a particular problem. Financial exclusion is no exception in this regard. Before deciding where to invest in solving a problem, it makes sense to see where current funding is going and what difference it is making.

Donors trying to orientate themselves within the financial exclusion sector will soon be struck by a particular feature of the organisations working in this field. Namely that, although this report

periodically talks about the financial exclusion sector, in truth this does not really exist. That is, there is not really a well-defined body of organisations that can yet be understood as constituting a shared charitable 'industry' in the way that there is for issues such as homelessness or child abuse.

Instead, there is a fairly broad mix of charities with an interest in 'money' problems, most notably organisations that provide debt advice and money education. To this can be added a growing number of housing associations and some anti-poverty charities. Also becoming more visible are charities that deal with specific excluded groups (such as homeless people or refugees), where staff help their clients with personal finance problems. Technically speaking almost no charities provide products, but there is a growing number of third sector lenders. These not-for-profit finance providers are usually registered as Industrial and Provident Societies. Only a few are registered charities.

The lack of unity in the sector reflects the relative youth of the terminology involved—as noted in the previous chapter, talk of financial exclusion only really dates back to the late 1990s. Also, many charities with relevant interests are primarily affiliated with neighbouring areas such as poverty, rather than labelling themselves 'financial inclusion' charities.

However, the diffuse field is gradually becoming more coordinated. One of the most important initiatives driving coordination is Transact, 'the national forum for financial inclusion', which was set up by the east London charity **Toynbee Hall** in 2005. Transact now has over 1,200 member



Photograph supplied by Esther de Jong

Education can give people the skills to make the most of their money, avoid financial problems, and work their way out of financial trouble.

organisations that identify themselves as involved in financial inclusion work, ranging from advice agencies and credit unions to housing associations. Through providing networking opportunities, research and resources, Transact is starting to increase understanding and cohesion in the financial inclusion sector.

Yet even Transact has found it difficult to judge the size of this diverse sector.<sup>41</sup> Its 1,200 member organisations indicate that there must be at least this number—and probably many thousands more—that can be associated with financial inclusion work.

A slightly different sign of the emergence of the financial inclusion sector is the interest that financial services firms are showing. Financial exclusion has become a buzzword in corporate social responsibility (CSR) reports of recent years, with firms putting increasing sums of money into charities in the area—although this is not always targeted at the most needy, as this chapter goes on to show.

### Charitable activity

Table 3 describes the main charitable approaches to tackling financial exclusion, and highlights some of the key players in each area. Broadly, the higher up the table, the more is being done by charities in this area.

As noted previously, some charities are meeting the needs of a particular client group, and include financial inclusion as a strand of their work. They include local branches

of **Age Concern**, the ex-offenders' charity **UNLOCK**, and the youth charity **Fairbridge**.

This report generally focuses on charities that are dedicated to or have a project dedicated to tackling financial exclusion, without singling out any particular group.

### Tackling crisis and building financial capability

The majority of charitable financial inclusion activity is found in the fields of debt advice, financial education and information provision. Unlike other solutions, these approaches are mainly concerned with helping people to be more financially included, rather than challenging the industry or changing product design.

#### Debt advice

There are around 1,000 organisations tackling debt by providing debt advice either face-to-face, over the phone or online.<sup>42</sup> Key players providing face-to-face advice include **Citizens Advice Bureaux** and a whole host of independent advice centres, many of which belong to **AdviceUK**, a rival umbrella body. Many do not only offer debt advice, but also provide other support. There are several large players as far as phone-based advice goes. National Debtline is one. It is run by the charity **Money Advice Trust** and funded partly by government. Its key rival is the **Consumer Credit Counselling Service (CCCS)**, which offers many similar services but is funded entirely by creditors. CCCS is also the market leader in providing web-based advice.

NPC tentatively estimates that the sector spends around £114m on free-to-client debt advice in total (see debt advice chapter), but of course a lot of this is spent helping over-indebted individuals who are not financially excluded.

As well as providing advice through the National Debtline, the **Money Advice Trust** is playing an important role in driving coordination and knowledge-sharing in the debt advice field, through its online '*Information Hub*'. The charity has also been influential in drawing together other big names in the sector, for example, to respond to consultation papers.

#### Education

Education can give people the skills to make the most of their money, avoid financial problems, and work their way out of financial trouble. There is a growing amount of activity by charities in this field, with a key distinction between work that is targeted at children or young people, and work that is aimed at adults.

A key player is **pfeg**, the **Personal Finance Education Group**, a national charity that supports teachers to give financial education to pupils.



Photograph supplied by The Passage

Table 3: Third sector activity to tackle financial exclusion

Approach	Level of activity	Key players
<b>Tackling crisis</b>		
<b>Debt advice</b>	Around 1,000 organisations in the UK offer debt advice. <sup>42</sup> A large proportion of these are charities.	Citizens Advice Bureaux Independent advice centres, many of which belong to AdviceUK, a rival umbrella body Two national phonelines: National Debtline, run by the Money Advice Trust, and the Consumer Credit Counselling Service Specialist agencies like TaxAid, which provides free tax advice to people who cannot afford a professional adviser
<b>Building financial capability</b>		
<b>Education</b>	Considerable activity, much of which is provided by a subset of debt advice agencies, including 86 Citizens Advice Bureaux. The government's strategy on financial capability surveyed 60 charitable financial capability initiatives, finding that this work often <i>'takes a piecemeal approach and ... [tends] to be short term.'</i> <sup>44</sup> Financial education in schools, colleges and universities has grown considerably in recent years. Education and training of their members is one of the main objects of credit unions. A handful of charities train staff in specialist charities in skills like budgeting in order to build their ability to help their clients with finance issues.	pfeg, the Personal Finance Education Group Citizens Advice Bureaux
<b>Money guidance ('generic financial advice')</b>	Modest activity. Most comes from charities working with particular groups, such as homeless people, refugees and victims of domestic violence. Staff give <i>ad hoc</i> money advice to clients. A few housing associations are building financial advice into the process for admitting new tenants.	Citizens Advice has piloted independent financial advice in its bureaux
<b>Practical support to access products</b>	Small-scale activity from a handful of charities. This might include going to banks with individuals or helping them to fill in forms.	Toynbee Hall's SAFE (Services Against Financial Exclusion) programme UNLOCK
<b>Design and delivery of financial products</b>		
<b>Banking</b>	Eleven credit unions (20 by the end of 2008) are using the back office of the Co-operative Bank to provide 'credit union accounts'. Two CDFIs are opening accounts for their clients by partnering with banks. There is also a small amount of campaigning for good practice from banks and staff (eg, on document requirements and provision of basic bank accounts).	Association of British Credit Unions Ltd (ABCUL) and several of its member credit unions like Southwark Credit Union and Leeds City Credit Union The Community Development Finance Association (CDFA) and members like Scotcash, Fair Finance and East Lancs Moneyline Toynbee Hall's SAFE programme
<b>Credit</b>	Third sector lenders make up 1.5% of the financial services market in Britain. <sup>43</sup> There are a lot of players here including 549 credit unions in England, Scotland and Wales and a handful of personal lending CDFIs, but most are small relative to other financial services firms. Credit unions have about £337m on loan to members. <sup>45</sup> CDFIs have about £2.7m. <sup>46</sup> A few housing associations offer loans through partnerships with banks. Rent deposit schemes are offered by a lot of homelessness charities and some housing associations.	Credit unions and CDFIs Housing associations Homelessness charities
<b>Savings</b>	The main activity here comes from credit unions, plus a handful of charities partnering with banks.	Credit unions
<b>Insurance</b>	Many housing associations offer insurance with rent schemes, though take-up is low.	ABCUL, working with the Association of British Insurers
<b>Improving the wider economic and regulatory system</b>		
<b>Lobbying and campaigning</b>	A handful of players are campaigning to improve access and regulation. They sometimes focus on specific products (eg, availability of suitable bank accounts). Many of these players are specialist charities that lobby in relation to the needs of their client groups.	Citizens Advice The trade associations of third sector lenders: ABCUL and the CDFA Toynbee Hall's Transact Specialist charities, such as Help the Aged, Age Concern, One Parent Families and Mind Money Advice Trust Debt on our Doorstep

#### Box 4: Women affected by domestic violence

Many forms of domestic violence can be described in terms of power and control. One way an abuser can control his victim is by depriving her of financial independence. This might include limiting her access to cash or taking on debt in her name. Little formal research has been done in this area. However, experts consulted by NPC suggest that there are very high rates of financial abuse among victims of domestic violence.

Here is the story of one woman called Angela:<sup>47</sup>

*'I never took money out of the cashpoint without telling him first. Not once in the 15 years we were together. No point in asking for trouble. Even if I needed shampoo I had to ask him and then when I got back from the shops he would check it was a cheap one. The same with clothes. He used to come with me to the shops and pick things out. "That skirt's too short, you look like a tart," or "What are you doing with that, you've not got the figure for it." I quite liked him taking an interest at first. But after I'd left him I realised that it was really just his way of controlling me. Now I've left him I have hardly any money anyway but being able to go down the shops and pick out whatever I like makes me feel like the richest woman alive.'*

Many victims of domestic violence, like Angela, need financial advice and guidance, especially if they have left the abuser and are trying to start living an independent life. A victim may need help:

- setting up a new financial identity (if she has fled to a refuge and left all her papers behind);
- transferring bank accounts to a new address without revealing the location to her abuser;
- dealing with debts forced on her that legally remain her responsibility; and
- learning how to manage money if she has not had responsibility before.

Many domestic violence charities recognise the importance of the issue for their clients, but lack the resources to tackle it strategically. Staff may also feel ill-equipped to advise others on money matters.

Nevertheless, people who work with victims of domestic violence do try to deal with financial issues as and when they arise. The Financial Services Authority (FSA) has funded the local organisation **East Surrey Domestic Violence Forum** to help clients with financial capability issues. **Refuge** is also developing an increasing policy focus in this area and is developing a financial guide for women and children experiencing domestic violence.

For both adults and children, a significant proportion of money education comes from a subset of debt advice providers, including 86 **Citizens Advice Bureaux**. Charities that provide money education often provide it in classes in schools. Some also focus on groups of socially excluded or needy adults, often targeted by partnering with specialist charities, such as homelessness charities. The main content of financial education is basic information (such as understanding interest rates) and key skills (such as budgeting or future planning).

NPC tentatively estimates that the income of the money education sector is around £12m (see Appendix 3). Again though, much of this is not targeted on financial exclusion but on financial capability more generally. NPC estimates that less than half of this work has an exclusion focus (see chapter on financial capability).

#### Money guidance ('generic financial advice')

Activity here is modest and, at the moment, is largely in the form of pilots. It is likely that many of the bigger debt advice providers will move into this space, particularly since the government is now seeking to establish a money guidance service in light of the conclusions of the recent Thoresen Review (see Box 11 in financial capability chapter).

Some work in this area comes from charities working with particular groups, such as refugees, older people or victims of domestic violence (see Box 4). These specialist charities tend to give *ad hoc* financial advice to clients, as money problems overlap with other social issues. For example, homeless charities such as **Centrepoint**, mental health charities such as **Together**, and substance abuse charities such as **Addaction**, all give money advice to their clients as money issues arise in connection with other personal problems. This advice typically comprises budgeting, benefits advice and income maximisation, and sometimes use of appropriate financial products.

A handful of charities, such as the national money education charity **Credit Action**, work to build the capacity of charities that specialise in particular groups. This is because the staff of specialist organisations do not always have the confidence or knowledge to talk to their clients about their finances. So Credit Action has a 'training the trainers' programme, equipping staff within organisations that work with financially excluded people to educate and advise on money issues.

NPC has been surprised at the lack of a 'financial healthcheck' approach. A few housing associations are beginning to build broad advice on finances into the process for admitting new tenants.

At present, very little money goes into general, personalised money guidance. But as government interest in the area increases, this may change.

#### Practical support to access products

A handful of charities provide direct practical support to tackle financial exclusion. For example, workers at **Toynbee Hall's** Services Against Financial Exclusion (SAFE) project will accompany unconfident individuals to the bank, help people fill in forms, or help them to understand literature (for example, if English is not their first language).

It is hard to be certain, but it appears that most activity in this area is small scale, with very little money going into it.

## Improving the design and delivery of financial products

Third sector organisations improve financial product design and delivery in two main ways. Some deliver services themselves to meet the needs of those who are financially excluded. Others partner with or influence financial institutions.

The main kind of organisations that deliver financial services are third sector lenders—credit unions and a small number of Community Development Finance Institutions (CDFIs)—most of which are Industrial and Provident Societies, rather than charities.

Both credit unions and CDFIs provide affordable credit to people who struggle to get access to banks or who rely on high-cost credit such as doorstep lending. Credit unions are the more established model and currently make up most of the personal lending sector. They are cooperatives, and members are united by a ‘common bond’. The key element of their approach is that they also encourage people to save. Some are now moving to providing a full range of banking services.

CDFIs are also beginning to provide banking and savings services, through partnerships with other financial institutions, including credit unions. CDFIs do not themselves take deposits, but loan to enterprises and, increasingly, to financially excluded individuals.

Third sector lenders include many small, young providers and the sector as a whole is still developing. It currently comprises about 1.5% of the financial services market in Britain.<sup>43</sup> However, lenders partly compete with non-mainstream (sub-prime) financial providers and are a more significant proportion of this market.

Nonetheless, lenders face challenges. One issue is who they reach. Credit unions and CDFIs have different client groups—the former often including a higher proportion of people on middle incomes.\*

The key dilemma is how to balance social goals—providing services to people on low incomes who are excluded from mainstream provision—with financial goals, establishing sustainable ‘businesses’ that can grow. The credit chapter below explores these issues in depth.

In total, credit unions and CDFIs have approximately £339m out on loan to individuals. The vast majority of this—all but £2.7m—is credit union lending (see Appendix 4).

A small number of charities improve the design and delivery of products by partnering with financial institutions. They generally operate on a limited scale. For example, the charity **UNLOCK** campaigns and delivers services to help prisoners and ex-offenders to reintegrate into society. It has managed to persuade some insurance companies to make their terms more



Photograph supplied by Positive Action in Housing

\* This reflects the origins of the movement—eg, many credit unions originally had or still have an employee-based membership. But it also often reflects the mission, with many credit unions preferring a broad-based service, arguing that it is more sustainable than one ‘built on financial exclusion’ alone and can reach as many or more excluded people by achieving scale.

flexible when it comes to providing insurance for ex-offenders. It also partners with banks to open accounts in prisons. Another direct partnership is the **Big Issue in the North**, which has worked with the Co-operative Bank to provide bank accounts to magazine vendors.

Charities that seek to influence financial institutions include organisations that lobby for changes in the delivery of particular products, such as **Toynbee Hall** and **Citizens Advice**. However, a lot of campaigning falls to consumer rights bodies like the National Consumer Council, which is not a charity.

### Improving the financial services market

A few players undertake work to improve the wider regulatory and economic system by lobbying and campaigning.

The most visible charity engaging with regulators and government to try and tackle financial exclusion is again Citizens Advice, which does this work as part of its wider focus on people's welfare and consumer rights. The **Money Advice Trust** uses its experience in providing debt advice services to influence the wider financial services market. Other active lobbyists are the trade associations attached to third sector lenders, and charities concerned with the needs of particular excluded groups, such as **Age Concern**. The relatively small volume and range of organisations campaigning for change in this area may reflect the fact that this kind of work is hard to get funded—partly because it has uncertain results.

### The funding situation

If this is the range of charities tackling financial exclusion, a key question for donors is what the funding situation looks like.

As noted in the previous chapter, the government's Financial Inclusion Fund supplied £120m for 2004–2007, and £135m for 2008–2011, working out at just over £40m per year. But charitable trusts and financial services firms are also active in this area.

### The financial services industry

It is difficult to estimate how much banks spend on financial inclusion work, partly because not all the data is publicly available and partly because banks sometimes channel their funds for financial exclusion through their foundations (see Appendix 1). On the evidence that NPC has seen, the sums involved tend to be in the low millions.

However, analysts have not been able to put a figure on spending as a whole.

Players visible in the sector include the Royal Bank of Scotland and Barclays. Prudential has been a strong supporter of Citizens Advice through its education programme, *Financial Skills for Life*.

NPC's impression is that funding from financial institutions is often about capability work and is in many cases targeted at schools or children rather than specifically aiming for excluded individuals.

Financial services firms also contribute to debt advice. Charities such as the **Consumer Credit Counselling Service (CCCS)** have an arrangement with creditors to pay for debt advice. In a *'fair share contribution'*, creditors agree to donate to the charity a proportion (usually 10%) of whatever debt the charity helps clients to repay. By maximising creditor contributions, CCCS's debt advice model is now self-sustaining.

One or two banks have carved out a distinctive role supporting third sector lenders. In particular, Barclays has given technical and financial help to credit unions through PEARLS, a financial monitoring and business planning system developed by the World Council of Credit Unions.

Finally, a few institutions are involved in tackling financial exclusion beyond making donations. For example, HSBC, the Royal Bank of Scotland and Barclays have devised financial training materials and involve staff volunteers in education and advice projects.

### Trusts and foundations

Charitable trusts and foundations also dedicate funding to financial inclusion issues but, as with banks, arriving at a total spend is not straightforward. Appendix 2 sets out information indicating variable levels of spending, with some foundations dedicating sums approaching six figures.

NPC's impression is that, on the whole, trusts and foundations have funded more broadly than banks. Funding is spread relatively evenly between money advice, financial education and third sector lenders. Research and evaluation have also received support.

Most charitable trusts and foundations adopt a nuanced approach to the funding of financial inclusion by supporting both general financial inclusion work aimed at people on low incomes, and work targeting particular deprived groups.

Charitable funders include some highly engaged donors, with the Esmée Fairbairn Foundation and the Friends Provident Foundation having a recognised expertise in the field.

## Donors and financial exclusion

The financial exclusion field described above presents donors with some challenges.

The first is that the field is fast-moving—there is a great deal of activity being undertaken and it is hard to keep track of new policy initiatives, not to mention emerging practice.

The second challenge is that the government is a dominant funder. A number of financial services firms and foundations are also keen to support effective or innovative work.

A third challenge is that the range of options is not very broad in every area. Lots of organisations with an interest in financial exclusion are structurally quite similar—most notably debt advice providers.

None of these points mean that current levels of funding are sufficient. There are still large numbers of financially excluded people untouched by any initiatives, with significant geographical gaps in coverage of services. Moreover, the nature of government activity in the area beyond 2011 is unclear.

But donors will need to think carefully about how their funding links in with existing activities and, on occasion, will need to be comfortable sitting alongside government funding.

Separate to these points, NPC has found that there are cross-sector issues in the field of financial exclusion, and there is a need for donors who are willing to get more involved. They may need to be particularly engaged in areas such as product design and delivery either because: (a) there is no organisation to fund; (b) the solution to a problem is not in one sector alone; or (c) it is not clear what to do. For these donors, assistance may sometimes be more about bringing to bear influence, capacity, skills and partnerships, than about providing funding alone. This is explored further below.

### What works?

In choosing what to fund, it is of course important that donors consider what their funding will achieve. Work to promote financial inclusion is very new in many areas, so the evidence base is scarce, and there are strengths and weaknesses in each kind of intervention used by charities. This in turn raises issues for donors to consider.

### Tackling crisis

Most charities in the financial exclusion sector focus on debt advice. The main benefit for donors here is that the short-term impact of debt advice is very clear: people seek it when they are in trouble, and for most individuals it can get them out of a crisis. There are several different models of advice available, none

of which is obviously superior. It can work well in outreach locations, such as health settings, prisons, credit unions and housing offices.<sup>21</sup> However, a need for debt advice is often related to other kinds of problem, both legal and personal. There are arguments for bundling specialist advice with other kinds of support (such as legal, employment, medical, relationship) or having strong referral mechanisms. An equally important issue is efficiency: tackling long waiting times, using triage astutely, and moving to more client-centred opening hours. Key concerns identified for potential funders include:

- Debt advice is an accident and emergency function—people access it too late, and it means that they have already suffered a lot of misery. Better ways to make this advice more timely involve building it into other interactions that over-indebted people might have—for instance, seeking credit, starting a new tenancy, or possibly falling behind on rent.
- It is not clear that debt advice stops people getting into trouble again in the future. Few charities track repeat client numbers and there appears to be a particular gap in post-debt advice guidance to prevent recurrence. One ambitious approach here might be to try to use debt advice as an opportunity to build future capability. There is not a great evidence base on how possible this is, but one interesting approach is to build in savings as part of repayment. The debt advice charity **Christians Against Poverty** does this already. The phone and online advice provider **CCCS** is also planning to do this in the near future, alongside a series of other improvements.
- It is hard to target provision at financially excluded groups, because other sections of the population also have debt problems. Outreach work is one way of getting round this problem, as is sensible triage to try to ensure that provision is rationed well.
- It is widely believed that excluded groups prefer face-to-face advice. But this is very expensive relative to other forms of delivery (phone and internet). There is inadequate evidence on what balance is appropriate, and how much face-to-face demand could be migrated to other approaches. It seems likely that face-to-face advice works well for people with literacy or language barriers. Conversely, some groups (such as people with mobility problems and carers) may prefer phone advice. CCCS has argued that there is great potential for phone and internet advice to be deepened (eg, by including benefits advice and other services).
- Arguably, creditors and the government should fund a significant proportion of provision.

Poverty and financial exclusion do not just affect wallets: they also affect relationships, health and dignity.

## Building financial capability

### Education

The point of financial education is to prevent people from becoming financially excluded and to bolster their capability so that they can optimise their behaviour, benefit from advice, choose appropriate products, budget well and plan over the long term. It is holistic, preventative and—potentially—cost effective. For instance, classes by **Toynbee Hall**'s SAFE programme cost just £6.73 per client.

The class-based approach seems to work best where it piggy-backs on other groups, where it is integrated into other programmes, and—because it will turn up debt cases—where there is the ability to refer to 'acute' services. Key issues for donors include:

- It is not clear whether classes for adults really prevent financial exclusion. Charities doing this work have a plausible theory supported by evidence (eg, forms filled in after courses are completed) that it increases confidence, gives knowledge of where to go for help and picks up debt crises. But there are as yet few long-term evaluations on whether it reduces future high-cost credit use, increases the likelihood of saving, or prevents debt problems.
- It seems unlikely that financial education will work on its own. As discussed in the chapter on financial capability, commentators have pointed out that for every pound the FSA spends on financial education work, £12 is spent on promoting personal loans.<sup>48</sup>
- There is also a need to look at the financial 'defaults' that people face. For example, whether their parents opened a bank account for them as a child, or whether they have to opt in or out of a company savings scheme.
- Financial education seems to work well when 'bundled' with the provision of products as this delivers a concrete gain, such as opening a bank account. Behaviour change is experiential. For instance, the charity **UNLOCK** offers financial capability training in prisons. This was successfully accompanied in its pilot by account opening. But a lot of education work does not link directly to new products.
- It is hard to target the right people: financially excluded people do not necessarily want to go to a class on APRs and bank accounts. The disadvantage of piggy-backing on existing community groups (be it a Sure Start children's centre or an ex-offenders' group) is that their membership is almost certainly a smaller subset of the wider population in need. Scale approaches have been tried, such as the **Public Service Broadcasting Trust**'s 'Save Yourself a Fortune'

programme. These may be an effective way of targeting low-income social groups.

- Needs vary dramatically for different groups, and provision is not always sensitive enough. A lot of charities that NPC has spoken to emphasise the role of budgeting skills. But many people on low incomes—especially lone parents—are skilled at making ends meet. Their needs are more around long-term planning and choosing products. For instance, HBOS has funded the **Refugee Council** to deliver financial education. It found that its client group was extremely sophisticated. They wanted to know not just how to open accounts and to remit money but also how to draw up cash flow statements and business plans.
- There is some evidence that education works best when targeting families and social networks. People who do not have bank accounts tend not to be in isolation—they often have friends or family who are also unbanked. A few charities, such as **Quaker Social Action** (see Box 5), do provide education for families. However, provision from most charities is for individuals.

### Money guidance

Like education in classes, money guidance is potentially preventative. But better than that, it is tailored to the individual, increasing the chances of life-changing effects. There is a positive way of selling money guidance too: a personal advice service is mainstream, not something that marks its users out as excluded or deficient in some way. And quite a lot is known about prompts, such as personal milestones like getting married or starting a family. Key problems for donors include:

- As explained above, few charities appear to provide money guidance, perhaps because tailored advice is very expensive. It needs skilled, flexible staff. There is a particular gap in relation to specialist charities focusing on particular groups. They currently provide some elements of money guidance but staff report problems with confidence and expertise.
- It may be hard to get financially excluded people to use it and, where necessary, to change behaviour. Survey evidence suggests that people on low incomes do not always feel they need advice, so programmes emerging in light of new government funding for money guidance will need careful marketing and monitoring.

### Practical support to access products

This is an important approach to helping very marginalised groups or those with deep needs—especially homeless people, refugees and migrants, and older people. It clearly has immediate, concrete effects.

A key issue for donors is the potential for scaling up this approach. Client volumes are inevitably small—both as a result of the difficulties of engaging hard-to-reach groups and because practical support and advocacy are labour intensive. This approach is likely to have most impact when it is linked with broader efforts to change banking policies and procedures. For instance, SAFE at **Toynbee Hall** helped to persuade a bank to change its processes so people no longer have to send identity documents to head office to open a basic bank account. A few charities, including **The Passage** and **UNLOCK**, have managed to negotiate ‘trusted signatory’ status from banks so that named staff can open bank accounts directly. This is a great model but the constraint on developing it further is support from financial institutions.

### Improving the design and delivery of products

As noted above, there are two options for donors here. The first is to influence mainstream product provision. However, influencing is uncertain to have an impact, as banks are only likely to be persuaded to change their products where there is a viable market or where there is regulation (or subsidy). The second option is to support specialist providers that offer alternative products. This is likely to reach some financially excluded people, but is unlikely to result in fundamental changes in the system at a fast pace.

### Banking

On bank accounts, research suggests that people want flexible, simple accounts from a trusted, safe provider. This need is met to some extent by basic bank accounts. But there is a lot of evidence that access problems persist. Moreover, it appears that many financially excluded people do not use their accounts properly once they are open. Low usage may be because of problems of convenience, trust or functionality. Barriers include high penalty charges and a lack of a bill payment system that works for excluded people. Post office closures may make issues of access and use more intractable still.

The key issue for donors here is that it is not wholly clear what to do. As previously noted, practical support can help local access and initiate larger change where charities lobby on processes. Otherwise, options include: scrutinising the performance of banks; creating a business case to highlight unnecessarily neglected groups; and technical research on bill payment. Some of these are likely to be challenging for donors, though a new think tank and research organisation, the

### Box 5: Quaker Social Action—*Made of Money?*

Quaker Social Action is a community-based charity that tackles poverty and isolation in east London. It is running a financial education project called *Made of Money?* (MOM), which gives disadvantaged families the opportunity to share their hopes and fears about money, and helps them to make the most of the funds they have.

There are many financial education courses in the UK, but most are entirely factual in content. MOM is distinctive in that it considers the social and psychological aspects of money, and targets families. Through group sessions and one-to-one support, it addresses issues including budgeting, communicating about money, and the power of advertising, giving parents help to resist pester power.

MOM has also come up with some imaginative and creative ways to look at consumption choices and financial behaviour. For example, there are sessions on how to budget for and cook pizza from scratch. There are also ‘blind-tasting’ sessions to look at branded versus value products, to see if people can taste the difference between McVities jaffa cakes and Tesco Value jaffa cakes, or Walkers crisps and Tesco Value crisps—people learn that cheaper is not necessarily worse.

MOM recognises that poverty and financial exclusion do not just affect wallets: they also affect relationships, health and dignity. Confidence and attitude are just as important as knowledge and skills, and addressing these side by side means that change is much more likely to take root in people’s lives.

MOM’s ongoing evaluation has a longitudinal dimension that will capture some outcomes (for instance, looking at spending diaries of former participants). Evidence to date shows that families are communicating more openly about money, and they are more confident and in control of their finances.

#### Feedback

*‘I feel less guilty now. Last week we were in Woollies, and [my son] wanted a toy. I said no and he just walked away. Since I’ve been coming to the sessions I’m wanting to save and it makes me feel better to say no.’*

*‘I talk more with my husband now. Before I just talked to him about money whenever I felt like it and he didn’t respond very well. Now I wait until I can see that he is relaxed. I feel I can communicate more effectively.’*

*‘When bills came before I didn’t understand them, but now I do. My husband has now given me the responsibility for paying them. I used to have to go to my neighbours to help me write cheques, but now I can do it myself and go to the post office with it.’*

**Financial Inclusion Centre**, has recently been established, and may offer a point of entry for interested funders.

A simpler option perhaps is lobbying the government—both as guarantor of access (see the discussion of social versus market goods in Box 2 in the previous chapter) and also in relation to post office closures.

A final option is supporting the relatively new field of alternative bank account provision, for example, through credit unions (although again, the credit union model often deliberately includes many people who are not financially excluded). This could be by social investment rather than donation.

Confidence and attitude are just as important as knowledge and skills.

## Credit

Research suggests that people on low incomes need flexible, convenient credit that is available quickly, in small sums, in cash and without unpredictable penalties for occasional missed repayments.

The loan products of credit unions and CDFIs have some of these traits. For instance, they can provide cash loans for small amounts, and often have a degree of flexibility about missed payment. Accordingly, there is lots of anecdotal evidence that they are helping some marginalised people to access affordable credit. This may save them the costs of more expensive lending, thus increasing disposable incomes and reducing poverty.

However, third sector loans do not include all of these features. They look more like traditional bank products than, for instance, a home credit service. Some people, including those who benefit from doorstep prompts to repay, may find third sector lending an inadequate substitute.

Nevertheless, supporting not-for-profit lenders remains the most sensible option for donors interested in the design and delivery of more appropriate products. The advantage here is that, because capital is lent out and earns an income, it gets recycled so will have a bigger impact than, say, a grants programme would.

Particular needs include capacity building and product development: some third sector lenders are high-cost and are not near sustainability. A step-change in performance requires a range of business and technical support. Issues for donors include:

- Third sector lenders are less strong than they should be at demonstrating their social impact. Organisations that NPC has spoken to can show that they lend money to risky people on low incomes, but they cannot yet show consistently what difference the money makes, for instance, to individuals' poverty levels.
- There is an underlying question regarding precisely who third sector lending is trying to help. It does not seem to be a full substitute for very high-cost lending such as home credit, partly because the products credit unions and CDFIs offer are limited by relatively low interest rates.
- Where support is needed, it is not entirely clear that it is best structured as donations. There may be a role for social investment for the 'business' part of lenders, with charitable support for ancillary services like advice.

## Savings

Research suggests that people on very low incomes will save if: small sums are allowed; it is easy to make deposits; there are tangible benefits (for instance, a bonus at Christmas); there is some form of lock-in; and it is marketed carefully.

A relatively straightforward option here is supporting credit unions, even though their client base is broader than just financially excluded people. Alternatively debt, loan or rent payment can provide opportunities to start a savings habit and, as already noted in the 'tackling crisis' section, some charities are now promoting this. This may be an area where cross-sector working is beneficial to foster new creative products and to facilitate collaborations. For instance, US research discussed later in the savings chapter, highlights 'Save more Tomorrow'—a scheme where people can commit future income increases to saving. It also includes evidence that a savings 'pocket' in basic bank accounts could encourage people to put money aside.

## Insurance

There has been little research concerning what works to promote insurance take-up. Extant approaches, such as insurance with rent schemes, have had limited success—perhaps because of marketing, perhaps because of cost, or perhaps because people on low incomes feel they do not have much worth insuring.

It is unclear what a donor should do in this area—first, because there are not many organisations tackling the issue; and second, because the causes of low take-up are complicated. The most obvious option is to fund product development, whether through the third sector, other lenders or think tanks. A donor could also fund partnerships between charities and financial institutions to tailor suitable services to particular groups and to improve their promotion to those groups.

## Improving the financial services market

Donors seeking to improve the market need to think about funding lobbying and advocacy work, in the knowledge that it is difficult to know what works in this area, and difficult to measure success.

A challenge here is that the terms of much of the debate on financial exclusion are already well-defined thanks to the government's forum to consider the issues at stake, the Financial Inclusion Taskforce.

As noted in the previous section, some effective approaches seem to be around helping service delivery organisations to use their experience on the ground with individual cases of financial exclusion in order to change large policies, procedures and structures. This can be by lobbying banks, by taking legal test cases, or by engaging with government.

Larger structural questions include: the future of post offices; rules on advertising of loans; whether or not there should be a UK equivalent to the US Community Reinvestment Act to promote investment in third sector lenders and poor communities; and whether government should guarantee rights to certain products, such as bank accounts.

## What should donors fund?

Overall, this analysis presents quite a complicated picture, with some gaps in our knowledge of what works. The potential 'donor concerns' set out above can obviously be seen in a negative light, and used as reasons for not funding organisations engaged in these activities. But each of the objections above also presents a range of funding opportunities.

Drawing on the analysis set out in this report, NPC identifies several priorities for donors interested in financial exclusion:

- more, and more 'holistic', debt advice, especially face-to-face;
- more effective financial education;
- capacity-building for third sector lenders;
- research and evaluation on issues such as product design and evaluation of what works; and
- campaigning on issues such as support for third sector lenders and greater scrutiny of financial services providers.

Box 6 sets out general criteria for donors to consider, whether they choose to fund financial inclusion work or any other sector. Table 4 sets out each of NPC's identified priorities against the broad approaches that can be used for tackling financial exclusion. There is an overall priority for each area, except for poverty, which, as noted in the previous chapter, is outside the scope of this research.

Next to each priority, NPC has summarised a range of different activities that are needed to deliver this priority. What should be apparent is that, in each area, the kind of activity that could benefit from funding is quite detailed. Some activities, such as increasing capacity of face-to-face debt advice, are straightforward funding options. Other activities, such as helping on the governance of third sector lenders, are more complex and may need a more engaged donor.

### Box 6: Criteria for what to fund

NPC considers a range of criteria when trying to identify priorities for donors. They are reproduced here so that donors interested in thinking about their philanthropy from first principles can apply them directly.

- **Priority of need.** How important a problem is this? How will addressing this area improve the lives of financially excluded people? How many people will it help?
- **Evidence of results.** What is the evidence that funding activities in this area will achieve the desired results?
- **The availability of organisations to fund.** There may be a clear need for action in an area and effective, known approaches. But is it possible to identify effective organisations within this area?
- **Is there a space for private funding?** Is private funding appropriate, given statutory responsibilities and the responsibilities of the financial services industry? This partly depends on the nature of existing funding, and partly on donor preferences.
- **Will private funding add something distinctive?** A related question is whether there is something distinctive private funding can do. In principle, philanthropic capital is better able to bear risk and to wait for long-term results than statutory funding, so it is best deployed where these characteristics are needed.



Picture supplied by Quaker Social Action

Table 4: What should donors fund?

Area	Priority	The range of things that is needed
<b>Tackling crisis</b>	More, and more holistic, debt advice	<p>More capacity, especially face-to-face, targeting financially excluded groups</p> <p>Efforts to make debt advice more preventative, eg, by linking repayment to savings and follow-up advice</p> <p>Efforts to ensure earlier access, eg, by putting advice in other interactions such as credit provision, starting a tenancy, or falling behind on rent</p> <p>Experimenting with different forms of delivery (phone and internet), and deepening phone advice</p> <p>Campaigning to maximise sustainable funding from government and business, and to achieve better coordination of the debt advice sector</p>
<b>Improving financial capability</b>	More effective, targeted financial education	<p>Research into what works</p> <p>Education that is bundled with other products (eg, banks accounts)</p> <p>New forms of education that target families and friends, not just individuals</p> <p>Large-scale marketing to reach those who do not go to classes</p> <p>Capacity-building for specialist charities</p> <p>Research, innovation and lobbying on ways of changing people’s financial defaults (eg, having to opt out of a savings scheme rather than having to opt in)</p>
<b>Design and delivery of products</b>	<p>Capacity-building for third sector lenders</p> <p>Lobbying and campaigning</p> <p>Research</p>	<p><b>Credit</b></p> <p>Evidence on areas such as the longitudinal impact of third sector lending</p> <p>Capacity-building, including:</p> <ul style="list-style-type: none"> <li>– Training and governance for third sector lenders</li> <li>– Funding for additional services, such as advice</li> <li>– Support for product development (eg, insurance and bill payment) and marketing</li> <li>– More challengingly, support for financial instruments for the sector to access market capital, and technical fixes to make it cheaper to lend (eg, new ways of credit scoring)</li> </ul> <p><b>Banking</b></p> <p>Support for lobbying and scrutiny on the use, terms and access of bank accounts, including support to keep post office branches open</p> <p>Support for product development, such as bill payment</p> <p><b>Saving</b></p> <p>Support for credit unions</p> <p>Support for saving alongside credit repayment or rent</p> <p>Funding to develop new products, such as savings pockets in basic bank accounts</p>
<b>Financial services market</b>	Support lobbying and campaigning	<p>Linking practical support and advice with advocacy for changes in policy and procedures</p> <p>Broader thinking about regulation (eg, of advertising, irresponsible lending practices, or a ‘Community Reinvestment Act’)</p>
<b>Poverty</b>	Outside the scope of this research, although activity reducing poverty would make mainstream products more accessible and useful to people on low incomes	
<b>Cross-cutting issues</b>		<p>More conversations between charities</p> <p>More thinking about how new technologies can help tackle financial exclusion</p> <p>More thinking about bundling services in different ways</p>

## Tackling crisis

More, and more ‘holistic’, debt advice is a priority because charities report that there is unmet need. Donors could usefully fund more activity here, in the knowledge that it is an effective intervention to ease a person’s financial stress. But, as noted above, it is important to target financially excluded people, to maximise the amount and quality of service given by phone and internet, and to press for more stable long-term funding from government or the financial services industry. Advice needs to be more ‘holistic’ in order for it to have a preventative effect, and to enable earlier intervention.

Donors could fund models of improved access such as outreach advice targeted at excluded groups. They could also fund models of earlier access. Either option might involve, for example, partnerships between **Citizens Advice Bureaux** and housing associations or credit providers. Both are good places to find financially excluded people and, more than that, may be in a position to spot debt troubles at an early stage.

Donors could also support debt advice agencies that try to make advice more than just an ‘accident and emergency’ function. For example, **Christians Against Poverty’s** model has an ongoing savings and bill payment account that continues after problem debts are resolved, meaning that clients are less likely to get into future financial trouble.

Experiments in mixing provision could have a wide influence. **CCCS** has been a market leader in developing efficient phone and internet advice, and it has a range of plans to deepen the phone-based services it offers.

## Improving financial capability

Financial education is a priority because the potential returns from improved capability are very high. Yet a lot of provision is inadequately evaluated, fragmented and small scale. There is no dedicated government funding for adult work (outside further education colleges).

NPC sees a clear role for donors to help charities explore new forms of financial education. This might include approaches that link education to products, or approaches aimed at families or social networks. **Quaker Social Action** has tried this latter approach through its pioneering *Made of Money?* scheme, which was described in Box 5. The scheme looks at family finances alongside creative group activities and discussion. Education may also work well where it is experiential. Donors should support efforts to provide it alongside products that people can actually use. The charities **Toynbee Hall** and **UNLOCK** have both found it beneficial

to incorporate financial education into the provision of bank accounts.

More generally, it is important to fund assessment of what works. Longitudinal evidence of the impact of particular approaches to education could have leverage, by influencing government funding.

Money education for adults also needs to reach greater scale, and charities like **Credit Action** are helping to achieve this through targeted campaigns using engaging materials. Targeting is crucial if the charity is to reach financially excluded people, and one way to do this is through intermediaries who are already working with excluded groups. Credit Action also builds capacity in other charities to give staff confidence and competence to teach their clients.

People may also be more receptive to education about budgeting or saving when they are already accessing another financial service, such as debt advice or credit. The CDFI **Fair Finance** gives advice and educational materials to people who apply for a loan, but whose finances do not allow them to borrow.

The final area where donors can make a difference is research, innovation and lobbying about ways of changing people’s financial defaults. Here it is less obvious what to fund, but research from behavioural economics, discussed throughout this report, suggests that simple changes to the environment within which people make decisions can have a huge impact. There are specific suggestions in later chapters, such as a ‘*Save More Tomorrow*’ scheme in the US, where people commit future income increases to saving.

## Design and delivery of products

Capacity-building for third sector lenders is a priority for donors interested in alternative provision of more flexible financial products—especially credit, savings and bank accounts. Lenders face challenges in relation to their scale and impact. Support to tackle underlying technical and organisational constraints is important in addressing these barriers.

One option for donors is to work with individual credit unions or lenders to broaden the range of products available. Donors could also work at the sector level, perhaps with the main trade associations, ABCUL and the CDFI.

There is an important need for more research—as the credit chapter below explains, little is known about the impact of lending.

Key products like insurance, bill payment and savings are underdeveloped. Activity here could be directed to fostering mainstream provision of more suitable products.

The sums spent on building financial capability and resolving money problems are dwarfed by the sums that are put into advertising and consumerist pressures.

Finally, donors could get involved by lobbying financial services firms to improve the delivery of products. This might be about persuading branch staff to treat low-income consumers with greater respect, persuading insurers not to make arbitrary distinctions on the grounds of age, or lobbying against post office closures.

### The financial services market

Campaigning is a priority because the wider context in which financial service providers operate shapes the success of efforts to tackle exclusion. Activity here might include surveillance of sub-prime credit or campaigning for reform of the Social Fund (through which the government provides interest-free loans).

It is important that more money goes into education and advice, but bearing in mind that the sums spent on building financial capability and resolving money problems are dwarfed by the sums that are put into advertising and consumerist pressures. Donors may therefore want to look at the wider environment. Financial inclusion work may only succeed with better regulation, such as restrictions on advertising, for example.

There is definitely a gap in the field for campaigning and lobbying, and this is usually a good use of philanthropic capital: campaigning aims for broad systemic change, and private funding is independent from government and the

industry. However, there are few organisations that are active in this area. **Citizens Advice**, the **Money Advice Trust** and **Debt on our Doorstep** have all been important voices.

### Cross-cutting issues

As explained above, the ‘financial inclusion sector’ is not really a unified sector, so there is plenty of scope for more conversations between organisations and more coordination in the field. **Toynbee Hall**’s Transact is doing good work in this area.

There is also room for more development and innovation across all the different financial products that this report explores (banking, credit, savings and insurance). In particular, NPC has been struck by the absence of innovative technology in financial exclusion work. Two charities that show potential in this area are **CCCS** and **Credit Action**, both of which are quite entrepreneurial.

Finally, donors could usefully support services that bundle different approaches together, thereby offering more ‘holistic’ solutions to financial exclusion. For example, new ‘Community Banking Partnerships’, such as **Financial Inclusion Services Yorkshire (FISY)**, provide education, debt advice and affordable credit under one roof.

**Table 5: Options for donors**

Different donors want different things from their giving. This table identifies several types of philanthropist and suggests some illustrative options for each. Clearly the ‘types’ suggested are over-simplified and not necessarily mutually exclusive, but they do provide one way of thinking about how to select different issues.

Approach	Type of funder	Action to take
Light-touch	<b>‘Classic’ donor:</b> wants to give in a hassle-free way, to an organisation that will use the money well.	Support an organisation that has a focus on financial exclusion, with a successful track record, such as <b>Toynbee Hall</b> .
	<b>Local supporter:</b> has a strong personal attachment to a particular place and funds local services. Usually visits grantees and potential grantees.	Fund a local debt advice provider, such as the local <b>Citizens Advice Bureau</b> . Most bureaux provide specialist debt advice, and many now provide financial education.
More engaged	<b>Strategic funder:</b> focuses on a few areas and aims to make a measurable difference. Is proactive in identifying solutions, organisations and opportunities. Funds research and advocacy as well as service delivery.	Focus on prevention, for example, funding a money education charity such as <b>Credit Action</b> . Or fund approaches that link different interventions. For example, <b>Financial Inclusion Services Yorkshire (FISY)</b> offers affordable credit, savings facilities, money guidance and financial education.
	<b>Grant-maker:</b> may specialise in financial inclusion charities. Fairly engaged with local organisations and thoughtful about funding.	Fund research and evaluation into the impact of third sector credit or help to develop credit scoring systems.
	<b>Innovator:</b> usually an entrepreneur who wants to fund individuals to develop an innovative model. Often provides non-financial support.	Fund a growth-oriented CDFI, such as <b>Fair Finance</b> , to develop new products and to come up with further innovative ways to reach and engage excluded groups. Or support <b>CCCS</b> to pilot a range of scalable services to people with problem debt.
	<b>Social investor:</b> believes in a market solution to poverty and provides loans and business support to social enterprises for a social or even financial return.	Make a social investment in third sector lenders, such as <b>Southwark Credit Union</b> or <b>East Lancs Moneyline</b> , both of which have a good reach into financially excluded groups.
	<b>Human capital investor:</b> wants to use skills and resources of staff to tackle social problems, not just give money.	Second staff to third sector lenders that have growth potential, to advise on marketing and product development.

## Choosing organisations to support

One way donors can set about choosing specific organisations to support is by using NPC's charity recommendations. In this report, NPC talks about many different charities and the excellent work they are doing to tackle financial exclusion. Alongside the report, we have highlighted a smaller sample of charities that we believe to be particularly effective, recommending one or two, where possible, in each priority area. These charities are listed on our website [www.philanthropycapital.org](http://www.philanthropycapital.org) and information about them can be downloaded without charge.

Analysts try to select charities according to the results of the organisations, their capacity to achieve these results and the risks threatening these results. The criteria used to analyse charities are outlined in *Funding success: NPC's approach to analysing charities*, also available on NPC's website.

NPC's recommendations are by no means a top ten or a ranking of the best organisations. They are, however, based on extensive due diligence—around 80 hours per organisation. They represent a set of charities that donors can have great confidence in backing.

NPC's recommendations in this sector will change over time. Analysts seek to review regularly the performance of the organisations identified and, periodically, to add new ones.

### Other charities

Of course, NPC was not able to visit all of the charities that focus on financial exclusion; there are simply too many. Donors who want to support a charity that NPC has not investigated (for example, a local charity) could examine the criteria in *Funding success*.

NPC holds the view that, too often, charities have to rely on funding that is restricted to particular activities or projects. This is damaging because charities end up not being able to cover their overheads. Costs like non-project staff salaries, administration and infrastructure can be a turn-off to funders, but they are fundamental to making organisations effective and enabling them to use their resources well. Charities need unrestricted funds to counter this problem. In general, it is best for them to decide how to use particular funds, according to the overall needs of their organisations.

Given that funding in the sector is not always stable, charities stand to benefit greatly from long-term funding. It saves them spending management time and money searching for funds to keep services running and allows them to think more strategically and plan ahead for the future. It also enables charities to deliver activities that have to occur over a prolonged

period in order to succeed (for example, campaigns to lobby government).

Donors should also consider funding charities to evaluate the impact of their own services. Most charities in the sector are so constrained in terms of funding and staffing that they have had little capacity to develop sophisticated ways to prove their effectiveness. By funding charities to measure their impact (eg, through evaluations, or by improving data collection), donors could have leverage: if a charity can demonstrate that its service works, it can attract additional funds from elsewhere.

## Conclusion

The first two chapters have provided an overview of financial exclusion, and started to show how donors can make a difference to charities that are tackling financial exclusion. These charities are building financial capability, helping people to overcome debt problems, and improving the financial services market by providing alternative products and campaigning for change.

While the government and the financial services industry are providing some important funding, private donations can help to broaden the range of services that charities offer, increasing their quality and allowing innovation and creativity. Donors can have a considerable impact on the sector by looking at the priorities highlighted in this report, and using their money to fund effective organisations.

The following chapters take a more in-depth look at each of the main issues in the sector. Each chapter broadly follows the same structure, asking:

- What is the issue?
- Why does it matter?
- Who is affected?
- How are the government and the financial services industry tackling the problem?
- How are charities tackling the problem?
- What are our priorities for donors?

The first issue addressed is financial capability, as it plays a part in all other aspects of financial inclusion, and poor financial capability is often a cause of financial exclusion.

The next chapters look at the four basic financial services that form the foundation of financial inclusion: banking, affordable credit, savings and insurance.

The final issue covered is over-indebtedness, or problem debt, which is a common consequence of financial exclusion and the struggle to manage life on a low income with inadequate financial products.

Given that funding in the sector is not always stable, charities would benefit from strategic and long-term funding.



Photograph supplied by istockphoto

# Financial capability

**Financial capability problems do not just affect the financially excluded. But poor financial capability matters most to those who are excluded, because they have the least money with which to cope with the consequences of bad decisions.**

There are a large number of initiatives to improve capability. For instance, 86 Citizens Advice Bureaux offer education and the Treasury has surveyed 60 different voluntary sector schemes. But they are not always targeted at financially excluded people and, where they are, they are variously overlapping, fragmented and piecemeal.

NPC identifies a clear role for donors in supporting work in this field. This includes filling gaps in provision for adults, fostering new forms of education that engage people better, and building third sector capacity. Another priority is establishing an evidence base.

Donors supporting capability work should approach it with a degree of realism. There are many wider economic, social and cultural pressures on people that make it hard to make good financial decisions. The scale of these pressures arguably dwarfs capability work.

The potential returns of education initiatives are large. But donors may also want to support broader approaches such as altering the financial 'defaults' that people face and addressing the environment in which decisions are made.

## Financial capability and financial inclusion

Financially capable people have the skills, knowledge and understanding needed to make the most of their money. Financial capability also has a crucial behavioural element, including the confidence and motivation to put this financial 'literacy' into practice.

The relationship between financial capability and financial exclusion is not agreed on by people working in the field. NPC takes the view that capability is important both to promoting financial inclusion and to minimising the negative consequences of being financially excluded.

Though skills, knowledge and confidence cannot make up for poverty or lack of appropriate financial products and services, people who are financially capable are more likely to:

- want and make the best use of available products;
- cope with financial pressure and avoid financial trouble;
- know where to turn in a crisis;
- budget well, making their income go as far as possible; and
- use savings and insurance to plan for the future.

## Why does it matter?

Financial capability matters to everyone, not just those who are excluded. This is in part because individuals across society bear increasing responsibility for their own finances.

For example, people have to bear the costs of further education more than ever before. Some benefits, such as personal budgets for care, are being 'individualised'. And people are increasingly responsible for planning for their retirement, many having to rely on defined contribution pension plans and personal savings in their old age.

Financially capable people have the skills, knowledge, confidence and motivation needed to make the most of their money.



Postcard distributed by Credit Action

Three million people say that it is a 'constant struggle' to keep up with bills or credit commitments.

Personal financial responsibility is growing even as the external environment is becoming more demanding. The financial services market is becoming increasingly complex, driven by competition and technological innovation. This is reflected in growing numbers of financial products. Estimates suggest that there are more than 8,500 different mortgages, 300 credit cards, and 4,000 savings accounts to choose from<sup>44</sup> (although these numbers may have dropped since the credit crunch). And financial decision-making is complicated at the best of times, taking into account jargon, small print and interest rates.

Financial capability also matters because of the sheer scale of financial mismanagement in the UK. Consumer debt is at a record level, and problem debt remains challenging. In 2006, the Financial Services Authority (FSA) published the results of a survey that assessed the ability of the UK population to manage money.<sup>12</sup> The survey found:

- 500,000 people (3%) have serious financial problems and have fallen behind with many bills or credit commitments. A further three million people say that it is a 'constant struggle' to keep up with commitments.
- Four million people (9%) say that they always run out of money at the end of the week or month.
- More than two in three people have made no personal provision to face a drop in income.
- More than 80% of people under retirement age do not think that a state pension will provide them with a decent standard of living in retirement. Nevertheless, more than a third of these people have not made any provision for their old age.

Potential benefits of increased financial capability include:

- **Financial trouble avoided:** reduced over-indebtedness, and people helped to get out of trouble.
- **Better planning for the future:** increased levels of savings and appropriate use of insurance, to protect against risk.
- **Reduced poverty:** because financially capable people are more able to make the most of their income and get better deals. This potentially offers savings for the government and the taxpayer.
- **Improved emotional and psychological well-being:** reduced levels of the stress and worry that money (or lack of it) can cause.
- **Improved financial services market and British economy:** capable consumers

demand financial products and drive competition, making the industry more efficient and innovative.<sup>44</sup>

If these are the benefits of financial capability for everyone, what does it mean for the financially excluded?

Lack of financial capability is a graver problem for the poorest and those marginal to mainstream products than it is for those on middle incomes. That is because people on the lowest incomes have fewest resources to cope with the consequences of poor money management.\*

The absence of financial capability can cause financial exclusion or make the effects of financial exclusion worse, because it means that people are not engaging properly with financial products and services, and they are not making the most of their money. Financial capability minimises financial exclusion, making life less stressful, more stable and less expensive.

### Who are we talking about?

There are people at all income levels who are bad at managing their money. Moreover, financial capability is a broad concept, and people can be capable in one area and incapable in another.<sup>48</sup>

However, the evidence suggests that the poorest people tend to have the lowest levels of financial capability. For example, they find it harder to make ends meet, are worse at choosing financial products, and are less likely to plan ahead than people on higher incomes. These factors may all be a direct result of living life on a tight budget, and go hand in hand with having fewer financial products. As the Institute for Public Policy Research (ippr) says: '*there is a strong, statistically significant correlation between people's financial stake—in terms of holding products, buying products or having savings—and their financial capability.*'<sup>48</sup>

In a similar vein, research by SAFE at **Toynbee Hall** has found that unemployed people generally have lower levels of financial capability than employed people.<sup>24</sup>

There is one area, however, where disadvantaged people tend to perform better than those who are better off: keeping track of their finances. This is probably because the more money you have, the more you can get away with not keeping track of it.

Another important dividing line is age: on every measure, younger people tend to be less financially capable than older people. This correlation is particularly strong when it comes

All my letters are on the floor in the toilet. I can't look at them, I get too stressed.<sup>5</sup>

\* It is worth noting that, as the Resolution Foundation has argued, the consequences of low financial capability are also potentially serious for those on low-middle incomes who are less reliant on the welfare safety net than the very poorest members of society.<sup>49</sup>

to making ends meet and planning ahead. However, older people do face particular financial inclusion needs, highlighted in Box 7.

Finally, there is a clear link between financial capability and basic skills. Education levels are a good predictor of financial capability, particularly because of its literacy and numeracy elements. In research for the Basic Skills Agency, the research organisation MORI found that:

- 12% of people cannot work out which is a better deal: £10 off or a 10% reduction on a £300 TV.
- 11% of people are unable to divide an annual bill of £120 into quarterly payments.
- 2% of people cannot work out whether to use a withdrawal or deposit form if they want to put money into their account.<sup>50</sup>

NPC has heard a number of stories of borrowers who believe that higher interest rates, like scores in school tests, are 'better' than lower ones.

## Tackling poor financial capability

Helping people to become more financially capable is usually thought of as a demand-side solution to financial exclusion. Good practice from the industry, and regulation of products and services, can both protect consumers from wasting money. However, they cannot empower consumers to make good financial decisions.<sup>44</sup>

There is an important macro solution to Britain's poor financial capability, highlighted by the ippr: *'Over the long term the best solution to financial capability is to engender a profound cultural change, in terms of attitudes to personal responsibility, behaviour, consumption, sustainability and debt.'*<sup>48</sup> The ippr's report argues that our society has moved from a *'thrift ethic'*, where people only bought what they could afford at the time, to a *'consumption ethic'*, where people buy now and pay later. *'We now need to move towards a "sustainability ethic", where both saving and borrowing are appropriate, but within the context of overall financial sustainability.'*

However, such a long-term perspective does not provide many options for donors. And a new economic ethic needs to be fostered by improving the financial capability of individuals and families. Alongside cultural attitudes to spending is the more specific problem of personal financial capability: people find finances complex and boring, and they tend to be bad at managing money.

Solving this problem is not straightforward. The dominant approach used by government, industry and charities involves giving people information, improving their skills, building their confidence and translating this into changed behaviour—in other words, educating people. A key question is whether this works.

It is fairly straightforward to demonstrate that financially capable individuals have, on average, better financial outcomes than those who are not capable. It is much more difficult to show that financial education actually makes people behave in a financially capable way. Some commentators dispute the value of financial education. They argue that financial questions are too difficult and countervailing forces are too strong for people's capability to be strengthened meaningfully. For them, the answers lie more in changing the context within which people make decisions.

### Box 7: Older people

In 2006, **Help the Aged** launched its Financial Exclusion Programme—a series of studies that raise the profile of the challenges that older people face when trying to access financial services. Access to appropriate financial services is crucial if people are to make the most of their money in later life. Yet older people are more likely to be financially excluded than the general population.

The work of Help the Aged, along with other charities such as **Age Concern** and **Action on Elder Abuse**, has highlighted several factors behind this exclusion. These include:

- **Poverty:** 1.8 million pensioners live in poverty,<sup>51</sup> which can cause and exacerbate financial exclusion.
- **Accessibility barriers:** Although older people tend to prefer face-to-face banking, mobility problems and lack of decent transport make it difficult to get to a bank. Sight problems make it difficult to read small print, and many older people find it difficult to remember their PIN number. Problems have also been highlighted around a lack of public toilets and fear of crime.
- **Technology barriers:** The technological evolution of financial services has left some older people behind. For example, many shops now refuse to take cheques. Also, there has been a move towards internet banking, yet less than a fifth of over-65s have ever used the internet.<sup>4</sup>
- **Discrimination:** A 2007 report from Age Concern and Help the Aged found that one in four over-75s and one in four over-65s were unsuccessful in getting quotations for motor insurance, travel insurance or car hire.<sup>52</sup> This compares with just one in 33 of those aged 30–49. The charities have found that insurance companies impose arbitrary upper age limits on products, sometimes discriminating simply on the grounds of age.
- **Abuse:** Financial exploitation is one of the most prevalent forms of elder abuse. A 2007 report found that 57,000 people aged 66 and over had experienced financial abuse in the past year. The charity Action on Elder Abuse has revealed that one in five calls to its helpline are about financial abuse.<sup>53</sup>

In order to make the most of their money, older people need information, skills and services to overcome these barriers. Some charities are beginning to focus on this area, particularly through lobbying work and financial capability initiatives.

For example, Help the Aged and Barclays have teamed up to provide financial education and debt advice to vulnerable older people, through 18 projects across the UK. *Your Money Matters* aims to support over 30,000 older people and their carers over three years. Each project has a Help the Aged adviser, supported by Barclays volunteers, who provide practical help to build confidence and skills. Some Citizens Advice Bureaux, including **North Liverpool Citizens Advice Bureau** and **North Somerset Citizens Advice Bureau**, run similar projects aimed at older people.

Figure 4: Improving financial capability



The evidence, discussed later in this chapter, gives food for thought on both sides. NPC’s view is that education can work and is worthwhile but needs to be designed and delivered in particular ways to be effective. It may be more appropriate for some domains of capability than others.

**Financial education**

Financial education can address any aspect of financial behaviour (such as credit use or budgeting), and it can be delivered in various ways, from leaflets being left in libraries, to intensive one-to-one sessions of objective, tailored advice. Financial education can be divided into three separate categories:

- literature and resources
- classes and workshops
- money guidance

As Figure 4 shows, the fewer people that the intervention reaches, the more intensive and tailored to the individual it can be. Also, the more personalised (and expensive) interventions are the most likely to have a lasting impact.

**Literature and resources**

There is an abundance of financial information in circulation, including websites such as Martin Lewis’ MoneySavingExpert.com, the financial sections of newspapers, and leaflets found in libraries and doctor’s surgeries. Sometimes this information is published by financial services firms and comes with an agenda, but there is also a great deal of impartial information available, much of which is produced by charities.

Such resources can play a big part in informing people about financial matters in a clear and easily understandable way, often interpreting jargon to make the industry less excluding. At their best, they can also build financial capability in a practical and interactive way, as a tool to help people to help themselves. One of the most popular forms of financial self-help is product comparison internet sites, which people can use to find the best deals on all sorts of products and services, including home contents insurance, savings accounts and holidays. There are also ‘self-diagnostic’ tests such as

budgeting calculators and debt-checks, found on the internet and in brochures. Here, personal information is inputted, and guidance is given on how to interpret and improve the situation.

Of all the interventions to improve financial capability, financial information and self-help materials are the most common and have the broadest reach. However, they do have limitations.

Because these resources are so ‘light touch’, they have the least certainty to have a deep impact: they rely on individuals to be proactive, pick them up and read them. Quite aside from the barrier of people’s own inertia, there is a risk that superabundance of material available actually worsens the problem by confusing people. There is growing research that too much choice and information can render people indecisive.<sup>39</sup>

Furthermore, financial resources rely on the reader having the skills to apply the information and advice given.

These factors mean that it is difficult to measure the impact of literature and resources, underlined by the practical difficulty that there is usually no personal contact in their delivery. Success here would mean people reading the information, learning from it, and applying it to their situation where appropriate.

One charity that is attempting to measure the impact of its publications is **Credit Action**, a national money education charity (see Box 9). In 2006, 94,000 individuals visited the website creditaction.org.uk a total of 213,000 times, with each session lasting an average of six and a half minutes. This does not tell us who the visitors are or what they did with the information they read. It does tell us that people return to the website, and they are active on it for a fair length of time. However, beyond such statistics, Credit Action has to resort to anecdotes and letters of thanks to demonstrate its success. The charity is exploring ways to encourage more responses through the websites, by building in an easy-to-use feedback mechanism.

A general lesson for the sector is to remember that distribution and marketing of materials is at least as important as their content. Money education charities do not always commit

Some borrowers believe that higher interest rates, like scores in school tests, are better than lower ones.

enough resources to making sure that their materials reach their intended audience. Separately, charities need to avoid reinventing the wheel when drawing up materials. For most groups it is likely to be the case that someone somewhere has written a guide. Charities' resources would be better spent seeking to distribute what exists rather than rewriting. This is a particular risk for specialist charities working with particular groups, who may not always know what is available.

### Classes, workshops and seminars

Of course, educational resources are not always used in isolation; they are often brought into play as part of face-to-face financial education. Delivering financial education to groups of people is a common intervention to improve financial capability, and it comes in a variety of forms, from large one-off classes to courses of small, interactive seminars. A key difference is between classes for children, who are often a captive audience at school with no choice but to attend, and classes for adults, which rely on people choosing to attend. Charities, including **Citizens Advice Bureaux** and **Toynbee Hall's SAFE**, often piggy-back on classes run by other groups to deliver money workshops.

How effective is this? Forms filled in before and after classes tell us that education increases people's understanding of financial issues, gives knowledge of where to go for help in the future, and increases confidence. Bertha's story in Box 8 is a good example of this. We also know that education picks up debt problems, so is a good way of engaging people before they face meltdown. However, evidence on long-term impact (eg, reducing expensive credit use, increasing savings or preventing debt) is decidedly mixed.

**Citizens Advice's Financial Skills for Life** programme gives classes to adults on low incomes. A detailed evaluation found some evidence of impact several months after beneficiaries had completed the classes.<sup>54</sup> Most participants reported adhering to budgeting plans worked out with their tutors, and they reported a continuing awareness of the risks of unsuitable borrowing. Also, beneficiaries from all the target groups, including the most excluded, reported having saved money as a result of the project.

There is also some large-scale US evidence that education in schools dramatically increases savings and wealth. For example, Bernheim, Garrett and Maki found that, trying to control for other factors, individuals in US states where financial education is compulsory were better off by a year's worth of earnings and tended to save 1.5% more of their income each year (see Box 10).<sup>55</sup> Writing for the *ipp*, Mike Dixon argues that, applied to the UK, this means that

### Box 8: Bertha's story

When her husband died, 74-year-old Bertha lost a lot of confidence, particularly when it came to managing money. She felt out of touch with current financial practices, was nervous about financial institutions, and worried about making ends meet.

After receiving an unsolicited credit card through the post, Bertha could not take the anxiety any longer. She confided in the community worker who served her housing estate, and the worker referred her to a local charity, Surrey Care Trust, which runs *Managing Your Money* classes as part of its Family and Community Education (FACE) programme.

After a couple of classes, Bertha grew in confidence and began to discuss her own money worries with the small group. She learned how to use the internet, through [moneysavingexpert.com](http://moneysavingexpert.com), and the project worker managed to persuade her that the bank did not have to be a daunting institution. The following week, Bertha returned having finally phoned her bank, finding out that what she thought was an unsolicited credit card was in fact a replacement debit card.

The *Managing Your Money* classes did not just give Bertha computer and money management skills; they gave her a new found confidence, and helped her to enjoy making the most of her money.

### Box 9: Credit Action—'Better thinking about money'

Credit Action is a national money education charity that aims to prevent financial troubles by helping people to manage their money well. *'Our passion is to help people stay in control, rather than let money control them and disrupt their lives.'*

Credit Action's primary business is producing and delivering resources to improve people's financial knowledge. It has two core guides, or *'Moneymanuals'*—one that helps people to make their money go further, and one that helps people to take control of their debts. There are also guides for students and lone parents.

The charity distributes tens of thousands of Moneymanuals through organisations including Citizens Advice Bureaux and housing associations. The booklets are well-written and well-received, as Ed Mayo, Chief Executive of the National Consumer Council, has commented: *'Not many consumers feel confident in managing their money, and yet there are few parts of our lives that carry the same degree of risk if it all goes wrong. These booklets by Credit Action are simply invaluable.'*

### Second tier training

Many charities regularly see people who need someone to sit down with them and talk about their finances, but staff do not always have the confidence or knowledge to do this. Credit Action is meeting this need via a 'training the trainers' programme, equipping staff within organisations that work with financially excluded people to educate and advise on money issues. Training is typically a full day, several times a year.

Partners are wide-ranging but include housing associations, homelessness charities and women's refuges. Working with partners therefore allows Credit Action to target groups that are particularly prone to financial exclusion. Also, partners can usually engage people at an earlier point than if money charities were simply to wait for people to approach them for help.

To tell the truth, I didn't understand what I was signing up for.<sup>1</sup>

a couple with two children could be better off by about £32,000. A single person with no children could be better off by £13,000.<sup>48</sup>

Both of these pieces of evidence sound impressive, but it is not all positive. For example, the evaluation of Citizens Advice's programme found that, unsurprisingly, those in employment were more likely to follow up on financial education than those leading more chaotic lives.

There are also some methodological problems with the US research, which relied on a survey of reported levels of education, savings and net worth. The study did not consistently correct for selection bias in the pool of people who responded. It seems likely that better off people would be more willing to answer certain questions and, if so, the figures overstate the gain. (See Box 10 for more detail.)

Finally, there is a contradictory view, recently reported in *The Economist*. Some US research has found that students who take a course in personal finance end up no more financially literate than those who do not.<sup>56</sup> Tracking students who took such a course over a five-year period, it found 'no positive impact on financial literacy, attitudes toward thrift or behaviour'. Indeed, there was some evidence that it increased harmful habits, such as running up short-term debt. One positive outcome was that teaching children using a stock market game consistently increased literacy scores. However, those 'junior investors' turned out to be the worst savers of any children who had taken a financial education course.

#### Box 10: The impact of financial education classes: evidence from the US

One important study from the US looks at the long-term behavioural effects of teaching money education in schools.<sup>55</sup> Bernheim, Garrett and Maki found systematic evidence that, controlling for other factors, individuals in states where financial education is compulsory had significantly higher levels of savings than those in other states, many years down the line. The study also found that financial education at high school dramatically increased future net worth.

However, the research did have some methodological problems. It relied on self-reporting and did not control for number of children, which might be expected to affect levels of savings. On increases in net worth, the study did not correct for selection bias in the pool of people who responded. It seems likely that better off people would be more willing to answer the question and, if so, the figures overstate the gain. On savings, there was a high non-response rate to the question, especially at the low-income end. Overall, the research was positive about financial education, but leaves open the question of the extent to which education affects poorer people.

Further evidence for the effect of financial education comes from an initiative developed in New Jersey in 1996, called Money 2000 (now Money 2020), which incorporates a longitudinal behavioural monitoring system. Participants set financial goals and are given education. They are surveyed about changes in their asset and debt level every six months. Goals are specific, there is consistent monitoring, and tools are tailored to people's needs. Regular monitoring and tailored provision also ensure that people are supported when moving through different stages of change. An independent evaluation found that 'the results of the programme are compelling'.<sup>48</sup>

It is worth noting that the author of this research partly attributes the problems to the way that education is designed and delivered. Overall, the evidence presents an unclear picture: the lack of consensus is frustrating and makes the situation more challenging for donors. The potential returns of well-delivered education are very high: further attempts to develop approaches that unambiguously deliver could be justified on these grounds.

#### Money guidance

The most expensive and intensive form of financial education is one-to-one, face-to-face advice. The best known form of this comes from fee-charging Independent Financial Advisers (IFAs), whose services are typically available to those on higher incomes. Recognising that this service does not reach unprofitable customers on low to middle incomes, the Resolution Foundation developed the idea of generic financial advice.<sup>49</sup> This is personalised advice that does not recommend particular financial products.

A government review (the Thoresen Review) has recently renamed this intervention 'money guidance', and has proposed that a service be rolled out nationally (see Box 11).

Money guidance can have a lot of overlap with financial education in classes—for example, both can give practical help with budgeting and understanding forms. However, education on a one-to-one basis is obviously more tailored, and can include clear guidance on specific actions that the individual should take. It may be particularly effective if advice is given every so often, rather than just being one-off. This intensity, in theory, should increase the chances of life-changing effects.

There is some evidence from schemes using IFAs that personalised advice increases people's financial capability and improves their financial well-being. Citizens Advice ran a pilot using volunteer IFAs that was well received. One particularly intensive experiment, AXA Avenue, tracked the finances of 20 households in Brighton over a year. Ten were given free access to an IFA, and ten were left to their own devices. Collectively, those who received advice were £50,000 better off, with higher increases in savings and reduction in debt. Those who did not receive advice actually got poorer: 'they frittered away a quarter of their savings and the group saw a 3% reduction in their net wealth'.<sup>57</sup>

This experiment was not aimed at financially excluded people and relied on the IFA checking up on families rather than them seeking help, so its findings need cautious interpretation. Nevertheless, such results do demonstrate that financial advice can increase wealth.

The effectiveness of money guidance has also been shown in the Thoresen Review's feasibility

study into a national service, described in Box 11.

Perhaps the key unknown on financial advice is the level of demand among financially excluded people. Survey evidence suggests that people on low incomes do not feel they need advice, though this may be an issue of language.<sup>21</sup> Citizens Advice's pilots found that a high proportion of the free IFA users were older people—typically seeking advice on issues like endowment mortgages, pensions and equity release. This is in line with the Resolution Foundation's work on unmet need among people on moderately low incomes and implies, perhaps, that there is less immediate demand among people near the bottom of the income scale (including those without assets). The Thoresen Review acknowledges that, for half the people in the 'most vulnerable' category it identifies, debt advice is more appropriate.

## What does good financial education look like?

There is a lack of systematic, longitudinal evidence across all types of money education. This is in part because of the nature of the intervention: knowledge and understanding do not always affect behaviour, and evaluation is made particularly difficult because education is preventative. But there is also a lack of data because the field is fairly new, and much has been carried out by voluntary organisations that do not have the capacity or resources to evaluate their work.

Notwithstanding these problems, NPC believes that financial education is worth supporting. It seems intuitively likely that, as with other kinds of education, its effectiveness is dependent on how it is taught and the context in which it operates. By looking at the relative performance of different kinds of intervention, it is possible to identify some success factors.

## Lessons from economic psychology and behavioural finance

Some commentators have looked to behavioural economics to design more effective financial education. The ippr, for instance, has stressed that a central challenge for financial capability work is '*closing the motivation gap*' between what people say is important and their actual behaviour.<sup>48</sup> This gap is obvious, for example, from the FSA research cited at the beginning of this chapter: more than 80% of people under retirement age do not think that a state pension will provide them with a decent standard of living in retirement, yet more than a third of these people have not made any provision for their old age.

The motivation gap can be explained using behavioural principles such as inertia (people tend not to make decisions if they do not have

to) and hyperbolic discounting (people tend to choose short-term gratification over long-term reward). So the role of education must be to give people the motivation to change their behaviour, as well as the tools necessary: '*people have to genuinely want to alter their behaviour*'.<sup>48</sup> Good financial education should bear in mind the following points:

- **Empowerment**, through imparting tools and support, is usually the most effective way to change someone's behaviour.
- **Commitment** '*plays a crucial role in changing behaviour*', so financial education should help people to make and keep commitments. This could be, for example, by setting small, specific and achievable saving goals, or helping people to book appointments.

Is 40% interest expensive? I don't know. You tell me.<sup>2</sup>

### Box 11: Thoresen Review of Generic Financial Advice<sup>58</sup>

In January 2007, Ed Balls, then Economic Secretary to the Treasury, appointed Otto Thoresen, CEO of AEGON UK, to review how best to deliver a national generic financial advice, or '*money guidance*', service.

The review proposed that money guidance should be multi-channel—available through the internet, phone and face-to-face—and that it should be impartial, supportive, preventative, available to all and sales-free. Its research concluded that '*a national service is wanted, needed and beneficial for the UK population*'.

A survey of 1,011 adults found that there is latent demand for a money guidance service. Three quarters said they were likely to use a '*national information and guidance service for personal finance issues*' and of these, over a quarter felt they would be very likely to use such a service. The review points out that '*even if only one-third of those who said they were very likely to use the service actually did so in one year ... this would suggest a level of demand of some four million users per annum*'.

Of course, the review estimated what level of demand would translate into actual use, and not everyone who uses the service will act on the guidance given. However, the review did find some evidence that guidance can drive behaviour change. Eight out of ten users of the prototype services surveyed went on to take at least one action within a week of using the service. Half of these (ie, four out of ten) took specific action such as buying a new product or speaking to a regulated adviser. The review cites evidence that only one in twenty people using such a service would do nothing.

As well as benefits for individuals, the financial services industry and society as a whole, Thoresen went on to estimate benefits for government. The review finds that quantifiable benefits, in net present value to 2060, would range from £5bn to £6bn. Quantifiable costs would be in the range of £390m to £839m.

However, the estimates for benefits are based on two premises. First, that advice will result in one in ten users acting on all of it throughout their lives. The authors admit this is an unlikely scenario but use it as a proxy for a wider group of people acting on less of the advice. Second, that advice is delivered in 40-minute face-to-face meetings, 30-minute internet sessions or 15-minute phone calls.

NPC is impressed by the thoroughness of the analysis but wonders if the assumptions of impact may be unrealistically high, given how light-touch the service is. Four out of ten people taking a specific action does not seem equivalent to the assumption that one out of ten acts on all of the advice throughout their lives. If the assumptions of impact are too high, the review overstates the gains of the new service.

A central challenge for financial capability work is closing the motivation gap between what people say is important and their actual behaviour.

Finance isn't that exciting and you can't make people do it, but short sessions around specific activities would help.

Homeless person at Centrepoin<sup>10</sup>

- **Incentives** are important in encouraging financial capability: *'almost all behaviour change theory stresses the importance of rewards'*.<sup>48</sup>

Finally, financial capability is usually a gradual process that takes time to improve. One-off seminars are less likely to improve behaviour than education that maintains some contact with the beneficiary.

### Financial education for the financially excluded

The lessons from economic psychology and behavioural finance come into the following issues for financial education—issues that are particularly important when considering financial exclusion.

#### Targeting

The idea of financial education is not immediately compelling, and it is unsurprising that many people do not want to go to a class on budgeting, bank accounts or APRs. Such classes are perhaps particularly unappealing to people who do not have much money and who are excluded from mainstream financial services. Yet it is these people who are most at risk from low financial capability.

Charities have learned that people can be persuaded to pick up leaflets on money or go to budgeting classes, but it involves careful branding, because they are unlikely to look for financial capability lessons off their own back. So it is important for organisations to use thoughtful outreach. This might involve targeting schools in the poorest areas, or partnering with organisations that are already working with excluded groups. The disadvantage of working with such intermediaries though, is that their members will almost certainly be a smaller subset of the wider population in need.

One way to get round this is by trying more 'scale' approaches. The charity **Credit Action**, highlighted in Box 9, is proactive in delivering some of its educational material to social housing, where most financially excluded people live. Credit Action has produced postcards that contain basic messages on managing money better, and prompt people to seek help for financial trouble. The postcards are being delivered through housing associations, free local newspapers and doorstep lending companies.

Scale approaches look like an important way of targeting low-income groups—because they have such a broad reach, they are likely to have an impact on the lives of some people

who would not access other services. In April 2006, the **Public Service Broadcasting Trust** broadcast a series of features on three regional ITV companies, called *'Save Yourself a Fortune'*. Viewers could phone a freephone number to book a free three-hour money-saving session near to their home. At the session, a tutor introduced them to a CD-ROM and before they left, they saved money on at least two household bills. They took the CD-ROM home to help them continue saving money.

Although many calls went unanswered, 16,500 people got through, and 81% of these booked a money-saving session. Most of these turned up to their session. Importantly, four times as many C2DEs as ABC1s\* watched the programmes, indicating good engagement with some of Britain's most deprived families.<sup>60</sup>

#### Social networks and families

As we have already seen, financial exclusion affects families and friendship groups, not just individuals. Unbanked people, for instance, tend to be clustered together both geographically and socially. More than this, research suggests that a key influence on financial habits is parental behaviour: good savers learn from their parents.<sup>55</sup>

These points suggest that education could sensibly target families and friends, rather than individuals. But to NPC's knowledge, few charities have used this theory to inform their financial capability work.

There are two notable exceptions to this, both based in east London. One is **Quaker Social Action**, which has a creative family-focused financial education project called *Made of Money?* (This is highlighted in Box 5, in the second chapter of this report.) The other is **Toynbee Hall**, which, through a series of coffee mornings with local families, has developed a booklet full of tips for families on issues such as saving, borrowing and consumer rights.

#### Sensitive content

Needs vary dramatically for different groups, and provision should be sensitive. A lot of charities that NPC spoke to emphasised the role of budgeting skills. But many people on low incomes—especially lone parents—are skilled at making ends meet. Their needs are more around long-term planning and choosing products. Other people are excluded because of language barriers, and personal money guidance can help to overcome this, as Box 12 shows. Another example of the need for tailored advice comes from the **Refugee Council**. A

\* For government definitions of these socio-economic classes, see [www.statistics.gov.uk/methods\\_quality/ns\\_sec](http://www.statistics.gov.uk/methods_quality/ns_sec).

financial education project funded by HBOS found that the client group was extremely sophisticated. They wanted to know not only how to open accounts and to remit money, but also to draw up cash flow statements and business plans.<sup>61</sup>

### Timing

The timing of financial education is just as important as how it is delivered. People can be more or less receptive at different points in their lives, and financial skills can be more or less useful at different times. Linking education to specific events—such as the birth of a child, passing a driving test, getting a new job, moving house or retiring—is thought to be particularly effective. It is about making the knowledge relevant.

The evaluation of Citizens Advice's *Financial Skills for Life* programme found that one-off training was most effective when delivered at such major points of transition: *'As the need for information, advice and support on financial issues became a priority, beneficiaries were more receptive to being challenged on their wider attitudes to finance.'*<sup>54</sup> The same research found that, for people with more chaotic lives, such as asylum seekers, ex-offenders and homeless people, repeat or sustained training was more beneficial than one-off training, due to their rapidly changing circumstances.

A finding from US research in relation to schools is that secondary school may be too late to start teaching finance.<sup>56</sup> Before they even get to primary school, children will have received a wealth of implicit lessons in money by observing their parents. It has been argued that habits may be too ingrained by secondary school and pushing some money education back to primary school is likely to work better. Interestingly, the evidence from Bernheim, Garrett and Maki, cited earlier, also found that financial education was most helpful to students whose parents had not taught them about money. It was *'largely redundant where parents communicate the basics of household saving'* and did not improve outcomes.<sup>55</sup> This implies targeting financial education on poorer schools.

### Experience and habit

Just as the timing of financial education is important, it should also be connected to changed behaviour—knowledge and information are of little use unless they impact actual money management. That is why people who actively seek out financial information tend to do so in relation to a specific decision they are about to take, such as which travel insurance to take out—hence the popularity of product comparison sites. In his thoughts

### Box 12: Language barriers to financial inclusion<sup>59</sup>

Farah is a 65-year-old retired schoolteacher from Baghdad, who was subjected to torture and imprisonment by the previous Iraqi government because of her political beliefs. Last year, she was granted exceptional leave to remain in the UK for four years.

Farah approached **South Tyneside Citizens Advice Bureau** because she was having problems with the housing and benefit systems. She was helped by Jabrail, also from Iraq and now a bureau adviser. Jabrail helped Farah to claim her full benefit entitlements, to find a suitable home and to secure a Social Fund crisis loan to help pay for essential household items. *'Because I speak Arabic, she felt more secure speaking freely to me,'* says Jabrail, who has also helped Farah enrol onto a language course at a local college. *'It's all about understanding the system as a whole. Without our help, it is likely that Farah would have suffered from ignorance of the system and been financially worse-off because of it.'*

Jabrail is one of four staff working for the bureau's Minority Ethnic Project. Through the bureau and using outreach, the Minority Ethnic Project alone sees more than 1,000 clients a year, most of whom are from the poorest parts of South Tyneside. Many experience language barriers, for example, finding it difficult to negotiate with creditors if they have a money problem. The project helps by working with debt advisers as well as giving tailored advice in issues such as immigration, housing, anti-racism and domestic violence. Advice is given in the client's own language, using a translator if necessary.

on economic psychology, Dixon argues that seminars in themselves are unlikely to alter people's financial capability unless they have an experiential element. That is, they *'should focus on practical ways of changing behaviour ... encouraging people to take specific actions immediately following the seminar.'*<sup>48</sup>

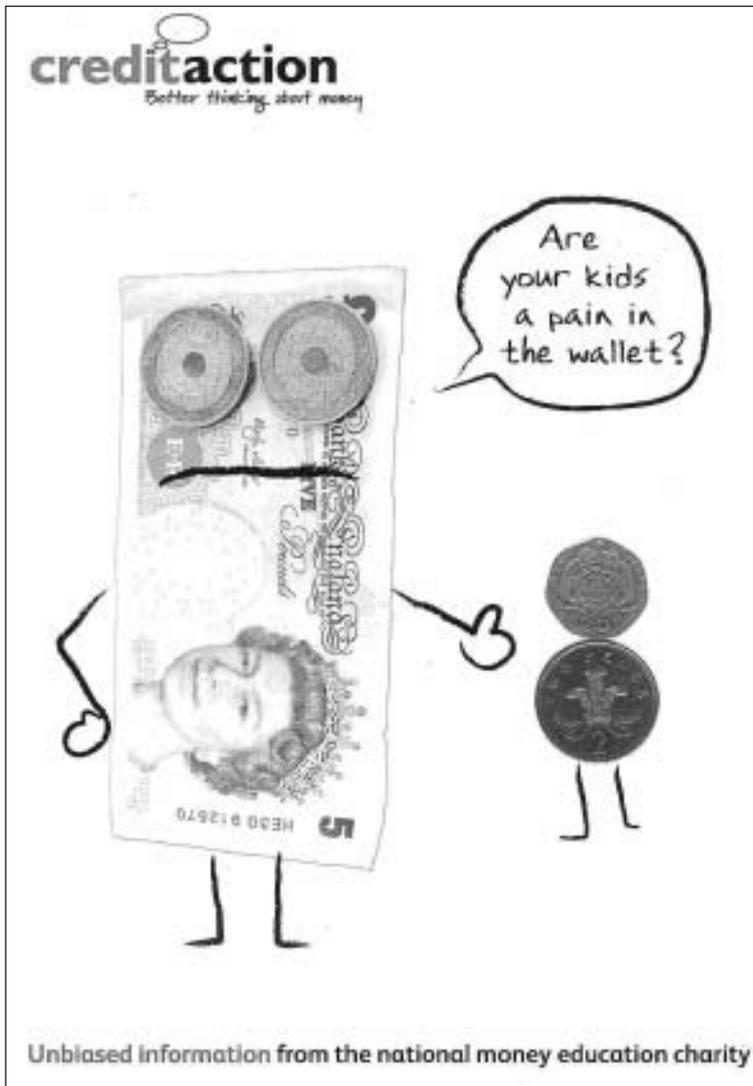
Making financial education experiential could be related to purchasing a product, for example, when opening a savings account for the first time. As part of its SAFE project, the east London charity **Toynbee Hall** gives one-to-one financial education and advice to people who need support opening a bank account.

Credit union junior saver accounts offer one model that could be rolled out more widely. The aim is to introduce and normalise particular financial habits in people's lives—whether opening and reading bank statements or putting money aside each month in an account.

It is notable though that most financial education work is not currently very well integrated with products.

### Quality

A key barrier to financial education working is that the people teaching it sometimes lack skills and confidence themselves. Teachers in schools are no more likely to be financially capable than other people, yet have been tasked with the job of training the next generation. The charity **pfeg**, the **Personal Finance Education Group**, has played an important role in providing support and training to teachers.



## Government and industry action

So what activity is taking place to tackle poor financial capability, and is it adequately addressing the scale of the challenge?

### Government

At the time of writing, we are awaiting the publication of the government's new financial capability action plan. The government is also setting up an informal Ministerial group, chaired by the Economic Secretary to the Treasury. In the meantime, however, the Treasury seems to acknowledge that governmental financial capability initiatives are not well coordinated:

*'Financial capability contributes to a range of related government objectives, and, conversely, many government services help increase financial capability. Yet, within government, no one department has overall responsibility for raising levels of capability; nor does any department have a duty to provide education, information or advice in relation to personal finance.'*<sup>144</sup>

In its financial inclusion action plan for 2008–2011, the Treasury sets out three long-

term aspirations for financial capability to ensure that:

- all adults in the UK have access to high-quality money guidance to help them to engage with their financial affairs and make effective decisions about their money;
- all children and young people have access to a planned and coherent programme of personal finance education, so that they leave school with the skills and confidence to manage their money well; and
- a range of government programmes focus on improving financial capability, particularly to help those who are most vulnerable to the consequences of poor financial decisions.<sup>62</sup>

The first two objectives are aimed at promoting financial capability for everyone, and perhaps indirectly preventing financial exclusion, whereas the third objective is more focused on helping the financially excluded.

### Money guidance

As Box 11 describes, the recent Thoresen Review of generic financial advice has concluded that a national money guidance service 'is wanted, needed and beneficial for the UK population'.<sup>58</sup>

In response to Thoresen's recommendations, the government announced in March 2008 that a £12m, two-year pilot would establish how a national money guidance service could be delivered, reaching 750,000 people. The pilot will be delivered by the FSA, and jointly funded by the government and the FSA. After this, the government and financial services industry are expected to support the roll-out of a national service.

### Support for schools

The government is introducing an economic well-being and financial capability programme as part of secondary school Personal, Social and Health Education curriculum, beginning in September 2008. The government has also announced that £11.5m will be spent over the next three years to support schools in England to teach financial skills to children.<sup>62</sup>

### 'Now let's talk money' campaign

The main government initiative that targets financial capability work on financially excluded people is the Department for Work and Pension (DWP)'s UK-wide 'now let's talk money' campaign, running between 2007 and 2008. The campaign aims to direct people who could do with financial help to trusted sources, where they can find out more about banking, affordable credit, savings and general money management.

The DWP is working with organisations that promote financial inclusion, and it is raising awareness about the campaign through media such as posters at bus stops, local radio adverts and leaflet drops. It is not yet clear what effect *now let's talk money* is having.

### Other financial capability work

Government is supporting financial capability work indirectly through other initiatives. For example, it sees both the Child Trust Fund and the implementation of personal accounts for pensions as opportunities to engage people in ways to make the most of their money. And, particularly for people on low incomes, some Sure Start children's centres are providing family finance projects to give help on money management and topics such as saving and borrowing.<sup>44</sup>

All in all, the government is addressing financial capability in an active but fairly fragmented way, particularly when it comes to people on very low incomes.

### Financial Services Authority

The FSA regulates the UK's financial services industry, and is financed entirely by the firms that it regulates. The FSA does have a statutory objective *'to promote public understanding of the financial system'*, but it has no statutory responsibility for financial inclusion. However, it says, *'we take the issue very seriously and have consistently tried to be thoughtful about and sensitive to the special requirements of those who find it difficult to gain access to financial services.'*<sup>63</sup>

Since 2003, the FSA has been leading the National Strategy for Financial Capability, which brings together the financial services industry, consumer and voluntary organisations, government and media. It is funded by a levy on the financial services industry, and a fair amount of money is going in: the FSA is spending £17m on financial capability in 2007/2008, up from £10m the year before and £8m two years before.

The strategy is working in seven areas: schools, young adults, the workplace, consumer communications, online tools, new parents, and money advice. One of the most visible aspects of the strategy has been the MoneyMadeClear website, which aims to *'cut out the jargon and give you just the facts about financial products and services'*.

In working with different groups, the FSA has some big targets. For example, by 2011 it aims to reach 1.8 million children in 4,000 schools, and to have given information to four million employees, and delivered 500,000 seminars in workplaces.

Yet the strategy has come under quite a lot of criticism, particularly among those fighting to promote financial capability for the financially

excluded. Claire Whyley, Director of Policy at the National Consumer Council has told the Treasury Select Committee that, *'rather than attempting to pool resources into meeting the needs of the hardest to reach, the FSA has effectively concentrated on those who were easiest to reach, aiming to reach the most people with the least input, and that is how we have ended up so far from anything that is aimed at people who are financially excluded.'*<sup>63</sup>

The FSA argues that even its mainstream financial capability work is aiming to prevent future exclusion, and is part of *'the journey towards financial inclusion'*.<sup>64</sup> Some of its work is so broad that it is bound to reach some low-income groups. For example, **pfeg** runs a project funded by the FSA called *Learning Money Matters*, which aims to build the confidence of teachers who teach personal finance. Some of these teachers will have contact with children from financially excluded families.

Some of the seven teams within the strategy have come up with specific ways to address financial exclusion. For example, the programme aimed at young adults is not only targeting the 2.3 million students in higher education; it is also aiming to reach a million young people who are not in education, employment or training (NEET)—a group that has significant experience of financial exclusion. This is through partnering with organisations that already have contact with excluded young people. For example, **Fairbridge West** has developed a toolkit called *On your own 2 feet*. This publication highlights the good practice involved in integrating financial education into existing courses, and developing more focused courses. It contains practical ideas and delivery methods for youth workers.

Building on this, the FSA is now funding a major free training programme to increase the money skills of youth workers. *Young People and Money* is for those working with young people that are either NEET or at risk of becoming NEET. It is managed by **LifeLine**, and is being delivered across the UK by the company A4e, and the charities **Citizens Advice**, **Fairbridge** and **LifeLine**. The programme aims to train 20,000 youth workers by 2010.<sup>65</sup>

### FSA Partnership Development programme

For people experiencing financial exclusion, perhaps the most important part of the FSA's strategy for financial capability is its Partnership Development programme (formerly the Financial Capability Innovation Fund). The programme *'reaches across and beyond the financial capability strategy to address the needs of a range of people and community groups, many of whom might otherwise find themselves excluded from the financial system.'*

It does this in two ways. Firstly, it supports partner organisations, for example, by helping

For every pound the FSA spends on financial education work, the financial services industry spends £204 on advertising.

### Box 13: Examples of financial services industry support for financial capability work

The Royal Bank of Scotland (RBS) has been running its MoneySense programme (formerly 'Face2Face with Finance') since 1994. The bank helps teachers to teach money education in schools, both by providing easy-to-use activities and materials, and by sending RBS employees into schools to help out. Between 2004 and 2006, the programme was delivered in 3,000 schools.

Barclays has given **Help the Aged** £2m over three years to help older people manage their finances, in a programme called 'Your Money Matters'. Volunteers from Barclays work alongside trained advice workers to give face-to-face financial education and advice on topics such as Chip & PIN and budgeting.

The Institute of Chartered Accountants has given **pfeg**, the **Personal Finance Education Group**, access to its members, with the support of GE Money, a consumer finance provider. The accountants are helping schools to deliver financial education, in an attempt to raise awareness about the importance of managing money.

them to evaluate impact or create resources. Secondly, it provides funding for organisations to do financial capability work with particularly excluded groups. Recipients include **Mencap**, **One Parent Families/Gingerbread**, **Macmillan**, the **British Refugee Council**, **East Surrey Domestic Violence Forum**, and **Age Concern Gateshead**.

#### Financial services industry

Financial capability work attracts a lot of financial services industry funding—it is where a good deal of CSR money ends up.

This is probably for two reasons. Firstly, improving the nation's financial skills and behaviour is an important goal for the industry as a whole. More capable consumers represent a more efficient market. Secondly, poor financial capability is consistent with a demand-side account of financial exclusion. It is identifying the 'problem' as one of people's skills and experience, rather than supply-side factors like the design of products or marketing practices. Supporting capability initiatives could be interpreted as regulatory risk management by the industry.

Several financial services firms are producing their own materials, or partnering with charities and schools to promote financial capability. Often they are targeting mainstream groups—particularly children. To a lesser extent they work with particularly excluded groups, though there is some commendable practice. Box 13 highlights three examples of industry support for financial capability work.

#### The effect of government and industry action

It is clear that the scale of activity is modest relative to need. The ippr has highlighted that for every pound the FSA spends on financial education work, the financial services industry

spends £204 on advertising. For every pound spent on promoting financial capability, £12 is spent on promoting personal loans.<sup>48</sup>

This does not augur well for the likely effectiveness of the financial capability strategy. How much can be expected of small-scale initiatives when wider pressures on people are so strong?

### Charitable activity

Financial education initiatives can be delivered in many different ways, from leaflets to classes to face-to-face advice. And some groups, such as homeless people, social housing tenants, unemployed people and the very poor, are over-represented when it comes to poor financial capability. With such variety, there are unsurprisingly a lot of charities involved in the field. For a few, financial capability is their main focus. But for many others, financial capability work is one part of their much broader work with socially excluded groups.

In theory, the voluntary sector is well-placed to deliver financial education. It tends to be trusted and is usually seen as independent, which is particularly important when there are so many products being sold. The following highlights some important work that charities are undertaking in the three different areas of financial education.

#### Literature and resources

Many of the charities that deliver any sort of money management help to their clients end up producing their own materials, which are sometimes tailored to their client group and local area. But this has resulted in some mediocre quality material and, as noted previously, unnecessary replication in the field.

Some organisations use their time more efficiently and adapt material that is already out there to suit their local area and client group if necessary. For example, the FSA's financial capability website contains tools and resources aimed at helping intermediary organisations in their financial education work.<sup>66</sup>

As mentioned previously, the biggest player that is making things easier for schools is **pfeg**. In order to ensure the quality of resources, pfeg has developed a Quality Mark accreditation system. This system means that, despite the plethora of information out there, teachers can be confident that accredited materials are accurate, up-to-date and tried and tested.

#### Classes, seminars and workshops

Face-to-face education to groups of people comes in many different forms and is delivered to many different audiences. The following gives examples of just a few different approaches.

In schools, charities give a range of support to teachers who feel like they lack expertise. pfege offers consultancy, training and guidance to teachers, as well as resources, but it stops short of taking over lessons, because it believes that schools should be encouraged to develop and sustain their own programmes.<sup>67</sup>

pfege has partnered with **Citizens Advice** on various projects: nearly 10% of bureaux in England and Wales are involved in supporting financial education in schools, in particular, helping teachers to plan and deliver lessons. Even though it is important that schools take ownership of these programmes in the long term, having an external agency teach in the school can make a potentially boring subject seem more interesting and be more engaging.

Bureaux have also been involved in providing financial education classes to groups of socially excluded or needy adults, often targeted through accessing groups convened by other charities.

In 2002, Citizens Advice launched a three-year pilot called *Financial Skills for Life*, the evaluation of which has already been discussed. Nine bureaux tested the delivery of face-to-face educational programmes to a range of hard-to-reach groups including prisoners, people with mental health problems and refugees. Citizens Advice also provided support to more than 60 other bureaux that offer financial education as part of their mainstream role. In light of the evaluation, Citizens Advice now wants every bureau in England and Wales to offer financial education by 2010.<sup>68</sup>

One bureau that is doing a particularly good job of taking money education into both schools and the community is **Flintshire Citizens Advice Bureau**, which has a project called '*Money Matters*', described in Box 14. Early results show that the course is increasing people's knowledge and understanding of financial issues, and increasing their financial control and confidence. This apparent success is down to, on the one hand, making money education interactive, interesting, and relevant. On the other, it owes a lot to being part of the Citizens Advice network, including the learning, training and support available.

Of course, some of the children most vulnerable to financial exclusion cannot be found in classrooms. Young people who are not in education, employment or training usually need more persuading than most to take part in lessons that do not seem particularly interesting. Some charities that already work with excluded young people are now incorporating financial capability lessons into their wider programmes.

For example, the national charity **Fairbridge** works with young people aged between 13 and 25, many of whom have been excluded from school or have other issues such as

#### Box 14: Flintshire Citizens Advice Bureau, '*Money Matters*'

The creation of *Money Matters* was prompted by high demand from schools and community groups for good financial education, and from the frustration of debt advisers who were repeatedly seeing avoidable financial troubles too late in the day.

After visiting existing financial education projects in England (since there were none in Wales), and consulting potential beneficiaries, the bureau successfully piloted the project with four Year 10 classes. An independent evaluation found that pupils' understanding of the importance of money issues doubled following the course. All the pupils said they found the course useful, and 95% said that the course would help them have more control over their lives.

With just one full-time member of staff, and a part-time administrator, the bureau has now rolled out *Money Matters* across the county. It reaches children of all ages in schools, and vulnerable or low-income adults through community groups.

The course teaches people basic money management skills and gives them confidence, with an emphasis on translating this into behaviour. It explains the dangers of mismanaging money, and combines formal presentations and classroom-based activities with more informal activities. For example, students are encouraged to get involved through:

- creating short dramas, and writing poetry and cartoon storyboards on the topic of debt;
- visiting local businesses—one motorbike retailer allows his premises to be used to explore the use of credit to make 'dream purchases'; and
- visiting local courts.

*Money Matters* has impressed the Welsh Assembly, which has included the model in its strategy for national financial education.

homelessness or mental health problems. The charity does not do specific money education lessons, as it recognises their unpopularity. Instead, it weaves financial capability work into other topics to encourage the young people to take control of their money. For example, a healthy eating and cooking course has involved planning and pricing menus for a week, and a film project has been on the theme of gambling.

Two other organisations that are doing innovative financial inclusion work with young people are **Kikass** and **MyBnk**, described in Box 15.

#### Money guidance

Compared to financial education in classes, general money advice is a much smaller area for charities—although this should change when the recommendations from the Thoresen Review are implemented.

General money advice is sometimes provided when someone is looking for a loan from a third sector lender. For example, **Financial Inclusion Services Yorkshire** (FISY) is a partnership of three organisations—Sheffield Credit Union, Moneyline Yorkshire and FISY. The credit union and Moneyline provide loans to people, but applicants are often required to have a session with a money adviser from FISY. This is not just about assessing loan eligibility; it is also about

### Box 15: Charities helping young people not in education, employment or training (NEET)

#### Kikass

Kikass is an innovative youth charity that provides volunteering and coaching opportunities for young people. Kikass has found that financial issues can be a big barrier to personal development, so several of its projects involve building financial capability. They include:

- **Stunt Academy (financial boardbreak).** This 'high energy workshop' looks at young people's limiting beliefs and concerns about money, and helps them to build positive goals. During the workshop, each participant receives an inch-thick wooden board. On one side, they write their biggest financial goal; on the other side, they write their biggest financial barrier (such as debt). The young people are then taught how to break through the board using just their hand.
- **Thrifty Squid Challenge.** This competition, in partnership with Barclays, got groups of excluded young people from youth groups all over the UK to come up with innovative and creative ways to tackle financial problems in their communities. The top five groups were invited to 11 Downing Street, and were presented with money to roll out their projects.
- **Money Mastery.** This project, in partnership with the FSA, is a one-day course looking at the psychology of money with youth workers, to help them to be better role models. An evaluation found that three months after the course, many participants had started budgeting, saving and reducing expenditure. Importantly, some youth workers had started to use what they learned in their work with young people.

#### MyBnk<sup>69</sup>

MyBnk is a new social enterprise that runs youth-led banking schemes in schools, colleges and youth groups. Each MyBnk branch, or 'MyBnk-in-a-box', provides a place for young people to save and take out small loans, which they can use to set up small enterprises. By giving young people hands-on experience of organising and using financial services, the charity aims to build money management skills and encourage enterprising choices, to prevent future financial trouble.

MyBnk also runs workshops on ethical banking, enterprise skills and money management. It works in eight institutions with around 2,100 young people, and has big plans for expansion over the next year.

looking at other options (such as saving) and building up wider financial capability (including budgeting skills) through personalised advice. FISY is discussed in more detail in Box 28 in the chapter on affordable credit.

One lesson that FISY has learned is the importance of targeting money advice outreach at financially excluded people. It has done some training for Sure Start workers, and has done an awareness-raising campaign that involved parking a caravan in local estates. The campaign showed people about saving money, for example, by giving out free energy-saving light bulbs, which help to save money on energy bills.

Most generic money advice from charities is actually done on an *ad hoc* basis, by charities working with particular socially excluded groups. There is a huge need here, because money problems coincide with many other social issues, as we have already seen. For example, on leaving prison, ex-offenders may not have the documents to open a bank

account; financial abuse is a common form of domestic violence; language barriers can prevent some refugees from entering the financial mainstream; and people with learning difficulties may struggle to fill out the necessary forms.

Improving the financial capability of vulnerable people can have a positive effect on their general well-being: *'charities working with other client groups, whose problems are often exacerbated by financial difficulties, would see a reduction in the complexity of issues faced by their clients, enabling them to provide a more effective response.'*<sup>48</sup>

Charities that work closely with such groups do advise their clients on their money issues as and when they arise. But staff often report that they do not feel confident enough to advise their clients even on basic financial matters, such as budgeting and opening a bank account. There is therefore a key role for financial inclusion charities to do capacity-building, training up staff and volunteers so that they can better help their clients.

**Toynbee Hall's SAFE** has produced a guide to financial products and services in partnership with the **Child Poverty Action Group**, called the *Personal Finance Handbook*. The handbook is now in its second edition, and some charities that NPC has consulted praised it for enabling voluntary organisations and community groups to help their clients.

Charities can also help their clients with money problems by developing partnerships with organisations like **Citizens Advice Bureaux** or by actually employing money specialists. An alternative is for charities to train their staff and volunteers, to build their knowledge and confidence to give advice about money.

A handful of charities provide financial capability training to social workers, youth workers, housing officers and other intermediaries.

**Credit Action** has such a programme, equipping the staff of organisations that work with financially excluded people to educate and advise on money issues. Training is typically delivered over a full day to a class of staff, and it may be repeated or updated after a few months. Toynbee Hall's SAFE has a similar scheme.

Partners are wide-ranging but include housing associations, homelessness charities and women's refuges. And although Credit Action does not proactively promote its second-tier training, demand is high.

### What is the role of donors?

With such a lot going on to build financial capability in the UK, it could be a confusing field for donors, not to mention a crowded one. Yet this is a valuable angle from which to reduce

financial exclusion, as it takes into account the entire demand side of the problem.

Some aspects of mainstream financial education are relatively well-served in terms of funding. Though this activity may theoretically be open to the most excluded, in practice the nature of people's disadvantage means that mainstream initiatives do not always reach them. So it is probably best for donors to focus on reaching the most excluded, which helpfully narrows the options somewhat.

There is need for more financial education aimed at adults, where provision is much more patchy than that given to children. Donors could also support large-scale campaigns to reach people who are not reached by classes, as the **Public Service Broadcasting Trust** has done.

Charities have shown how difficult it is to reach the most excluded people, so it is useful to build partnerships between organisations. Box 16 highlights one successful partnership between a housing association, a Citizens Advice Bureau and a credit union. Donors could also make a difference by expanding training for the staff of organisations that work with particularly excluded groups, such as ex-offenders, victims of domestic violence and refugees. **Credit Action** is active in this area, providing training for the staff of other charities.

Donors could usefully support organisations that combine financial education with other initiatives to tackle financial exclusion. This makes education more holistic, and can give the incentive of a concrete gain. For example, **UNLOCK** and **Toynbee Hall** have both helped people to open bank accounts, as part of engaging them in financial capability work.

Research has shown that the way money education is delivered is key to its effectiveness. The most holistic forms of financial education, which consider social networks, for example, are likely to be effective. As described earlier in Box 5, **Quaker Social Action** is a particularly good example of taking emotional and family aspects of money into account, and delivering

#### Box 16: Money Advice Centre in Weston-super-Mare<sup>70</sup>

**North Somerset Citizens Advice Bureau** opened the Money Advice Centre in December 2006 in partnership with **North Somerset Housing** and **Weston-super-Mare and District Credit Union**. The centre was established in response to high levels of rent arrears and evictions, which had made the housing association concerned about the impact of indebtedness and expensive credit in the area.

The centre is funded by the housing association and based on its Bournville housing estate, in one of the most deprived areas of the UK. A grant from Barclays converted a derelict unit at the local parade of shops, between a hairdresser and a takeaway.

The centre is staffed five days a week by a receptionist and a 'gateway' adviser from the bureau, who refers people to specialist advisers if necessary. North Somerset Housing refers people who are having trouble paying their rent, as a way of intervening early to prevent evictions and reduce costs. And the presence of the credit union gives people an opportunity to save and to take out low-cost loans. The centre receives around 80 visits a day. Within the first seven months:

- North Somerset Housing's rent arrears fell by 9%.
- The number of tenants with rent arrears over £1,000 reduced from 148 to 104.
- 96% of clients surveyed said that advice from the bureau was 'crucial' in resolving their problem.

Helen is a single mum caring for three children under the age of eight, one of whom is disabled. She had accrued bank overdraft charges because a fee charging credit card was putting her overdrawn each month. The bank refused to cancel the card. The adviser at the Money Advice Centre contacted the bank and only then did the bank agree to cancel the card and return charges of over £100.

When Anne moved house, she informed the Department for Work and Pensions, thinking that it would inform Housing Benefit. But her Housing Benefit was stopped, and she got into rent arrears. The housing association had started to take possession action against her. Anne was receiving letters that she did not understand, because she cannot read. Even when her benefit was reinstated, the council refused to backdate payments to cover the arrears. With the help of a specialist benefits adviser, the Money Advice Centre took Anne's case to appeal and her arrears were cleared. Anne now has the ongoing help of a support worker from North Somerset Housing.



Photograph supplied by Kikass



Images from the 'now let's talk money' campaign. Note: the helpline closed as planned on 31 May 2008. Callers will hear a recorded advice message.

education in an engaging and memorable way. There is certainly not enough financial education that engages people this well, so there is room for donors to work with charities to develop new forms of education.

One point that crops up throughout this report is the importance of financial 'defaults' and learned family habits. Education is important, but the circumstances in which people make decisions have a big influence on behaviour. Donors can therefore make a difference by funding research, innovation and lobbying on ways of changing financial defaults, alongside building financial capability. Some specific suggestions are made in the following chapters, such as a 'Save More Tomorrow' scheme, where people commit future income increases to saving.

Finally, unsurprisingly, given the dearth of evidence concerning financial capability, there is a need for more money to be put into research, measurement and longitudinal evaluation, to examine the effectiveness of financial education in its various forms.

# Banking

Bank accounts are fundamental to financial inclusion. They are a way of managing money securely, a gateway to other financial services, a means of paying bills and a way of getting cheaper goods and services.

Discussion and policy have focused on getting the 'unbanked' to open accounts, and both banks and the government have made real progress. They are 60% of the way to meeting their shared target of halving the number of people without bank accounts (although there is no deadline by which to meet this goal).

But certain groups continue to struggle to open accounts. And successes to date are only a first step. Many of the newly banked are 'dormant' or 'underbanked'—failing to use their account at all or to make the most of it. Many have basic bank accounts or Post Office Card Accounts—products without the full range of functions available to someone with a current account.

Charities and other third sector bodies are playing a relatively modest role in improving access to banking—by giving practical help to access accounts; by scrutinising banks and campaigning for change; by giving financial education to excluded groups; by lobbying the government to ensure minimum standards; and, for credit unions, by providing accounts directly. Donors can make a significant difference by supporting this kind of work to grow. The ultimate aim of third sector activity has to be to strengthen the incentives of banks to serve excluded customers where possible and support alternatives where not possible.

Wider impact may also need forms of support beyond giving money—for instance, on product design. A key gap at the moment (and one that makes accounts less attractive for the unbanked and newly banked) is the lack of a bill payment system that works for those on low and unstable incomes. Solutions here are likely to need work across the third, public and private sectors—requiring a more engaged donor and, potentially, new kinds of partnership.

## Banking exclusion

There are two million adults in the UK without access to a transactional bank account, according to the latest figures.<sup>71</sup> Although this is a fall of about a third since 2002/2003, the numbers remain substantial, and lack of an

account is closely linked with poverty. Among the poorest households, one in ten has no bank account.<sup>13</sup>

Many of the newly banked have opened products with limited functions. Around two million 'no frills' basic bank accounts were opened by 2006, half by the previously unbanked.<sup>40</sup> Basic bank accounts are offered by all major retail banks. All feature direct debit facilities, access to cash machines, and cash withdrawals at the post office. Some offer a debit card. However, they have no overdraft facility and no cheque book, and access to cash machines is in some cases limited to the bank's own branches.

Even more limited is the Post Office Card Account (POCA)—a simple account for the electronic payment of benefits, accessible at post offices but offering no wider functions. In April 2006, there were 4.3 million customers with POCAs, a third of whom did not have access to a bank account.<sup>40</sup> These people are not included in the count to track the reduction of unbanked people.

What about bank account use? Here the picture is less clear. There is little published data from the banks. However, available information does suggest that large numbers of people are not making the most of their bank accounts.

The National Consumer Council, for example, found that around half of basic bank account holders prefer to withdraw all their income and manage it as cash.<sup>72</sup> Here, a bank account is no more than a tool for receiving benefits or wages; it is not used to improve money management or security in any other way. Survey data collected for the Financial Inclusion Taskforce in mid-2007 found that only a third of basic bank accounts were being used for direct debits or standing orders.<sup>62</sup>

Who are the unbanked and those not using accounts? They include some of society's most vulnerable people:

- They are concentrated in low-income households, where one in ten people does not have access to a bank account (compared to one in twenty of the population as a whole).<sup>13</sup>
- 60% are in social housing.<sup>40</sup>
- Half have been receiving benefits for more than five years.<sup>72</sup>
- People with disabilities, the unemployed, lone parents and the elderly are all over-represented groups.

Two million adults in the UK do not have access to a bank account.

## Bank accounts are a gateway to competitive credit, insurance and savings facilities.

### The impact of banking exclusion

Bank accounts are fundamental to people making the most of their money. Without using an account, managing money becomes more time-consuming, expensive and insecure.

The unbanked (and people who do not use their accounts) are more vulnerable to loss and theft, and have to pay commission to cash cheques. They cannot access the discounts on bills that come from paying by direct debit, and many have to pay for fuel using pre-payment meters, thought to cost £140 more every year than fuel paid for by direct debit.<sup>73,\*</sup>

The unbanked are also excluded from online shopping and mobile phone contracts. They cannot access several other financial products, as bank accounts are a gateway to competitive credit, insurance and savings facilities. Finally, most employers now pay salaries electronically, so people without bank accounts may find it more difficult to get work.<sup>22</sup>

### The causes of banking exclusion

#### Demand-side problems

Many people lack bank accounts or do not use them because they do not want them. More than half of the unbanked do not see the need for a bank account, according to research by the National Consumer Council.<sup>72</sup>

This reasoning is often rational. Living on a low income and having to balance the competing demands of creditors, it is arguably easier to operate in cash. First, because of skills: handling cash that is physically present helps people to keep track of their finances; second, because of control: people can decide whom to pay first; third, because of risk: the costs of penalty charges where things go wrong are high, and visible. This last point bears particular scrutiny. The charge for a failed direct debit can exceed £30. This is particularly painful for a single person living on income support of £60.50 a week, or a pensioner living on £90.70 a week.<sup>74</sup>

A preference for cash may also arise from habit. Despite the growing prevalence of electronic payment by employers (making lack of accounts a barrier to work), much low-paid employment still operates in cash—particularly seasonal work, self-employment and jobs in the informal economy. In the US, a lot of emphasis has been placed on encouraging banking by making employers switch from paying by cash to paying electronically, in the belief that using accounts can be learned.

Lack of banking is also a consequence of the past experience of some individuals and broader cultural attitudes towards banks among excluded groups. Around one in six people have not applied for an account because they assume they will be turned down (eg, because of an impaired credit history).<sup>72</sup>

For those who do want accounts, one barrier to opening them is identity requirements. Some people who do not have bank accounts will have had problems getting identity documents or proving their residency, both of which are necessary under money laundering regulations. The rules on permissible forms of identity have now been made more flexible, but charities report that there remains a problem of local implementation. As Richard's story in Box 17 shows, the rules are not being applied consistently at branch level.

#### Supply-side problems

On the supply side, outright refusal to offer an account is one barrier to opening an account—particularly for those with a history of bad debt, including undischarged bankrupts.<sup>75</sup>

There are also problems of physical access. Bank closures in the 1990s focused on urban neighbourhoods and rural areas and disproportionately affected low-income groups. Closures continue today, albeit at a slower pace.<sup>76</sup> Though not widely cited in surveys as a reason for being unbanked, closures continue to affect particular groups with access needs (such as older people and people with disabilities) and reinforce more general psychological barriers (*'banks aren't for people like me'*).

For those seeking accounts, the key supply-side factor is what happens in bank branches. Problems identified by mystery shoppers for the Banking Code Standards Board (BCSB)<sup>77</sup> include:

- **Inadequate marketing and uninformative literature from banks:** in 2005, literature on basic bank accounts was clearly displayed on only 38% of visits.
- **Staff not offering accounts or cherry-picking customers:** Mike Barry from Blackpool Citizens Advice Bureau told the Treasury Select Committee: *'at ground level ... the individual banks are in some cases actively discouraging the opening of basic bank accounts. One customer went to a local high street branch to speak to the customer services manager, who told him, "Those accounts are only opened by the lowest of the low." We find that is a widespread issue.'*<sup>140</sup>

\* The high cost of pre-payment meters is for some people part and parcel of the issue of fuel poverty, that is, spending more than 10% of income on fuel bills. Around 2.5 million households are in fuel poverty, and this is set to increase as gas and electricity prices rise. In May 2008, energy regulator Ofgem announced a plan to tackle fuel poverty. The plan includes data sharing to identify people on certain benefits; a cheap tariff test; and energy efficiency measures. But campaigners like the National Housing Federation say more effort should be made to cut costs for those paying for fuel on pre-payment meters.<sup>73</sup>

- **Staff accepting only traditional identity documents:** even though a wide range of forms are now valid.
- **Staff running credit checks:** even though checks are not a legal requirement, because basic bank accounts offer no access to credit.
- **Processing delays:** some branches have in the past sent off important identity documents for considerable lengths of time. The time limit to open a basic bank account under the Banking Code is now ten working days.

BSCB annual research suggests that most of these areas are improving, as banks continue to train staff and implement policies. But there remain many instances of people being denied access to appropriate products—particularly because of inadequate display of information and staff failing to identify the need for a basic bank account. Moreover, the BSCB has said it is not proposing further large-scale mystery shopping exercises, which may reduce pressure for future improvements.<sup>78</sup>

Lessons from research in behavioural economics suggest that people's views of how they will be treated in a bank are very important to their take-up and use of products. Perceptions of being an outsider are reinforced by advertising clearly intended for people of substantially greater wealth. This can help reinforce the belief that banking is not intended for, and ought not to appeal to, those of lesser means. Financial exclusion may also be reinforced by people being subjected to scrutiny, interviewed by an authority, and by the official nature of requests and applications.

Those who are most vulnerable are likely to feel the weight of such sentiments even more than the rest. People on low incomes are often painfully aware of society's norms and of their own struggle to abide by them. For instance, a visibly homeless man may feel ashamed of his appearance. A single mother who lacks access to childcare may suppose that her small children are not welcome in a bank. Along with a limited knowledge and understanding of financial instruments, and with very little money to show for it all, poor clients may feel reluctance, shame and a general sense that they could never be important or valued customers to the bank.<sup>39</sup>

Such sentiments are not wholly a supply-side problem (after all, banks need to position themselves as attractive to high wealth customers), but they do suggest that exclusion is unlikely to be tackled without banks proactively making efforts and reaching out to welcome poorer customers.

Some of the signals that banks have given out suggest that they are at best neutral towards poorer customers. For instance, some banks have restricted counter access for basic bank

#### Box 17: Richard's story<sup>75</sup>

Richard was wary of banks, having been refused a current account several times due to lack of documentation. But when he had to turn down a job because he did not have a bank account, he decided to open a basic bank account.

The phone application went smoothly and Richard was told that his passport and benefits entitlement letter were sufficient proof of identity, as long as he signed a 'financial exclusion' form in the branch. However, at the branch he was told that he needed a letter from his GP as a third piece of ID.

Despite this setback, Richard duly returned with the letter from his GP. His documents were photocopied and sent off to head office. But a few weeks later he received a letter from head office, saying that he could not open the account as he had not produced sufficient documentation.

Richard became disillusioned and gave up on the whole idea, as he had done as instructed at every turn and had still failed to open an account.

account customers. Customers with a Lloyds TSB Cash account cannot withdraw money from the branch counter for amounts less than £200. For HBOS Easycash customers, the minimum amount is £300.<sup>40</sup> ATMs are only useful for withdrawing multiples of £10, and if there is only £9.50 in the account, this money is effectively inaccessible.

For many of those who do not want to open or use an account, there are further 'supply-side' causes at play—people may be unbanked or dormant because existing products do not meet their needs.

The key problem here is that the design of the main accounts on offer has not always worked well for people on low incomes—particularly in terms of bill payment and penalty charges (whether for unauthorised overdrafts, failed direct debits and standing orders or bounced cheques).

Direct debits and standing orders may give discounts on some utility bills, but they are inflexible, and become very expensive if there is not enough money in the account to cover them. Moreover, monthly automated payments do not fit with the weekly or fortnightly budgeting (driven by the benefits cycle) that many people on low incomes prefer. Part of the responsibility for this lies with originators. If utility firms made weekly direct debits available and had flexibility on the date money could be drawn down, this would mitigate the risk.

In the UK, where charges are not levied for (in-credit) accounts, penalty fees have been an important part of the business model of nominally 'free' retail banking. Fees have fallen significantly on two, overlapping, groups: people with low financial capability (including those who are poorly organised); and people with low, irregular and unstable incomes.

One way to address the problem is by simplifying the products available and removing or adjusting some of the features that can lead

Individual banks are in some cases actively discouraging the opening of basic bank accounts.

I don't like direct debits because if you haven't got the money they charge you and you're in a bigger hole than when you started.<sup>4</sup>

to charges. This, as we shall see, is broadly the approach taken by the government and banks with basic bank accounts. But this also reduces the account's functionality and versatility. Arguably what is needed is not a pared-down version but a different sort of account altogether.

The sustainability of the wider model of retail banking is unclear. Changes in the banking system, including court rulings on unfair penalties, may have serious implications for the way retail banking is funded in the UK. In November 2006, First Direct announced it would be introducing a £10 monthly charge for customers who fail to pay in £1,500 a month, or who do not maintain an average monthly balance at that level. It has been suggested that the introduction of charges more widely could, counter-intuitively, benefit financially excluded people by increasing the certainty and transparency of costs.<sup>79</sup> However, it is uncertain how the distribution of costs will change. A wider group of people on low incomes could end up bearing fees. And any gain will depend on changes to penalty fees.

### Government and industry action

As noted already, the government's main focus to date has been getting people to open accounts. It has made progress here—but at the risk of neglecting some of the underlying issues.

Its core commitment was announced in the 2004 Spending Review—namely, to halve the number of adults in households without a bank account, and to have made significant progress within two years. The retail banks agreed to work with the government towards this 'shared goal' (as it became known), as part of their voluntary commitment to the Banking Code. All major retail banks now offer 'no frills' basic bank accounts.

The shared target is on the right lines, but unhelpfully unspecific. No time frame for reaching it has been specified, and the 'significant progress' that is to be made within two years has not been defined. More than that, it is unclear what government thinks about the remaining half and whether more targets will follow to reduce this group further.

Changes to the voluntary Banking Code have also helped to remove some of the barriers that people have faced with account opening procedures in banks. Notwithstanding the implementation problems already noted, the code includes a commitment to offer a basic bank account to any customer whose needs would be best met by one. It also requires basic bank account literature to be easily available, identification procedures to be processed in-branch, and new forms of proof of identity to be accepted, including letters of entitlement to benefits.

The other major piece of action—initiated by the government but funded by the banks to the tune of £182m—has been the development of the Post Office Card Account (POCA). Originally conceived as part of a universal bank offering a full range of services to financially excluded people, for cost reasons it was implemented as a simple facility into which the government could pay benefits, pensions and tax credits. No other money can be paid in (including wages), it does not bear direct debits and money can only be withdrawn over the counter in post office branches. For these reasons it is best understood as a policy driven by the government's desire to make the process of benefit payments cheaper, not to reduce financial exclusion *per se*.

On numbers alone, progress has been good on banking. The baseline of the 'shared goal' was set with reference to data from the Family Resources Survey (FRS) 2002/2003, which found that 2.8 million adults lacked access to an account of any kind. FRS 2005/2006 shows that 60% of the progress needed to meet the goal has been made: the figure has dropped by about a third.

Analysis of the make-up of the unbanked shows that its distribution is shifting away from those on the lowest incomes, including groups such as lone parents and social housing tenants.<sup>84</sup>

There has also been some modest progress on issues of design. Six banks out of 17 listed by the FSA in its guide to basic bank accounts now have a £10 interest-free 'buffer zone', so that customers can go into the red by a few pounds, without incurring a penalty charge that might represent a large proportion of their weekly income. This is an increase on the four banks that offered buffer zones in 2003, and the two that offered buffer zones in 2006.<sup>85</sup> Most banks do charge a fee for a failed direct debit in a basic bank account, and this can be anything up to £38. The banks that do not charge a fee instead have a policy whereby if it happens more than three times, the account is closed.

But wider issues remain. As discussed above, there has been little progress on bill payment. And the jury is still out on the extent to which basic bank accounts can be a route into wider financial services. The chief executive of HSBC reported to the Treasury Select Committee that the bank had seen almost 70,000 people progress from basic bank accounts to other products.<sup>40</sup> But only 10% of people who have opened basic bank accounts since June 2003 have upgraded to a full current account.<sup>86</sup>

Finally, the degree of success apparent in the numbers of people opening basic bank accounts has been eclipsed by the popularity of POCAs—this despite the fact that government has not advertised them. POCA poses a headache for the government, as providing the service via the post office is much more expensive than doing it via retail banks.

I have to conduct my banking on the pavement in full view of anyone passing by and in all weathers. I don't feel secure and I would like to go into the bank like everyone else.<sup>5</sup>

Wheelchair user<sup>9</sup>

The government's contract for POCA in its current form expires in 2010, and its future is unclear. The government announced in 2007 that there would be a nationally available successor and currently has the contract out to tender. But it has yet to be determined who will run it and how the transition will be handled—there are potential risks in relation to the latter point. The government has rejected calls for the new system to offer further functionality (eg, cash deposits), disappointing some campaigners.

## Solutions

If the problem of banking exclusion comprises both residual take-up issues, and the fact that people are not using accounts properly, the solution must have at least two dimensions. One, making bank accounts more useful for excluded people. Two, overcoming the trust problems that come between excluded groups and banks.

### Making accounts more useful

Research that the National Consumer Council conducted with low-income consumers found that basic bank accounts are lacking sufficient mechanisms to help with managing a tight budget. It would be helpful to have frequent, clear information on the account balance and impending direct debits, and a warning notice to consumers if they are about to go into the red.<sup>40</sup> Addressing this need is a matter of product development, perhaps via platforms like mobile phones, which allow text message reminders and updates.

Similarly with bill payment. Researchers at the University of Bristol have argued for automated payments triggered by money entering an account, so that payments cannot be made if there is not enough money to cover them.<sup>14</sup> This looks technically very challenging. Exploring the possibility of such a system would require '*substantial further investment*'<sup>14</sup> as the timings of direct debits are not controlled by the bank, but by the organisation that is billing the customer.

Financial exclusion expert Elaine Kempson has proposed a different idea: the introduction of the kind of 'budget account' that used to exist around 50 years ago to smooth expenditure.<sup>67</sup> A single regular payment would be distributed to creditors, and the account could fluctuate in and out of credit over the course of the year, provided that it netted off as a positive amount. But this kind of approach is likely to be expensive for financial service providers.

### Building trust between banks and excluded groups

It has long been known from anecdotal evidence that some people on low incomes



Logo from Communities Against Post Office Closures Action Group

do not feel at home in banks. Behavioural economists have suggested that these barriers can be hugely potent in driving exclusion. Surprisingly though, relatively modest interventions can overcome them—particularly support to strengthen the 'channel' between an individual and a financial product.

For instance, recent research has suggested that, without any further intervention, the presence alone of a banking staff member on

#### Box 18: The post office

In May 2007, the government confirmed that 2,500 post offices—a fifth of those left in the UK—were to close by 2009. The current network is said to be unsustainable, losing £4m a week.

The announcement has been met with opposition from councils and campaigners, who believe that closures will be to the detriment of local communities, particularly in rural areas. Organisations are campaigning in particular on behalf of pensioners, disabled people and people living in rural or deprived urban areas, many of whom rely on their post office to pay bills and even buy groceries.

A recent **Citizens Advice** survey found that more than 90% of respondents said they would be personally affected if their local post office were to close.<sup>60</sup>

**Age Concern** has found that 99% of older people in rural areas consider their local post office to be '*a lifeline*', with many fearing that post office closures would leave them more isolated.<sup>61</sup> Other charities campaigning in this area include the **National Pensioners Convention** and the **RNIB**. In February 2008, a national action group, **Communities Against Post Office Closures**, was formed. The group is made up of 37 local action groups, plus larger organisations such as **Help the Aged** and **Countryside Alliance**.

In May 2008, councils, campaigners and industry officials held a summit to come up with ways to save threatened post offices. At the time of writing, we are awaiting the results of this summit. Some action has already been taken. For example, Essex County Council has set aside £1.5m in the hope of saving half of its 31 threatened post offices. The Greater London Authority has launched a legal challenge against the planned closure of 171 London post offices.<sup>62</sup>

The government claims to support efforts to save branches, as long as they are based on viable business plans.<sup>63</sup> Up to 500 of the 2,500 planned closures may be replaced by an alternative 'Outreach' service—for example, providing a post office service through community centres, pubs, schools, or even a mobile post office.

courses to get people to open bank accounts increases both take-up and usage.<sup>39</sup>

**Toynbee Hall's** SAFE programme runs one-off events called '*Bulbs, Benefits and Bank Accounts*', where low-income people receive a free low-energy light bulb but can also get benefits advice and help opening a bank account. The charity reports that the visible involvement of banking staff has contributed to helping people to open accounts.

Language and how choices are framed are also really important: emphasising customers' identity as economic agents rather than marginal groups, showing that their business is wanted, and having simple forms all seem to matter.

We can perhaps see further evidence for the importance of trust and simplicity in the success of POCA. Its two distinctive features are the simple nature of the product and the known, friendly network of the post office where people feel at home. Being able to conducting banking at the post office may be crucial to some people using their account, but recent post office closures are threatening this accessibility, as Box 18 shows.

### Delivering these solutions

If these are the needs, how can better designed products be delivered? And how can trust and simplicity in relations between excluded people and mainstream banks be delivered?

One answer is about the incentives of banks to serve financially excluded customers. Financial institutions talk a lot about exclusion and literacy in their CSR strategies, and many can point to decent track records in taking the issue seriously. But overall, the incentives for serving excluded customers are mixed. There are some groups for whom there is a business case—either by identifying a previously hidden profitable customer segment or by building an inclusive brand. But it is also the case that some excluded customers are likely to be loss-making, and meeting their needs would incur costs (especially if it means coming up with new products). For these customers, banks are likely to undersupply outreach and products. Currently, individual banks bear the costs of serving their basic banking customers. Not only do banks have fairly weak incentives to build

products for these customers but, where they are loss-making, each has an incentive to serve fewer than its competitors.

One response to this is to subsidise unattractive customers. Several commentators in the US have argued for tax credits to banks serving the most excluded. This could create a positive incentive to seek out customers and create suitable products.

A second response is to introduce a UK equivalent of the Community Reinvestment Act, requiring banks to publish data on how they serve low-income customers.

A third is to introduce a universal banking requirement. This might tackle the trust part of the problem in that it would make banking a matter of rights. It is possible to imagine this being used as a 'bottom up' crusading message, motivating excluded groups and tackling the perception that banking belongs to those who are better off.

So far in the UK, the government has rejected calls for both a Community Reinvestment Act and universal banking. Despite this, anyone can in theory get some kind of account, through POCA and basic bank accounts. The British Bankers' Association publishes quarterly data on the number of accounts opened across different banks, but it is not broken down by individual organisation. The Treasury Select Committee recommended in November 2006 that banks regularly publish their figures for the numbers of basic bank accounts they have opened.<sup>40</sup> The committee published figures for the five largest banks (see Table 6), and several banks that did not do so previously now publish their own figures.

### Charitable activity

The third sector fits into this picture in a relatively modest way.

### Campaigning and lobbying

Campaigning activity has been dominated by non-charitable bodies like the National Consumer Council and the Financial Inclusion Taskforce. Charities like **Citizens Advice** and **Toynbee Hall** have played a vital role too. The charity **UNLOCK** has done a good deal of lobbying on the issue of pre-release banking for

**Table 6: Basic bank account figures for the five largest banks<sup>40</sup>**

	HSBC	Barclays	Lloyds TSB	HBOS	RBS	
Share of openings in 2006	16.7%	14.7%	12.8%	10.9%	19.8%	<b>Total number of accounts opened in 2006: 257,946</b>
Total number of accounts	318,000	417,000	294,000	3,300,000	862,000	<b>Total number of accounts open: 6,515,000</b>

Note: The numbers do not add up to the total and percentages do not add up to 100% because of the numbers of accounts opened by smaller financial institutions. These figures are from 2006, and are therefore not necessarily reflective of today's situation.

prisoners. It partners with banks to allow people to open accounts in prison, and is using this work as a springboard to wider system change, now working closely with the British Bankers' Association.

On products, the range of levers available to charities has been small. Banking is a specialised service dominated by large, closely regulated businesses. New products both have a technical dimension and are cross-sectoral. Accordingly, the main possibilities for third sector involvement include research, campaigning for banks to modify existing products, and putting pressure on government to intervene.

There have been some important successes from lobbying and individual advocacy work. These include promoting incremental changes to the design of products (for example, the introduction of buffer zones) and calling for changes to the Banking Code. Lots of Citizens Advice Bureaux have been active here, feeding into the national picture through Citizens Advice.

### Provision of products

More recently, a key supply-side initiative from third sector organisations has been the emergence of alternative products. These may play a role in establishing a scale 'trusted alternative' to both mainstream banking and sub-prime providers.

At the end of 2006, some credit unions began to provide current accounts to their members, in partnership with the Co-operative Bank. Eleven now offer the service, and this should rise to 20 by the end of 2008. There is a fee on the account of around £1 per week. This account stands out from basic bank accounts in that it has lower penalty charges for failed direct debits. And, although they do not have an overdraft facility, credit union accounts can lead to a line of credit, through the credit union.

At least two CDFIs are now offering current accounts, in partnership with banks. **East Lancs Moneyline** is partnering with both Barclays and HBOS to offer current accounts and savings accounts. **Scotcash** in Glasgow has also increased its offering beyond affordable loans and money advice. It offers a savings account in partnership with Glasgow Credit Union, white goods packages with Scottish Hydro Electric, and basic bank accounts with the Royal Bank of Scotland or Glasgow Credit Union.

### Helping people to open accounts

The challenge of how to create and embed more appropriate products perhaps explains why third sector organisations have generally focused more on the demand side.

#### Box 19: Access to banking at Toynbee Hall

*'The work of organisations like SAFE is important in improving access to banking amongst individuals who face particular hurdles ... lessons learned by SAFE in undertaking this work represent a valuable practical contribution to tackling financial exclusion.'* Ivan Lewis, MP

Toynbee Hall has been carrying out financial education and access to banking work since its SAFE (Services Against Financial Exclusion) work started in 2002. As well as providing broader financial education, SAFE aims to tackle banking exclusion from all sides: demand, supply and government policy.

Most of SAFE's activities make use of a wide range of partners in order to reach excluded groups. Activities on banking include:

- **Access for individuals:** one-to-one help for people to open and use bank accounts, including information, advocacy, and financial capability work. In the words of one client who opened an account with SAFE's support: *'It helps to see that my life is a lot different now to what it used to be, there's a lot more manageability in my life.'*
- **Training support staff:** help for frontline staff in other charities, enabling them to support their clients to access and use bank accounts and other financial products.
- **Outreach events:** one-off events in local communities to increase awareness and facilitate financial inclusion.
- **Influencing banks:** Toynbee Hall's core value is *'learning from local action, delivering national solutions'*, so wherever possible, projects share their experience with key stakeholders, including banks and government. One result is that Barclays now allows basic bank account applicants to verify identity documents in-branch rather than having to post them off.

SAFE has also carried out some important research in the area. In 2005, it published *Banking the Unbanked*, the first report on the experiences of the previously unbanked as they overcome access barriers. Forthcoming research includes:

- an in-depth study of basic bank account holders into the relationships between access, capability and usage;
- a review of changing basic bank account features; and
- a guide to accessing proof of identity and address for basic financial services.

In 2008, SAFE launched a new project through which it aims to influence staff training in bank branches. By building awareness and understanding of the issues faced by the financially excluded, SAFE hopes to break down further barriers to access.

Key approaches focus on quite simple interventions, and they are not always well-evidenced. However, they are sometimes consistent with research lessons on how to make banking more attractive. They include:

- On the demand side, practical help—for instance, filling in forms or travelling to a bank with a client to provide support. In a handful of cases, banks have granted 'authorised signatory' status to charity staff, so they can open accounts in-house. This is an important approach to helping very marginalised groups or those with complicated needs, such as homeless people, refugees and migrants, and older people.
- Also on the demand side, financial education to excluded groups—typically, this is

provided to classes and covers a range of topics, not just banking. In a few cases, however, it has been provided in conjunction with the actual opening of an account.

- On the supply side, scrutinising banks and campaigning for change—specific lobbying demands sometimes emerge from insights gained from services providing practical help for individuals.

However, there is actually relatively limited activity in each of these areas.

When the move to electronic payment of benefits was introduced, practical support from charities was quite well-funded by the government. But now that electronic payment is well-established (often into POCAs rather than bank accounts), many of these projects have ended. Most practical help to open bank accounts is now provided on an *ad hoc* basis, either by advice agencies (notably Citizens Advice Bureaux) or charities that help particularly excluded groups, such as homeless people or ex-offenders.

The main charity that NPC has visited that provides banking support is **Toynbee Hall** in east London, whose SAFE programme includes work to help people access bank accounts. SAFE also provides personal money guidance and money education workshops, and trains staff in other charities, such as homeless hostels—see Box 19 for more detail.

Using charities as a ‘trusted signatory’ has helped homeless people to open accounts through **The Passage**, and prisoners to open accounts through **UNLOCK**. The Passage has a dedicated member of staff who is able to process application forms and submit them directly to the banks with relevant documentation. This is a good model in terms of reaching excluded groups, but the constraint on developing it more widely comes from lack of support from financial institutions. Where these schemes have been tried, they often

depend on a particular relationship between individuals in a charity and banking staff. When a branch manager moves on, it is hard to keep the relationship going.

### What is the role of donors?

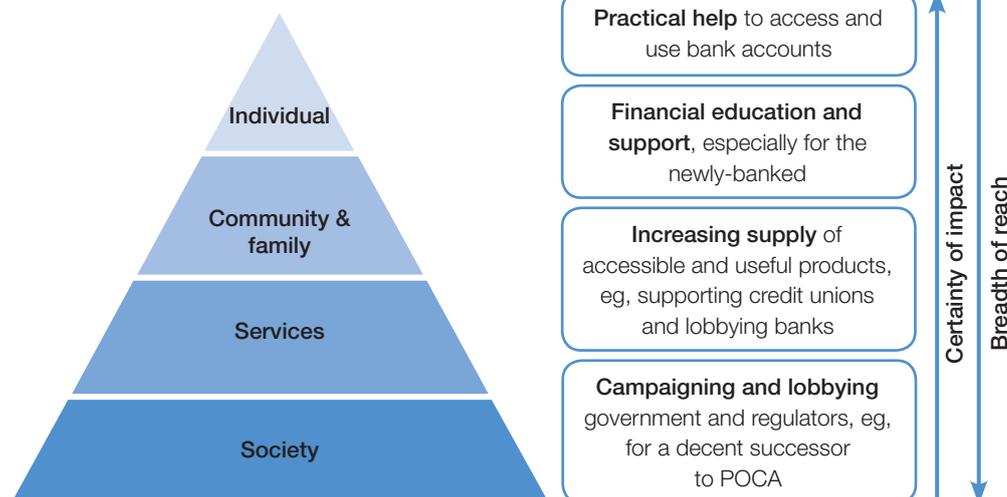
Banking is one of several areas within financial exclusion where the range of options available to donors is relatively limited. However, the work is valuable and could be scaled up. Figure 5 shows the different approaches.

As the triangle suggests, donors face a trade-off between breadth of reach and certainty of impact. Helping individuals to access accounts clearly benefits those individuals but, on its own, creates no wider system change. Conversely, lobbying could make a difference across the banking system. But it is not certain to be successful.

As Box 19 shows, **Toynbee Hall’s** SAFE programme is interesting here. One challenge for individual support is that it is not very scalable. Client volumes are inevitably small—both as a result of the difficulties of engaging hard-to-reach groups and because practical support and advocacy is labour intensive. Shrewdly, SAFE has tried to maximise its impact by linking its efforts to broader attempts to change banking policies and procedures. For instance, it helped to persuade a leading bank to change its processes so people no longer have to send identity documents off to head office to open a basic bank account.

The emergence of credit union accounts looks like a promising avenue, and they could be available more widely if funding was provided to meet start-up costs. However, it is not entirely clear that such support would need to be by donation, and philanthropists interested in making a difference here should also consider social investment options into particular credit unions (see the next chapter). Perhaps the best

Figure 5: Tackling banking exclusion



starting point would be to talk to ABCUL, the main trade association for British credit unions.

A slightly different approach where there is more to be done concerns charities building business cases for serving particular customer segments. If charities can establish convincingly that there is money to be made by providing banking for a particular group, then banks will see the incentive for serving this group. Also likely to be valuable is advising banks on the simple changes that can make their services more accessible to financially excluded people. If there are cost-neutral changes that strengthen channels, these are worth pursuing. Donors interested in this area would need to fund research to establish cost-benefits. They could also usefully support third sector banking providers to show that they sustain apparently unprofitable customer segments comfortably.

Although not directly about improving access to banking, donors interested in this area could also play a part in campaigning against post office closures, or campaigning to improve access to free ATMs. Several charities—particularly older people’s charities, such as **Help the Aged**—are active in these areas. Preventing closures and increasing access are likely to be indirectly significant to tackling both trust and practical barriers to banking.

Finally, a key technical gap remains flexible bill payment. Here, solutions might again include supporting third sector lenders, particularly by funding product innovation. More broadly, solutions are likely to require some kind of partnership among financial service providers, the public sector and the third sector. This is a very difficult space to fill, but an engaged donor might be able to play a brokerage role or fund research.



Photograph supplied by istockphoto



Photograph supplied by stock.xchng

# Affordable credit

There are millions of people on low incomes who are unable to access mainstream credit. They may end up turning to expensive sub-prime providers. This matters because the high costs of servicing debt contribute to poverty, damaging individuals and communities.

Charities and policy-makers worry most about home credit (doorstep lending), which offers small and flexible cash loans, made by a network of agents on the doorstep, but with a typical APR of 177%.

The government has tried to tackle this problem by focusing on developing third sector lenders—organisations that lend at APRs of under 30%. Government funding has had some success making cheaper credit more accessible and there are now calls to expand growth further via a new *'shared commitment'* between Whitehall and the financial services industry to fund national coverage.

Where do donors fit into this picture? The most obvious option for those interested in making a difference in this field is also to fund third sector lenders—either by giving capital or capacity-building support. On the Financial Inclusion Taskforce's analysis, only a fortieth of potential demand is currently being met by the government's activity. NPC's view is that funding third sector lenders is a good option, but one that is not straightforward.

It is a good option because money given to third sector lenders gets recycled multiple times as it is re-lent.

It is not straightforward because of two challenges. The first is one of scale and sustainability. Third sector lending to financially excluded people is currently small and often does not cover its own costs. Plans for lenders to be financially independent and to reach more of the most excluded people are hard to square. To be viable, they will need either: ongoing grant funding; as yet unproven technical fixes (eg, better credit scoring); or cross-subsidy from selling a broad range of financial services to a wider pool of people.

The second challenge is one of impact. Third sector lenders could be stronger at demonstrating their social returns. There is

lots of anecdotal evidence suggesting that they make a real difference, but this has not been systematically measured.

It seems likely that third sector lenders are most appropriate for the top end of the sub-prime market—those who are relatively more stable and well-off. In particular, their services are not a good substitute for home credit. Both lenders and donors find it unpalatable, but to deepen their reach they might need to offer more expensive products.

Underpinning the challenges of scale and impact are some ambiguities about what third sector lenders are trying to do: donors should press for clarity. A key question is whether lenders are trying to solve a problem of competition or of social justice. Each implies a different funding need.

More generally for donors: financial exclusion on credit does not sit in a vacuum. Some philanthropists may want to think about challenging the framework of current policy.

A key driver of both exclusion from mainstream credit and demand for it is poverty. There is a role for lobbying to change both the tax and benefits system and employment brokerage.

Some voices want to compel the credit industry to support third sector lenders—either directly, via a UK equivalent of US legislation, the Community Reinvestment Act, or indirectly, via tougher regulation on irresponsible lending.

More than three million people living in the poorest households are excluded from the mainstream credit market.



You know that you pay over the odds but if you are desperate you take it.<sup>2</sup>

Finally, donors could usefully support research into what remains a contested and complex field.

### The problem

Like everyone else, people on low incomes sometimes need to borrow money. Credit is important for smoothing income, managing large purchases and dealing with crises—particularly where individuals may not have savings.

Data suggests that, in 2005, more than three million people living in the poorest UK households were excluded from the mainstream credit market. A similar number used expensive sub-prime credit, such as doorstep loans and pawnbrokers.<sup>14</sup>

At least until the advent of the recent credit crunch, donors might have been forgiven for being bewildered by this. Debt advice agencies have long reported dealing with clients who, despite very low, irregular or unstable incomes, have run up large debts thanks to inappropriate borrowing. They may also have ‘priority’ debts not related to consumer credit (such as rent arrears).

But the paradox is a real one: consumer debt is one facet of a credit boom, yet there are large numbers of people for whom mainstream credit is inaccessible. These people (likely now to be joined in a credit downturn by some who have previously accessed mainstream credit) have historically turned to different sorts of sub-prime lender.

Credit access matters, but not because credit is an end in itself. Clearly it is only suitable for people who can afford it. Borrowing is not

a sensible way of dealing with problems of poverty, such as long-term inadequate income, in order to afford basic goods and services.

But there is a real problem of credit exclusion. Figure 6 highlights the problem as presented by both consumer groups and charities: the vicious cycle whereby people on low incomes find themselves paying more for their credit than people on middle and high incomes, compounding the poverty that makes their credit more expensive. People get into a situation where a short-term ‘shock’ leads to an irrecoverable deterioration in their overall financial health.

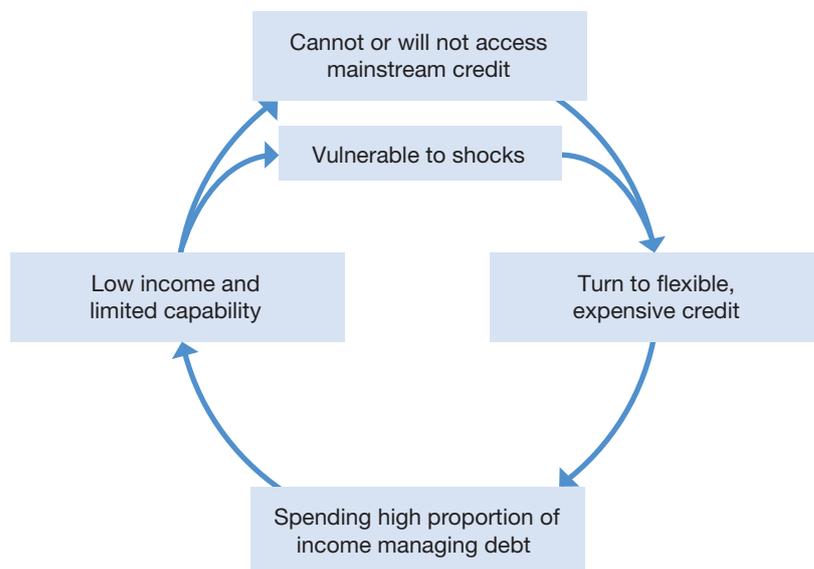
Organisations like the New Economics Foundation have argued that this hurts communities as well as families and individuals. Excess cash handed over to a doorstep lender such as Provident Financial (*‘the Provy’*, the biggest player in the market) cannot be used by borrowers to support local businesses (although lenders do support local employment through their agent network, and loans may be spent locally).<sup>23</sup>

So the basic problem of financial exclusion and credit is not primarily that people do not have access to any credit at all.\* Rather, it is that first, they cannot or will not access mainstream credit and second, that the available alternatives cost too much.

### Why do people not access mainstream credit?

The key reason is that mainstream products do not work well for people on low incomes. Potential borrowers often have a bad credit history or no credit history at all (eg, migrants and refugees). This means that they look like bad or uncertain risks.

Figure 6: The cycle of expensive credit



\* Although total credit exclusion is true of some people—see later in this chapter on numbers affected. There are both credit ‘deserts’ and individuals who cannot borrow even from sub-prime lenders.



Photograph supplied by Esther de Jong

Mainstream lenders do not usually lend to those on benefits or without assets. Around a quarter of borrowers in the poorest fifth of households have missed credit payments in the last 12 months, and the proportion is slightly higher among people who do not have a full-time wage coming into their households.<sup>14</sup>

Often, as already noted, not lending is clearly sensible—where people are borrowing more than they can afford, for instance. But for some borrowers in the ‘history of bad debt’ group, the problems that led to their negative status were as much to do with the way products are designed as with the borrowers’ underlying solvency.

In particular, bad debt histories can arise as a consequence of products that require regular, unmovable payments—with penalty charges attached.

Poorer people who could afford credit overall may still struggle: partly because their income and expenditure may be ‘lumpy’; partly because they lack a useful bank account; and partly because monthly payment cycles sit badly with the weekly budgeting that many poor households prefer.

People who live on a low, irregular or unstable income have a different set of financial needs—flexibility, support, certainty on costs—to mainstream consumers.

The very success of sub-prime providers like the home credit industry tells us that there are large numbers of consumers who want a different kind of credit agreement. The key features such people need include:<sup>14</sup>

- small, short-term cash loans (typically around £500);

- rapid access to credit, without lengthy or intrusive application procedures;
- affordable weekly payments compatible with household budgeting cycles;
- freedom to take occasional payment ‘holidays’ without disproportionate or unpredictable penalties;
- external prompts to repay; and
- lenders that understand the circumstances of low-income consumers.

Against these criteria, most mainstream credit scores badly.

For instance, minimum sums for bank loans are generally too high for low-income consumers, and loan repayment allows no flexibility. Whilst an overdraft can be seen as equivalent to a small cash loan, there are no external prompts to repay. Financially excluded individuals are likely to be suspicious of banks, often because they have been hit by high penalty charges.

Faced with inadequate mainstream products, low-income borrowers turn instead to a market more tailored to their needs: the sub-prime market.

### Commercial sub-prime credit

The sub-prime market is a vast industry offering different kinds of product and service. They range from high-interest credit cards and cheque cashing at the top end of the market (that is, for more stable and wealthier customers) to home credit and pawnbrokers at the lower end.

Table 7: Credit options for the financially excluded

Type	What is it?	Customers	Gross annual advances
<b>Commercial loans</b>			
Note: all of these players are legal lenders subject to government regulation under the Consumer Credit Act. They are distinct from loan sharks, which are illegal lenders.			
<b>Home credit</b>	Cash loans, usually under £500, repayable over several months. Weekly repayments are collected by an agent from the customer's home. Typical APR is 177%, or £65 interest on every £100 borrowed.	2.3 million <sup>88</sup>	£1.3bn <sup>88</sup>
<b>Agency mail order</b>	Customers buy goods from a catalogue, through agents. Repayments are weekly, and goods paid for in under 40 weeks are technically interest-free. However, prices tend to be significantly higher than identical items for sale in the high street.	5.7 million <sup>88</sup>	£2.9bn <sup>88</sup>
<b>Payday loans (cheque cashing)</b>	To receive a payday loan, the customer writes a cheque to the lender and receives the amount in cash, less a fee. The lender agrees to wait for up to a month before presenting the cheque to the bank. Charges are around £25 for a £100 loan. <sup>63</sup>  The same companies will also cash cheques on the spot from third parties, for a fee.	250,000 <sup>88</sup>	NPC has not identified data
<b>Pawnbrokers</b>	Small cash loans over several months, secured on property—usually jewellery. Interest rates range from around 7% to 12% per month, which is an APR of between 70% and 200%. Around 29% of people using it fail to recover the pawn. <sup>2</sup>	600,000 <sup>25</sup>	£60m <sup>88</sup>
<b>Sale and buy back stores</b>	Customers sell household and electrical goods to the company, retaining the right to buy them back within a set amount of time (usually a month). There is usually a large difference between the sale and buy back prices. <sup>14</sup>	NPC has not identified data. The leading retailer in this space—Cash Converters—has 100 stores.	
<b>Rental purchase</b>	Customers can buy furniture, white goods and other household items on weekly credit, with no credit checks. Goods are repossessed if payments are not sustained. Nominal 29.9% APR, but goods are highly priced relative to the high street, and customers are strongly encouraged to pay extra for 'optional' insurances. <sup>14</sup>	NPC has not identified data. The leading retailer in this space—Brighthouse—has 130 stores.	NPC has not identified data
<b>Sub-prime credit cards</b>	High interest rate cards for people with low credit scores or incomplete credit histories.	NPC has not identified data. Two of the leading providers have around 300,000 customers each.	NPC has not identified data
<b>Illegal loans</b>			
<b>Loan sharks</b>	Some illegal money lenders are organised networks of agents; others are local people operating alone. Costs are very high—for example, borrowing £25 on Friday, and repaying £50 on Monday.	170,000 <sup>6</sup>	£40m <sup>6</sup>

Informal loans			
<b>Friends and family</b>	Borrowing from friends and family is usually interest-free and not subject to rigid repayment schedules. But it can put a strain on relationships. More importantly, people on low incomes often do not know anyone who could lend them anything more than a few pounds. <sup>14</sup>	One in four Britons owes money to friends and family; we borrow £29bn every year from each other. <sup>90</sup> However, it is not clear how much of this borrowing is by people on low incomes. For example, only 4% of home credit users are currently borrowing from friends or family. <sup>88</sup>	
<b>Informal savings and loans schemes</b>	Informal schemes are typically based on a group of friends or relatives who save collectively and take it in turns to access the money saved. These schemes are unregulated and risky. <sup>14</sup> Most are found in minority ethnic communities. For example, they are known as 'Gún' or 'gold days' in the Turkish community (see Box 20), and known as 'Kommittis' among Pakistani migrants. <sup>8</sup> Similar schemes exist in some white British communities—for example, in Liverpool, they are known as 'Tonnies' or 'Tontines'.	'Commonplace' among poor communities <sup>14</sup>	NPC has not identified data
Non-commercial loans			
<b>The Social Fund</b>	The government provides grants and loans through the Social Fund, described in detail in Box 23.  Budgeting loans are interest-free, and available to people who have been on income-related benefits for at least six months. The average is around £300, and it is repaid by deduction from benefits. A quarter of applicants are refused, either because of outstanding Social Fund debt or for not meeting the eligibility criteria.  Crisis loans are for people who have no other sources of money in a crisis, for example, for people who have had money stolen. <sup>88</sup>	2.6 million awards in 2006/2007 <sup>91</sup>  Just under half of Income Support recipients are thought to have applied for a loan in the last 12 months, or to be paying one off <sup>88</sup>	In 2006/2007, £590m on Budgeting Loans and £98m on Crisis Loans <sup>91</sup>
<b>Credit unions</b>	Not-for-profit financial cooperatives, offering loans as well as the opportunity to save. Credit unions have a common bond (such as a geographical area), which determines who can be a member. Maximum interest rate is 2% per month, or 26.8% APR, although in practice, rates are often much lower.	550,000 members, in 557 credit unions <sup>45</sup>	£337m <sup>45</sup>
<b>CDFIs</b>	Not-for-profit organisations that make loans to individuals and businesses in disadvantaged areas. APRs are typically around 24%. <sup>46</sup>	3,555 personal loans <sup>46</sup>	£2.7m (personal, excluding home improvements) <sup>46</sup>

The main different categories of product available are set out in Table 7. Sub-prime lenders as a whole are quite varied. As specialist services, they tend to meet the needs of people on low incomes better than mainstream providers—particularly in terms of flexibility and (often) cash payment. However, they are also expensive.

### Home credit

The focus of many financial exclusion campaigners is home credit or doorstep lending. This is a large, profitable industry that, in 2005, lent about £1.3bn to 2.3 million customers and collected £1.8bn in repayments.<sup>88</sup>

The main features of doorstep lending are reflected in its name. Networks of agents, typically middle-aged women, deliver modest cash loans to people's front doors and come weekly to collect repayments.

The service is very popular with its customers because loans are highly flexible, paid in cash, hand delivered, and can be rescheduled without penalty charges. Its downside is its cost, which, as advertised by Provident Financial, is 177% APR on a typical loan.

#### Box 20: Gold days in London's Turkish community—Ayse's story<sup>8</sup>

*'My sister was ill in Turkey, and needed £1,500 to go to hospital. In Turkey it is not like here where the government pays for hospital fees and medicine costs. It is very hard for people there—you have to come up with the money or you get no treatment. I don't have that much money; my husband doesn't even work! I told a friend at my daughter's school and she told me of her gold day. I know of gold days but I don't have enough close friends to invite. Bless her, she said she would invite her friends from her own group. And that is what we did. Some people brought large gold pieces and others brought £100. At the end of the day I got just under £1,500—I will have to sell the gold and when I do so the gold will lose some of its value. Over the next two or three years, the women will arrange gold days and they will invite me to their houses and I will do what they have done and so give them a large piece of gold or £100. I do not have to pay interest or anything so that is nice.'*

**Box 21: Annual Percentage Rate (APR)**

APR is an expression of the total cost of credit to the borrower. As well as including the total interest to be paid on the loan, APR takes into account the length of the loan agreement, the frequency and amount of payments, and any fees. All lenders are required to disclose their APR before finalising an agreement. Generally, the lower the APR, the better the deal is for the borrower.

Home credit companies are often criticised for the high APRs of their loans. A 55-week loan from Provident Financial, for example, has a typical APR of 177%. But some critics, including the Competition Commission and sub-prime credit providers, have argued that APR is a flawed measure of the value of a doorstep loan. This is for three main reasons:

- Firstly, APR does not take into account non-price issues, such as the convenient service that home credit companies offer.
- Secondly, unlike many other types of loan, doorstep loans incur no penalties or additional charges, even when a customer defaults. Other lenders do have some costs and default charges that they exclude from the calculation of APR.
- Thirdly, APR can distort or exaggerate the apparent cost of short-term loans. For example, a £100 loan repaid at £10 per week for 14 weeks has an APR of more than 1,000%. APR also magnifies differences between very similar products, being very sensitive to small differences in the period over which the loan is offered. It is therefore hard to use as a basis for comparing different loans.

For these reasons, the Competition Commission's inquiry into the home credit market found that APR is a weak measure of the price of home credit loans.<sup>88</sup> Instead, it suggested that the total charge for credit (TCC) was a better price measure, indicating how much more than the amount borrowed is to be paid back to the lender. This can be illustrated as follows:

- A Provident loan over 32 weeks has an APR of 400% and a TCC of £60 per £100 lent.
- A Provident loan over 105 weeks has an APR of 103% and a TCC of £89 per £100 lent.

The Competition Commission argues that TCC is more appropriate than APR when judging home credit loans, because it is easier to understand and less sensitive to small differences in the loan term. Yet it still concludes—and the examples above illustrate—that *'the prices of home credit loans, however measured, were high by comparison with the prices of other credit products'*.

TCC may be the best way of comparing very similar products in the same market, but APR is still a valuable tool, because it considers more than just the interest charged, as the National Consumer Council has argued: *'Despite its imperfections, annualising interest in the APR calculation means it reflects the true cost of credit by taking into account time for repayment as well as interest charged. Despite its weaknesses, APR is the best tool consumers have for comparing credit products.'*<sup>89</sup>

**Why does home credit cost so much?**

The answer is a complicated one and has long been the subject of argument between campaigners and the credit industry.

Critics have argued that, in a market where Provident Financial has a 60% share, there is a lack of competition and prices are artificially high. The industry, by contrast, has argued that its price reflects its costs—particularly doorstep delivery and flexibility on repayment. It has also pointed out that APR gives an inaccurate impression of price (see Box 21).

Thanks to the 2005 Competition Commission inquiry into home credit, the answers here are now clear.<sup>88</sup>

- Prices are indeed too high. The Competition Commission concluded that the market is not working competitively. Excess profits of at least £75m each year were earned in the industry over the period 2000 to 2005. The Competition Commission has ordered a range of remedies (currently being implemented) to reduce costs.
- On any metric, home credit is expensive. The Competition Commission proposed an alternative measure to APR that offers a fairer view of short-term loans: total cost of credit. On this basis, it costs the borrower £65 to borrow £100.
- Combining these two pieces of data, the price is about £7 per £100 loaned higher than would be expected in a competitive market.

Critics have taken some comfort in these findings, and they have certainly helped to build momentum to tackle financial exclusion.

But the findings also make uncomfortable reading for those interested in helping people to meet their credit needs more cheaply. Most notably, even bearing in mind excess profits, doorstep lending is a very expensive business to run. The 'competitive' cost of credit delivered in this way is over £58 per £100.

Analysts interested in the bottom end of the sub-prime market—people moving in and out of total credit exclusion, who rely occasionally on illegal lending—have also highlighted the complexity of the issues here. The inquiry found that home credit is a mature and, at least at that time, declining market. The bottom end of its customer base is made up of people who would probably have to rely on illegal lending or go without if it were not for the doorstep service. The weekly prompt to pay and personal relationships built into the industry in a sense make such customers 'manageable' risks.

It has been argued that increased competition for the top end of the sub-prime market (via credit cards for instance) risks undermining the cross-subsidy model that allows home credit to serve the poorest people.<sup>14</sup>

NPC does not find this last point wholly convincing. As we discuss in more detail later in this chapter, the Competition Commission pointed out that people combine rather than substitute different types of credit. Also, it may not be sensible to ask very low-income people to subsidise those who are even poorer.

However, it is worth bearing in mind that an estimated 850,000 households live in postcodes not served by home credit, because some estates are too dangerous for agents to walk around. There is some evidence that this is

a cause of illegal lending.<sup>6</sup> Those without even high-cost credit options are overwhelmingly the poorest in society—including many single mothers and people who are dependent on benefits. Three quarters of people who borrow from illegal lenders have no one working in their household, and a third are on disability benefit.<sup>6</sup>

### Government action

If this is the problem, what is being done to tackle it?

The short answer is: quite a lot.

The government has made increasing access to affordable credit one of the three core strands of its financial exclusion strategy. Its most high-profile initiative has been efforts to expand alternative providers of flexible low-cost credit via a 'Growth Fund', worth £36m in 2004–2007, with a further £38m in 2008–2011.

Figure 7 shows the logical model underpinning the government's efforts: if an alternative provider can break into the vicious cycle of high-cost credit, then it can save low-income families money and, with other support, pave the way for borrowers to become more stable. This interrupts the cycle of inescapable debt. The alternative provider is not a mainstream provider, but an accessible and affordable alternative to high-cost commercial sub-prime credit. Ultimately it might lead to the borrower entering the mainstream.

The exciting thing about this model is that money spent by lenders can, theoretically, have big returns. As Box 22 shows, capital gets recycled multiple times as it is re-lent. It should also have a wider impact because, other things being equal, increased competition will drive down the costs of other providers.

### Box 22: Recycling capital

The third sector lenders that NPC has looked at in detail that have a client base predominantly made up of financially excluded people are nowhere near self-sustainability.

For instance, not including capital, NPC analysts estimate that it currently costs one of the best CDFIs 26p in administration alone, and 37p in administration plus bad debt, to lend a pound. The organisation generates just half of its costs, implying a net subsidy to lend a pound of 13p (admin costs) or 19p (including bad debt).

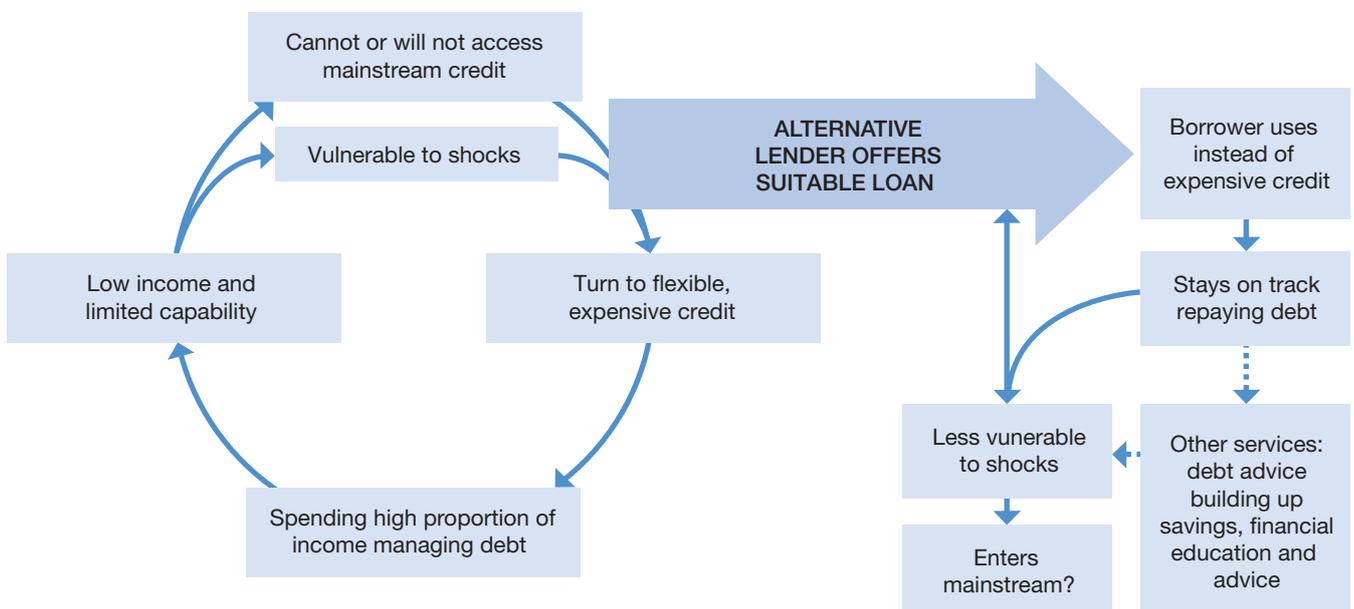
This sounds expensive. But it is worth reflecting that the capital will be recycled several times and half of this loss is recouped from interest on other loans.

A £10,000 donation would translate in its first year to a loan of £8,700 after admin costs (13%). Each subsequent year the capital is reduced by 19% due to bad debt and admin costs. So the amount lent in year two will be £7,050 and the amount lent in year three will be £5,710 and so on until eventually the capital dwindles to zero. The total of all of the loans made from the initial investment of £10,000 comes to **£45,790**.

Assumptions: Each loan only recoups 63% of the original value (admin + bad debt), but half of the loss is covered from interest from other loans so the value of the original donation only decreases by 19% with each lending. The first loan only incurs a cost of 13% as there are only admin costs and no bad debt costs. (Calculated as an infinite sum of a geometric series.)

The Growth Fund has been given to third sector lenders—credit unions and Community Development Finance Institutions (CDFIs). These are described in detail in Box 24 and Box 25. In brief, credit unions are mutuals whose members are united by a 'common bond' (typically living or working in an area). Members generally save as well as borrow, and some credit unions also offer banking facilities. CDFIs are rather different. They are lenders alone, rather than saving institutions, and were set up with local and central government support almost a decade ago primarily (as the name suggests) to help develop communities.

Figure 7: Breaking the cycle of expensive credit



### Box 23: The Social Fund

The Social Fund is a valuable safety net for many of Britain's poorest people. It is a government-funded grants and loans pot, delivered through Jobcentre Plus offices. The fund was established by the 1986 Social Security Act, to replace one-off supplementary benefit payments.

The fund is made up of two schemes. The regulated scheme includes Maternity, Funeral, Cold Weather and Winter Fuel Payments. Payments from this scheme are not limited by a budget. The discretionary scheme includes Community Care Grants, which help people to live independently, and two loan funds, which the following table describes (data from 2006/2007):<sup>91,93</sup>

	Budgeting loans	Crisis loans
<b>Description</b>	To spread the cost of one-off expenses, such as furniture or a winter coat. Interest-free, and repayable by deduction from benefit payments. Available to people who have been receiving certain benefits for at least six months.	To meet the costs of an emergency. Interest-free, and repayable by deduction from benefit payments. Available to anyone, where it is the only way of avoiding serious risk to health and safety.
<b>Applications</b>	1,750,000	1,448,000
<b>Awards</b>	1,298,000 = 74% of applications	1,072,000 = 74% of applications
<b>Gross expenditure</b>	£590.4m	£97.9m
<b>Average award</b>	£451	£88

The Social Fund discretionary loan system has been widely criticised, and reform was first identified as a priority by the Social Exclusion Unit's Policy Action Team 14 in 1998. Since then, calls for change have come from charities, think tanks, academics and government ministers.

Critics believe that it fails to meet the needs of some of the people who need it most. Its cash limited budget and strict eligibility criteria mean that many people only get part of what they apply for, and a quarter of applicants are refused. The National Consumer Council and Policis have found that many of those turned down simply do without, and one in four turn to expensive doorstep lenders or unlicensed loan sharks.<sup>20</sup>

In addition, awareness of the fund is low. Less than half of people on low incomes are aware of it, and only 14% of those potentially eligible have used it. For some groups, including older people and ethnic minorities, take up is particularly low. What is more, applicants view it as bureaucratic, complex and arbitrary.<sup>94</sup>

The Resolution Foundation has been particularly active in calling for reform. In March 2006, it hosted a policy seminar to discuss ideas, including options for attracting private capital to increase the availability of loans under the scheme. This followed a pamphlet it published in October 2006, in which the Rt Hon David Blunkett MP made a series of proposals.<sup>95</sup> Blunkett argued the fund should do more to promote financial inclusion, including savings: *'For too long, it has remained a legacy of the old, passive welfare state, encouraging dependence and undermining self-reliance.'* He also argued that it should attract private investment, to meet need on a greater scale.

Reform is beginning. There have been increases in the fund's budget in recent years, and administrative changes. For example, there is now a telephone application process for Crisis Loans, and the restrictive and complicated *'double debt rule'* has been abolished. Also, the fund is being publicised more widely, through leaflets targeted at particular client groups, including lone parents and carers.<sup>91</sup>

In 2007, the DWP announced a feasibility study into whether the private sector can be brought into partnership in delivering a reformed and expanded Budgeting Loans scheme.<sup>62</sup> And the DWP is planning to explore ways for the fund to contribute to wider financial inclusion, including saving and managing money.<sup>91</sup> These plans look like promising first steps, but it remains to be seen what changes they will result in, and whether they will succeed in improving this important source of credit for the financially excluded.

Originally this was by loaning to businesses and social enterprises, but a small number now offer personal lending as well.

The government is also looking at unlocking capital for third sector lenders through the Commission on Unclaimed Assets, which has been considering how to use dormant bank funds. One product of the Commission's deliberations is the launch of a social investment bank designed to help give third sector organisations better access to the capital markets. This could make a big difference to lenders struggling to accumulate enough capital to reach scale.<sup>92</sup>

Other relevant government initiatives include:

- £10m to help administer the Eligible Lending Deduction Scheme, whereby lenders can apply for repayment from defaulters by deduction from benefits—to reduce the credit risk of low-income lenders.
- An initial £2.6m on pilots aimed at tackling illegal lending in Birmingham and Glasgow. These have focused on enforcing the Consumer Credit Act and transitioning victims to third sector lenders. The pilots are now being rolled out nationally with further funding.

- A series of regulatory changes to make it easier for credit unions to grow, and tax breaks—Community Investment Tax Relief—to promote investment in CDFIs (although this latter reform has had limited success).

Many wider areas of government policy also affect credit—most obviously benefits levels and administration. But perhaps the government's biggest programme with direct relevance is the Social Fund. This is a loans and grants pot administered by the Department for Work and Pensions, with a £752m budget in 2007/2008. It is designed to help people on very low incomes. Though widely criticised as being too small and arbitrarily administered, its reach remains wide, with 2.6 million awards made in 2006/2007.<sup>91</sup> (See Box 23 for more detail.)

## Industry action

High street banks and the mainstream credit industry tend to argue that they do not see themselves serving the kinds of low-income consumer that use sub-prime lending. This is for both economic and reputational reasons—not least because they do not want to be associated with very high APRs. For example, in their evidence to the Treasury Select Committee's inquiry into financial exclusion in 2006, chief executives emphasised that instead they saw their role as supporting third sector lenders.<sup>63</sup>

There are some good examples of bank-led initiatives designed to help credit unions—the most well-known being Barclays' support for the introduction of the PEARLS system, which helps credit unions manage financial ratios (see Box 29 later in this chapter).

## Third sector activity

### Lending

By volume and by visibility, the biggest activity of the third sector in this space is as lenders, with credit unions and CDFIs offering more flexible versions of bank loans, partly as an alternative to expensive sub-prime credit. (See Box 24 and Box 25.) It should be noted, most credit unions and CDFIs are not charities. Most are Industrial and Provident Societies regulated by the FSA.

**Table 8: Capacity of third sector lenders to serve the financially excluded<sup>97</sup>**

Score	Categorisation	Number of lenders
0	Not serving the financially excluded	139 (34%)
1	Limited potential to serve the financially excluded	88 (21%)
2	Displaying some potential to serve the financially excluded	116 (28%)
3	Currently serving the financially excluded and displaying potential to grow	54 (13%)
4	Currently serving the financially excluded and with capacity to grow	17 (4%)

From sample of 16 CDFIs and 298 credit unions.

## Campaigning

Third sector organisations play a wider role as lobbyists and campaigners, but this tends to involve a relatively small number of organisations. Subjects include:

- Highlighting failings of both sub-prime and mainstream credit providers, providing advocacy support for individuals, and using that experience to campaign for changes to policy and practice.
- Lobbying for regulation—**Debt on Our Doorstep**, a grassroots network of anti-poverty organisations, has called for a form of statutory price control on credit, by capping interest rates that can be charged. There are also periodic calls for a UK equivalent of the US Community Reinvestment Act, legislation that compels banks to disclose investment into low-income areas.
- Highlighting the failings of the Social Fund, researching how it might be reformed, and lobbying to fix it (see Box 23).

## Reducing demand for credit

Facing financial exclusion more indirectly, the third sector plays a large role in tackling some of the underlying factors driving demand for credit among low-income groups. This is probably most obvious in financial education work, but there is also a large 'industry' of organisations that seek to tackle poverty—typically through benefits advice, help for individual families and campaigning on benefits levels.

## Third sector lenders

How well are third sector lenders doing?

Looking at the sector as a whole the picture is mixed. Lenders face a challenge of scale and a challenge of impact. These are considered in turn.

### Challenge of scale

Credit union and CDFI personal lending is small. Combined volume is around a quarter of home credit lending (see Table 7), and even this may

850,000 households live in postcodes not served by home credit, because some estates are too dangerous for agents to walk around.

When you're in a block of flats, it's very difficult to get people to loan you money.<sup>6</sup>

### Box 24: Credit unions—moving towards financial inclusion

Credit unions are not-for-profit financial cooperatives, which offer members the opportunity both to save and to borrow. Members are united by a common bond, typically either living or working in the same area (community-based credit union) or working for the same employer (employee-based credit union). Members receive a dividend on their 'shares' (savings) rather than interest.

In Britain, financial cooperatives date back to the nineteenth century,<sup>100</sup> but the movement only developed in its modern form after the Credit Union Act was passed in 1979. Credit unions grew rapidly under this new legal structure, often supported by local authorities, which saw them as a means of *'regenerating local economies, community development and as a means of the poor helping themselves'*.<sup>101</sup> Community-based credit unions grew, supported by grant funding, and many employee-based credit unions continued to thrive, funded by payroll deduction.

By 2000, the sector was well-established, but it included a large number of small, local credit unions that had unsustainable business models. Where credit unions were enjoying success they tended to be employee-based—arguably not reaching financially excluded groups. This highlights a trade-off affecting all social lenders: how to balance financial and social goals.

In 2002, the FSA began regulating credit unions. This resulted in wider professionalisation, including more use of paid staff, mergers, and the use of better financial monitoring via the PEARLS system.

There has also been a renewed focus on broadening social impact. Many employee-based credit unions have moved to community-based common bonds so that low-income individuals can join. Fast growth *'new model'* credit unions are moving from share-based to capacity-based lending—that is, where people previously had to save before they could borrow, those that can afford to repay can now borrow immediately. This is crucial to attracting low-income members.

Regulatory changes in 2006 allowed credit unions to charge up to 2% a month interest (26.8% APR) rather than the previous maximum of 1% a month (12.7% APR). This has increased reach into low-income groups, because credit unions can now lend to higher risk individuals. Finally, a handful of credit unions (20 by the end of 2008) are now offering their own bank account in partnership with the Co-operative Bank.

Latest figures published by the FSA show that in 2006, there were 557 credit unions in Britain, serving 550,000 adult members with an asset base of £498m.<sup>45</sup> The movement has seen rapid growth, with membership doubling over five years.

Debate continues about how effectively credit unions can meet the needs of financially excluded consumers, given lack of geographical coverage. Their traditional orientation towards low-paid workers presents two challenges: on the one hand, building trust and profile with financially excluded people who may not be in work; on the other, attracting and retaining better-off members (and therefore an asset base) in the face of a historic image as *'the poor man's bank'*. A related challenge is the interest rate cap: some argue that this makes the model inherently unsustainable if the goal is to reach the poorest.

Notwithstanding these challenges, the savings element of the credit union model makes it an attractive approach to address financial exclusion, rather than just addressing lack of credit. Member savings also provide a crucial capital base to lend out.

overstate their reach, as not all their customers are financially excluded.

The Financial Exclusion Taskforce has identified *'massive gaps'* in geographical coverage of third sector lenders.<sup>96</sup> It identifies 25 local authority areas where there is higher than

average demand for affordable credit and no lender serving the financially excluded at all. There are a further 56 areas where demand for affordable credit outstrips supply. Key areas in the Midlands, the North and Scotland have limited coverage, as do pockets of deprivation within richer areas.

This is not a straightforward problem to solve. The credit union movement has increased rapidly since 2001, doubling its membership to 550,000 people. There are some strong organisations making a real difference to their members. But according to analysis conducted for the Financial Exclusion Taskforce, only 4% of lenders (15 credit unions and 2 CDFIs) are serving financially excluded borrowers and have capacity to grow. A further 13% were judged as currently serving financially excluded borrowers and displaying potential to grow and, more encouragingly, 28% had *'some potential'* to serve the financially excluded (see Table 8).

Barriers to expansion are partly organisational and partly regulatory.

#### Organisational barriers

Organisational barriers include getting the right staff mix, product range and infrastructure. Lenders are often still fairly new and have not always developed adequate technical capacity (eg, on underwriting and IT). They do not always have suitable premises, either in terms of location or quality. And they face a big marketing challenge. Their sub-prime 'competitors' spend large sums advertising and have well-established brands. By contrast, third sector lenders are not well known.

#### Regulatory barriers

Regulatory barriers are a particular impediment to credit union growth. The main trade association for credit unions, the Association of British Credit Unions Ltd (ABCUL), is calling for changes to the rules governing credit unions including:

- A broader definition of a common bond—currently community credit unions are tied very closely to particular geographies. This makes it hard to expand or to partner with other organisations (eg, housing associations) that are regional or national.
- The development of organisational membership—currently only individuals can join credit unions. If local and national government agencies, charities and social enterprises could join, the capital base of the movement would be increased.
- The ability to offer interest—currently credit unions pay a dividend rather than offer interest. If they could opt to pay interest instead, it might be possible to attract deposits from more savers, again increasing the amount of available credit.

## Sustainability

Third sector lenders have received capital and revenue funding under the Growth Fund to make loans to people who they would not otherwise lend to at affordable rates. But the ultimate aim of policy appears to be to develop free standing institutions that cover most of their own costs.

NPC's view is that achieving high levels of self-sustainability looks like a very challenging goal if you are trying to build a business focused on lending mainly or exclusively to excluded groups.

The basic economics of small loans with relatively low interest rates are very unfavourable. In particular, fixed costs are high and returns are low. So high customer volumes are needed to offset these costs. But it is hard to grow the volume of loans without sacrificing quality in terms of bad debt. There is a problem of 'adverse selection'—new or growing lenders are likely to attract bad risks. More than that, scale may be a threat to the local knowledge that allows risk to be managed.<sup>98</sup>

Organisations have only a limited number of options for managing this problem.

One is to focus organisational mission and limit social reach, only helping those with the lowest risk profiles.

A second way of delivering sustainable growth is to find ways to reduce the costs per loan, perhaps by technical 'fixes' like more sophisticated credit scoring. **Big Issue Invest**, a specialist provider of finance to social enterprises, is developing an Alternative Credit Scoring Index to help increase access to mainstream credit. Some CDFIs are also exploring this idea, as a way to improve their risk management. It remains to be seen how easily this can be done, though its proponents argue that similar approaches are showing promise in the US.<sup>99</sup>

A third way is to accept that small loans to excluded and marginal groups are never going to cover their own costs and instead, lenders need to find a way of cross-subsidising them. ABCUL for instance argues strongly that its members need to attract a diverse client base, selling a wide range of products. Credit unions cannot be built on financial exclusion alone but need to serve a much wider range of people including those higher up the income scale. Products will include not just small loans but banking services and mortgages: *'we do not believe it is possible to build a strong sustainable credit union ... making only £300 loans. Marginal costs will always outweigh income, never mind contributing to overheads.'*<sup>143</sup>

In principle this last approach seems sensible. A large organisation, a modest proportion of

### Box 25: Community Development Finance Institutions (CDFIs)

CDFIs are not-for-profit finance organisations that make loans to individuals and businesses in poor areas and under-served markets. Unlike credit unions, they do not offer saving accounts (although some partner with deposit-takers).

CDFIs date back to the 1980s and loan funds established by local government to stimulate business. However, most have developed since 2000—given impetus by the government's Social Investment Taskforce, which looked closely at community finance in the US. The taskforce made a series of recommendations, including tax breaks for private and business investors who invest in CDFIs (Community Investment Tax Relief), and direct financial support for CDFIs, which came in the form of the Phoenix Fund until 2006. It also led to the establishment of a trade association, the Community Development Finance Association (CDFA).

Today, the CDFA has 74 members, financed from a mix of grants and, to a lesser extent, commercial borrowing. Their loan portfolio stood at £285m in 2007.<sup>46</sup> The original thinking behind CDFIs was that they would promote enterprise. Their spending reflects this: most loans were made to social enterprises, with the personal loan portfolio (excluding loans for home improvements) at £2.7m.

Since 2004, the government has focused much more on personal finance, and some CDFIs have benefited from the Growth Fund. There has also been some consolidation, particularly in England. For example, the West Midlands now has five CDFIs, where before it had seven. Regional Development Agencies now have lead responsibility for funding enterprise CDFIs.

As several commentators have recognised, the sector has had to think hard about its goals.<sup>98</sup> It has suffered from short-lived and uncoordinated government support. Most CDFIs are still very new and were set up with widely differing levels of skill and experience. Accordingly, their financial and social results have been variable. A handful of high profile personal lending CDFIs have emerged, typically offering loans at up to 30% APR. Like credit unions, they have struggled to balance social and financial objectives.

However, experience is leading to greater impact. The CDFA now has a performance framework in place, which will support CDFIs to develop stronger models.

whose clients are financially excluded, can of course be helping as many or more people than a small lender that is purely looking at excluded groups. But questions remain about how much a credit union can expect its members to cross-subsidise marginal groups and, in practice, whether having breadth affects reach—for instance, because of understandable efforts to protect returns for better off members or because the 'respectable' culture of the organisation makes it hard to engage some groups.

The best evidence to date that lending can be scaled up is from the Growth Fund. Since July 2006, more than 100 organisations (most of them credit unions) have received money from the Fund and advanced over 46,500 loans totaling more than £20m.<sup>62</sup>

The loan portfolio has been reported very positively to the Taskforce with lenders apparently hitting overall targets on volume of loans made and bad debt.<sup>96</sup>

This is very encouraging. However, these loans still enjoy a handsome subsidy (not least, the

**Box 26: Fair Finance**

Fair Finance is a CDFI based in Tower Hamlets, one of the poorest boroughs in London. It began trading in 2005, providing a variety of products and services to tackle financial exclusion. As well as personal loans, Fair Finance provides business loans, social enterprise loans, debt advice and money guidance to people who cannot access mainstream services.

More than half of Fair Finance's clients are single mothers, and 90% are dependent on benefits. They include anyone whose other sources of finance are limited and expensive. When Fair Finance began, it decided to enter into direct competition with high-cost lenders by setting up a high street office and a network of local surgeries. Because its main competitors are those lenders that can make an instant decision, the CDFI has a very quick turnaround on personal loan decisions.

It is a young organisation but early signs show that the model is proving to be successful. The personal loans, typically around 20% APR, have resulted in some of east London's poorest people turning away from expensive lenders, thus saving thousands of pounds' worth of interest payments. The microcredit business loans have seen entrepreneurs set up successful businesses, and the money advice programme has helped people to climb out of problem debt and learn how to make the most of a low income.

One person who has been helped by Fair Finance is an elderly lady who borrowed £200 to pay for her husband's funeral in 1999. After falling ill herself, the repayments began to skyrocket. By 2005 she had repaid nearly £2,000 on the £200 initial loan. As a result, she had serious debt problems, including Council Tax and rent arrears. Fair Finance intervened by negotiating with her creditors and setting up a repayment plan. It also rescheduled her loan, to be paid off at the rate of £1 a week for 50 weeks. Needless to say, this was an enormous relief for a frail and anxious woman.

Faisal Rahman, Managing Director of Fair Finance, emphasises that his CDFI does not aim to be like a normal—albeit more accessible—high street bank.<sup>105, 106</sup> Rather, it is more like private banking, only for the very poor. Just as the wealthy will pay for bespoke services, Faisal argues that some people at the bottom end of the financial services system need a personalised service, because of chaotic lives and fluctuating or consistently low incomes. There is a need for more products and better service delivery for people who require accessible, flexible and personal financial services. It is in this gap that financial exclusion is found, and it is this gap that Fair Finance is trying to fill.

cost of the capital itself). In addition, one would expect adverse selection problems to get worse as organisations scale-up: the easiest part may be the first period of growth when there is 'low hanging fruit' to be picked.

**Challenge of impact**

The Financial Inclusion Taskforce's Working Group on third sector credit recommends expanding third sector lenders to serve the financially excluded.<sup>96</sup> But a question it leaves unanswered is what serving the needs of the financially excluded actually means in practice.

Third sector lenders have some reasonable evidence of their social impact, which suggests that they are making a real difference to their users. But overall the information is not as strong as it should be.

**Positive evidence of impact**

Growth Fund data shows that leading third sector lenders are succeeding in making loans to people on low incomes.<sup>71</sup> In theory this will reduce their poverty and stress and have psychological, economic and social benefits.

There is a lot of anecdotal evidence that community finance organisations are having a positive social impact. Many lenders cite case studies of helping families achieve their first debt-free Christmas. Users report that they highly value the services provided by CDFIs and credit unions—especially their friendly approach and support.

Where lenders are integrated with advice and support, they may have reduced debt. For example, North Devon Homes provides financial risk assessments and underwrites credit union loans for residents: *'Our rent arrears fell from 5.7% in January 2005 to 1.9% in March 2006, and we have released tenants from the clutches of moneylenders.'*<sup>102</sup>

In relation to third sector lenders' impact on poverty, some organisations have tried to show their social value by doing 'money saved' calculations on the basis that people borrowing from third sector lenders are using that money instead of money borrowed from other sources. These indicate, as one might expect, large net gains for people on low incomes. This is helpful to know, but there are some questions about the robustness of this methodology. While they show what borrowers have saved relative to getting that money from a different source, we do not know how affordable credit affects overall credit use or long-term solvency. In particular, it may only partly be displacing other expensive credit use or even supplementing it. The Competition Commission inquiry found that different forms of credit did not substitute well for each other (see Box 27).

To date, a higher proportion of CDFIs' clients are from poor, marginal groups than credit unions' clients.\* This may change as credit union capacity-based lending increases (previously, the requirement on borrowers to save before they could take out a loan has been a barrier). ABCUL points out that it reflects the 'mixed' model of credit unions, which try to have a broad client base.

**Unanswered questions about impact**

Third sector lenders look like they are better designed for the top end of the sub-prime market than the bottom. Although people who borrow from third sector lenders are more likely than the general population to have a relatively

**We had to go hungry to make sure he was paid.**

Person who borrowed from an illegal lender in the West Midlands<sup>6</sup>

\* Research on a sample of credit union members found that they tended to be middle aged, white women, with just over half in paid work.<sup>103</sup> People who borrow from CDFIs are more likely to be unemployed or self-employed, and to live in social housing. A report that looked closely at the reach of both **South Coast Moneyline** and **Portsmouth Savers Credit Union** found that the Moneyline had the greater reach into excluded groups measured on employment rates and income.<sup>104</sup>

low income, rent their home and manage without a bank account,<sup>103</sup> there is evidence that neither credit unions nor CDFIs yet have a reach nearly equivalent to that of doorstep lending. Analysis by Policis has found that third sector lender customers have higher incomes and make greater use of other credit products on average. Even on the most deprived estates, they are more likely to be in work and less likely to have a disability or mental health issues than home credit users.<sup>107</sup>

In practice, getting people to switch from expensive sub-prime lending to third sector lending is hard. Government pilots attempted to tackle illegal lending but showed very limited success in moving people into third sector lending or even money advice.<sup>108</sup>

There is little evidence of impact on other sub-prime borrowing or poverty levels. One assumption of the theory of third sector lending is that people save money by using third sector loans instead of expensive sub-prime credit. But the poverty reduction effect is partly based on the view that (a) third sector credit displaces more expensive sub-prime credit and (b) it proves manageable. It may be the case that third sector lending only partly substitutes or is complementary to sub-prime use. Of course, any substitution for high-cost credit is likely to be a net gain for the individual and it does not need to be full substitution to save people a lot of money. Nonetheless, this complicates its poverty-reduction claims. Equally, third sector products do not have many of the flexible features other sub-prime products enjoy. There is some risk of people defaulting and even incurring charges, for example, if they pay third sector loans by direct debit.

### Explaining third sector lenders' reach

There has not, to NPC's knowledge, been a huge amount of research into the reach of third sector lenders, so the sorts of findings noted above should be interpreted with a degree of caution. However, if we accept them at face value, it is perhaps an unsurprising finding that third sector loans do not reach the same group of people who use home credit.

First there is the question of mission. Credit unions, for instance, were not generally established to compete with home credit or with that primary focus. They have often chosen to have a wide range of customers and not to prioritise the needs of the most excluded above those of their other members. This is for broader reasons, including an attempt to be sustainable.

Second, there are the organisational barriers noted previously, such as establishing a brand and having capacity to deliver. This includes the limited opening hours that many lenders have because of lack of resources, which limits the range of clients that they can attract.

### Box 27: Third sector lenders and home credit

The relationship between affordable credit, people's other credit use and their overall financial situation is not very well understood. But available information suggests that third sector lenders will not easily impact upon home credit use. In particular:

#### The overlap between home credit and third sector lenders is modest.

A report from the Personal Finance Research Centre surveyed 1,473 credit union members, finding that 22% had used home credit at some point. More positively, four in ten of these had stopped using home credit as a result of joining the credit union.<sup>93, 103, 109</sup>

The Competition Commission inquiry into home credit found that **other kinds of credit do not displace home credit use.**<sup>88</sup> Rather, people tended to use them alongside home credit. For example, increased access to credit cards neither reduced home credit prices nor led to switching.

The National Consumer Council's submission to the Competition Commission found that some people had moved from home credit to credit union loans. But those ceasing to use home credit had distinctive traits, tending to be older and without dependent children. Its conclusion was that the individuals' credit needs had changed rather than the credit union substituting. '*Life stage changes*' meant that consumers had more stable financial circumstances and more predictable credit needs.<sup>89</sup>

Commentators have also raised questions about how well those moving out of home credit do so using other products. **Home credit firms themselves have struggled to migrate people** from a doorstep service to credit cards finding that, without weekly prompts to repay from a visit, bad debt increased.<sup>27</sup>



Photograph supplied by Esther de Jong

**Box 28: Financial Inclusion Services Yorkshire (FISY)**

Financial Inclusion Services Yorkshire is a partnership of three organisations:

- **Sheffield Credit Union** offers loans to people who have saved for at least 12 weeks. It has more than 60 collection points around the city, 4,500 adult members and 2,500 junior members.
- **Moneyline Yorkshire** offers instant loans to higher risk borrowers, so as not to put people's savings in the credit union at risk. There is a strong correlation between Moneyline clients and the poorest parts of the city.
- **FISY** offers general money guidance and financial education.

The partners work closely together, aiming to tackle financial exclusion by providing a holistic service—including building people's financial capability, helping them to solve financial crises, and providing affordable credit and savings facilities. FISY also works closely with other agencies, including Sure Start centres, housing associations and schools, in order to reach the people who would benefit the most.

Jane's husband left her with two children and growing financial difficulties. Needing £250 for compulsory school uniforms, she turned to doorstep lenders. But she could barely cope with the repayments. The loan agent rescheduled the debt—Jane had paid over £800 but still owed almost the full £250. Scared for her family's safety, she cut herself off from gas and electricity so she could make the loan repayments. She and her children suffered from frequent illness. At times, candles were the only source of heat or light in the house, and bread was the only food.

Jane finally found out about Moneyline Yorkshire and FISY. She received debt counselling and took out an affordable loan, which has turned her life around. Jane no longer uses doorstep lenders, less of her low income goes on loan repayments, and she and her children feel comfortable and safe again.

Alison moved into a council house with her toddler son. She needed a sofa, but had no money saved up. She was turned down by her bank and by the Social Fund. So Alison went to her local Brighthouse store, which offers household goods on credit to people who struggle to get mainstream credit.

The sofa cost £1,500, plus another £1,000 in charges, interest and delivery. But soon after she had put in the order, Alison found out that the same sofa was only £600 in the Argos catalogue. Feeling ripped off, Alison spoke to her Sure Start worker. The two went to Brighthouse and, after some argument, finally got the store to cancel the order. They then went to Sheffield Credit Union. Alison bought the sofa with a credit union loan of £600, paying back a total of £750 over two years. She also started to save for the first time, putting aside £3 a week for herself and £1 a week for her son.

Third, there is the issue of the actual products on offer. Some credit unions and CDFIs do share features of home credit (lending small amounts, sometimes through instant cash loans, and sometimes with no penalty for the odd missed payment). However, credit union and CDFI loans do look more like traditional bank products than a home credit service. People who actually *need* to make use of doorstep provision—for instance, benefiting from prompts to repay—will find third sector lending an inadequate substitute.

It is also possible to venture some speculation about why third sector lenders have this focus, and draw some lessons from it. An emphasis on the top end of the sub-prime market rather than the bottom may reflect the constraints under which they are working.

Currently, third sector lenders operate with three aims or characteristics, some of which come from their funders, and some of which come from their staff. These are:

1. a desire to have social reach;
2. a commitment to interest rates that are low compared to sub-prime providers; and
3. a long-term goal of greater self-sustainability.

If the aim is to achieve all three, these goals are arguably mutually incompatible.

Most lenders accept that the third goal is a challenging ask: 'low' interest rates and deep social reach are not easy to reconcile with self-sustainability (though of course, grant funding offers the prospect of a different kind of sustainability).

Some recognise too that sustainability might be achievable by sacrificing reach. Lenders could try and pick only the most viable customers.

One thing NPC has not heard much about is the third iteration falling out of these three commitments, namely that self-sustainability and social reach might be achievable with higher interest rates.

One way of characterising the products offered by third sector lenders is that they have been designed starting with an *a priori* idea of the 'right' interest rate. Indeed, the interest rate cap for credit unions is a legal version of this. The argument has run that rates much above 30% make lenders part of the problem rather than part of the solution.

The possible problem of this approach is that it limits the reach of the product. Reducing costs to a 'reasonable' APR can reduce depth of reach—for instance, by limiting flexibility or requiring bank account repayments.

On this reading, policy-makers face an irony. They have worried a lot about APR being so high that it prices people out of credit. But this can be inverted and a counter-argument made, namely that a 'low' APR may prevent lenders from developing products that meet the needs of more excluded groups.

Of course, neither donors nor lenders have to be interested in serving the whole sub-prime market. There are perfectly valid reasons to target underserved segments of it and picking the 'low hanging fruit'. But those that do want to help the most excluded may have to take a more tolerant attitude towards higher interest rates.

The Joseph Rowntree Foundation is currently investigating the viability of a not-for-profit doorstep lending service. It is likely that achieving economic viability for such a model would mean pricing loans at levels that look very expensive relative to 'affordable' credit.

### The underlying vision of third sector lenders

Underpinning the challenges of scale and impact are some ambiguities about what third sector lenders are trying to do. Donors should press for clarity.

There are several distinct features of third sector lenders' mission. But commentators often conflate them or present them in a way that does not make it clear precisely what the long-term aims are, or what funding is meant to be doing.

One goal of credit unions and CDFIs is to **solve a problem of competition**. The argument here runs that people on low incomes face a monopolistic credit market with too few players and, as the Competition Commission has found, with prices that are too high. They may also face a gap in innovation—that is, it might be possible to meet 'poor' people's needs with products that are less inherently expensive, but lack of competition means that no one has done it. There has been a market failure—perhaps because of information or reputational barriers. On this reading then, their objective is to compete away super-inflated profits, and offer a service that is still expensive relative to the mainstream market, but cheaper than sub-prime. It will make a contribution to lowering people's expenditure and thus help to reduce the severity of the vicious cycle that subjects people to inescapable economic shocks. Part of making this work means giving lots of support and advice to customers or potential customers. This is a business cost, essential to establishing a viable market.

A different goal of third sector lenders is to **solve a problem of social justice**. The argument here is that the problem is bigger than one of competition. It is not just that the

### Box 29: Southwark Credit Union—the move to capacity-based lending<sup>110</sup>

In 2001, Barclays sponsored the introduction of the PEARLS monitoring system into Britain. PEARLS stands for Protection, Effective financial structure, Asset quality, Rates of return, Liquidity, and Signs of Growth. This tool provides credit unions with financial variables on which to base their business planning.

Southwark Credit Union (SCU) was one of the first to join the project. It was already a well-established organisation with a 'live and work' common bond, but it experienced rapid growth following the implementation of PEARLS. Within four years, membership more than doubled to 4,400 members, and savings went from £2m to nearly £4m.

The credit union scrapped the link between savings and loans, by which members had to save for three months before they could borrow. Instead, it moved to a capacity-based lending system, lending on the basis of ability to repay. This meant that the organisation could reach a greater number of financially excluded people, as well as improving its judgement of risk. For example, in a particular four-month period, the PEARLS system revealed 35 applicants who had almost £250,000 of outstanding credit commitments in default. The previous system would not have highlighted this. So instead of inadvertently contributing to this bad debt, the credit union signposted these members to a local money advice agency.

SCU estimates that £13m is drained away from the borough's residents in high-interest payments each year. It aims to take business away from local high-cost lenders, thus reducing the amount that is wasted. One example of success here is Lara, a fairly typical credit union member. Lara has her benefits paid into the credit union each week, withdrawing some for everyday living expenses, but leaving the Child Benefit in to pay for her savings and loan payments.

Since Lara began using SCU, she has cleared all of her loans with other companies and relies on the credit union when she needs help to pay her bills. She has built savings of £350, and tries to budget for items that she needs to buy. She is adamant that she will never use catalogues or doorstep lenders again, now she knows that the credit union can help her.

price of credit does not reflect its true cost (or, with different products, its true potential cost). Rather, it is unfair that poor people should pay more when the things that make them expensive to serve (their unstable income; capability issues) are due to their unjust circumstances. On this reading then, the objective of third sector lenders is to tackle this unfairness. Third sector lenders seem to do this in two ways. First, they provide advice and support to improve capability as a charitable activity. Distinct from the 'problem of competition', above, this is not part of the business. Second, they sometimes seem to want to subsidise credit below its true cost. The argument is that credit can be a vehicle for what is effectively an income transfer.

These different features of third sector lenders' missions show that they have at least two different parts. The part that is trying to fix a broken market is a social enterprise, needing start-up and growth funding to prove its model or scale up. And the part that is trying to address unfair circumstances, which exclude people from the mainstream, looks more like a charity. Important points arising out of this include:

“People know when they are being ripped off, but ... if they have no other choice, it makes no difference.”

Citizens Advice Bureau  
worker, Liverpool<sup>2</sup>

**Box 30: D£von Pound<sup>112</sup>**

D£von Pound was established as a Community Banking Partnership in 2006. It provides financially excluded people with 'a single access point to get whatever assistance they need to move towards financial security and mainstream status'.

D£von Pound's work is predominantly done through eight outreach workers, who operate in local 'patches' across Devon. They visit people's homes, and meet people through local organisations such as village halls and Job Centres. The organisation has five aims:

- access to mainstream banking;
- budgeting support;
- credit at an affordable rate;
- deposits with ethical companies (saving with credit unions); and
- education on financial literacy for all ages.

D£von Pound does not provide financial services itself. Rather, it provides advice and education, including practical support to access suitable products. It works closely with a number of partners. For example, it takes referrals from Citizens Advice Bureaux, does financial healthchecks for new housing association tenants, and helps people to save and borrow from credit unions.

- Different aspects of third sector lenders may need different kinds of support.
- The 'competition' view does not obviously need philanthropists to make donations. Since the aim is to create a free standing 'business', a social investment approach might be more appropriate. As the Taskforce states, there is also a great deal of capacity-building needed.
- Talking to third sector lenders, NPC has found that the boundaries between what is a business cost and what is a charitable cost are unclear. Organisations are not as good as they could be at segmenting them. In particular, they are not always internally consistent on where advice costs should sit. Some of it should be seen as customer acquisition cost and reflected in the APR.
- Subsidising credit below its 'real' market cost is equivalent to a cash transfer programme. The money making up the loan subsidy could instead be handed out directly to the borrower. But some people argue that there are reasons for transferring this cash



Photograph supplied by Julie McEver

through saved interest on a loan. Firstly, it is efficient, because most of the money will be paid back. Secondly, it means giving according to actual rather than presumed need.

So far, this section has periodically talked about third sector lenders as a single type of organisation, but of course, CDFIs and credit unions have very different models. A key concern for donors should be the long-term vision of lenders, and the different approaches inform this very markedly.

Is it a vision of a world of people borrowing money at around 30% APR rather than higher rates? Or one in which their needs are tackled so that they can be integrated into mainstream (or mainstream-priced) lending?

It seems likely that approaches that promote saving alongside borrowing are a better model for actually addressing financial exclusion over the long term. Credit unions have an edge here. A small number of CDFIs and credit unions have become part of Community Banking Partnerships, one-stop shops where education, advice, banking and saving opportunities are on offer alongside loans. **Financial Inclusion Services Yorkshire**, described in Box 28, and **D'Évon Pound**, described in Box 30, are two interesting examples of Community Banking Partnerships. In principle, this looks like a good model, aiming to be a 'holistic' approach to promoting financial inclusion.<sup>111</sup>

However, there is a dissenting view. Some of the most effective third sector lenders look at it very much as a business and are sceptical of the possibility of changing people's behaviour and circumstances in a dramatic fashion. Those who see credit use as relating to capability and culture think it is possible to move people into the mainstream. Those who see it as an issue of poverty are more questioning.

## What is the role of donors?

Donors interested in credit and financial exclusion could support service delivery by funding third sector lenders or helping with capacity-building. They could fund lobbying to challenge the framework of current policy. There is also a potentially useful role to play in funding research into the impact and role of third sector credit.

## Supporting third sector lenders

The government is very active in this space via the Growth Fund, but there remains a large amount of need. A working group of the Financial Inclusion Taskforce recently identified national demand for affordable credit at three million customers, totalling £1.2bn per year. The government's current activity amounts to 75,000 loans, totalling £30m. On this basis, only a fortieth of demand is being

### Box 31: Debt on our Doorstep—social justice

Debt on our Doorstep (DOOD) is a campaign against the injustice of financial exclusion, '*working to end extortionate and irresponsible lending, and to ensure universal access to affordable credit and fair financial services*'. Its 90 members include Oxfam, the New Economics Foundation and the National Housing Federation, as well as small community organisations and credit unions.

DOOD has a big grassroots dimension. It focuses on how financial exclusion is experienced, and its priorities grow out of research and conversations with people living in poverty.

DOOD is currently calling for an investigation into the growth of high-cost payday lending. It has had some success in the past, for example, influencing the National Consumer Council's super-complaint to the Competition Commission in 2004, which was important in raising the cost of home credit as an issue for investigation. Remedies have now been introduced to increase competition in the market and lower prices for customers.

Even where DOOD is campaigning for things that might not command consensus (notably, an interest rate cap), it is playing a significant role in framing the debate and keeping issues of social justice on the agenda. NPC's experience is that the financial exclusion debate can become very theoretical and detached from the experience on the ground. This is where DOOD stands out.

met by the government.<sup>96</sup> It should be noted that the taskforce working group reached its conclusions before the current credit crunch fully came to light, so this is likely to be an underestimate.

The taskforce has proposed a new '*shared commitment*' between government, the financial services industry and the third sector.<sup>96</sup> This follows the model of the existing shared goal to halve the number of people without a bank account. Under the taskforce's proposals, government would provide capital to third sector lenders while banks would provide revenue funding and other support (second staff; invest in IT and equipment; help with back office; increase risk assessment capacity; offer access to banking platforms) to expand third sector lenders.

Donors keen to make a difference on lack of affordable credit will need to take account of this proposal and any response to it by banks. The government's financial inclusion action plan indicates that the banks have committed to '*support new provision in 25 high priority areas identified by the Financial Inclusion Taskforce*'.<sup>62</sup>

NPC's overall view on third sector lenders is that they are a good option for donors but not a straightforward one. In particular, the evidence of their impact is only just being established, and there remains a degree of uncertainty about how much difference they can make. As the Taskforce's analysis makes clear, extra money is only one of the things that they need to be successful—it is likely that they could benefit from 'engaged' donors bringing skills, experience and expertise as well as cash.

For example, a report from the Joseph Rowntree Foundation highlights the skills deficit that some credit unions have at board level: *‘many boards have almost no directors with a “knowledge of risk management and effective management”... or “familiarity with marketing concepts”’. Perhaps more worryingly, many boards have a considerable number of directors with no “ability to read and interpret financial statements”.*<sup>1113</sup> There could be an opportunity here for donors to provide non-monetary help, for example, by bringing financial expertise to a board.

However, there remains some ambiguity over what kind of answer third sector lenders offer to financial exclusion. It may be that donors need to challenge these lenders to be clearer on what they are trying to achieve and help them clarify their business and social models.

### Responding to different visions of lending

Figure 8 identifies at least three different possible visions of lending, each of which implies a slightly different role for philanthropists.

First, there is a vision of a scale, not-for-profit, inclusive financial service, which increases competition in the sub-prime market. Donors face challenges here in that much of the help required goes beyond money. Also, where cash is needed, it might be best structured not as a donation, but as social investment or a broader attempt to open up private finance for the sector as a whole. The role of donors is therefore for start-up funding, growth funding and capacity-building support, to get the organisation to scale.

Second, there is a vision of a lender that attempts to tackle the underlying factors excluding someone from the financial mainstream, as well as providing loans. As with the first vision, donors face the challenge

that more than just financial support may be needed. The role of donors is therefore in start-up funding, growth funding and capacity-building support. Also donors may provide ongoing charitable funding of advice, education, and savings facilities.

Thirdly, there is a vision of a lender that serves those who are wholly credit excluded—those who cannot even get doorstep loans, relying instead on illegal lenders. There is a challenge for donors here in that this end of the sub-prime market arguably cannot afford credit at all, and is using credit as a way of coping with inadequate income. The role of donors here may be to fund a grant-giving charity rather than a lending service.

#### What should donors do?

NPC recommends that donors talk to the main trade associations of third sector lenders, ABCUL and the CDFI. This would be the starting point for identifying organisations that need either capacity-building support or social investment. Leading individual organisations range from established players like **Southwark Credit Union** (see Box 29), **Leeds City Credit Union** or the CDFI **East Lancs Moneyline** to more emerging organisations like **Hackney Credit Union** or the CDFI **Fair Finance** in east London (see Box 26). They could be funded to improve training, to cover advice costs or to develop new products that better meet the needs of financially excluded people. Donors could also approach local lenders directly.

Looking at it from a different angle, a new organisation has recently been launched, aiming to operate as a think tank for the sector. The **Financial Inclusion Centre** is a start-up but it could be of interest to donors seeking to fill particular gaps in capacity. The centre seeks to focus on researching unmet needs and identifying better ways of meeting them, as well as adapting private sector financial instruments for the third sector.

Figure 8: Responding to different visions of lending

Vision of third sector lender	Challenges	Role of donors
To increase competition in the sub-prime market, being a scale, not-for-profit, inclusive financial service.	Much of the help required goes beyond money. Also, where cash is needed, it might be best structured as social investment or a broader attempt to open up private finance for the sector as a whole.	Start-up funding, growth funding and capacity-building support.
To provide loans and tackle the underlying factors of exclusion.		Start-up funding, growth funding and capacity-building support. Also ongoing charitable funding of advice, education, and savings facilities.
To serve those who cannot even get doorstep loans and rely on illegal lenders.	Arguably, this end of the sub-prime market cannot afford credit and is using it as a way of coping with inadequate income.	Fund a grant-giving charity rather than a lending service.



Photograph supplied by Association of British Credit Unions Ltd

## Lobbying

There is a strong ‘in theory’ case for private capital to pay for activity on lobbying about the wider environment within which lending takes place. It is not the kind of work that generally attracts statutory funding, and corporate funding is difficult where businesses may be the target of lobbying and campaigning.

One key difficulty for donors wanting to fund ‘off the shelf’ is that, perhaps as a consequence of the challenges of getting sustained backing, there are relatively few organisations in this space.

Another difficulty is that the political environment is not very favourable to some large-scale changes. For example, calls for a UK equivalent of the US Community Reinvestment Act have been rejected for the time being by influential voices such as the Treasury Select Committee. This is because the Act was introduced in the US in 1977 as banks were refusing to lend in certain areas, and it seems that this problem does not exist in the UK. Instead, the committee has called for greater transparency.

Another large-scale change that has been called for is radical reform of the Social Fund. Despite some good research by the Resolution Foundation, reform is ‘*in limbo, pending wider Government action on financial inclusion*’.<sup>114</sup> The government’s most recent action plan has committed to a ‘*practical feasibility study*’ into bringing in the private and third sector to deliver a reformed Social Fund.<sup>62</sup>

**Citizens Advice** does effective work, and campaigners on behalf of particular groups are also active (notably **Age Concern**). The main trade associations of third sector lenders, ABCUL and the CDFA, have quite specific lobbying goals to support their members. These groups could be seen, to some extent, to be lobbying inside the framework of existing policy—something reflected in their presence on the Financial Inclusion Taskforce.

Donors who want to look outside that forum have a limited range of choices. **Debt on our Doorstep** brings together a diverse range of organisations, from small anti-poverty groups to national charities such as **Oxfam**. Debt on our Doorstep seeks to represent these groups to engage in critical dialogue with government and the financial services industry, and calls for tough regulation (see Box 31).

Otherwise donors may want to turn to more general anti-poverty groups, such as **Save the Children UK** or the **Child Poverty Action Group** (CPAG). CPAG, for instance, is a vocal campaigner trying to build a coalition to address some of the fundamentals driving poverty, particularly the way the benefits system works. Though financial exclusion is not the main lens through which it is viewing the world, success in its activities would mean higher incomes for many of the poorest families. This would remove some of the reasons that products do not work for excluded groups, enabling more people to be included in the financial mainstream.

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**Box 32: Where does microfinance fit in?**

Microfinance is an increasingly high-profile part of development policy in poorer countries, often based on the model developed by Grameen Bank of 'peer lending' to circles of (often female) borrowers.

The nearest equivalent in the UK are Community Development Finance Institutions (CDFIs), but these lend to individuals and businesses, not to groups. Circle-based lending has been tried on a tiny scale, including by the east London charity Quaker Social Action. Its project *Street Cred* partners with Fair Finance, a leading CDFI, to make small loans to 'borrowing circles' of low-income women. The circles also provide advice and mutual help.

The original rationale underpinning *Street Cred* was that it would provide access to affordable credit otherwise unavailable to female entrepreneurs in east London. In practice, however, the other dimension of the scheme—peer support, and help to improve women's financial literacy and business skills—has become increasingly important to the programme. Loan volumes and values are low, but social impact is high.

Academic research has highlighted a whole series of reasons why microfinance works less well in developed countries than in developing ones.<sup>115</sup> These include:

- Greater competition for customers—the dominance of supermarkets and large chains makes it hard for micro-enterprises to succeed. In developing countries, small shops generally compete against each other.
- Higher relative risks and strong disincentives for potential entrepreneurs—unemployed people face high effective marginal tax rates because means-tested benefits are withdrawn as incomes increase. Self-employment arguably has a heightened disincentive effect since a high proportion of businesses fail. The risk of losing housing benefit, for instance, is likely to be a serious barrier to micro-enterprise. In developing countries, by contrast, the welfare safety net does not exist and these disincentives do not apply.
- Lack of skills among potential entrepreneurs—it is incredibly demanding to run a business. Many people at all income levels lack the skills and experience required for success in areas like book-keeping and marketing. This barrier may be higher for people on low incomes who are more likely to have literacy and numeracy problems.
- Greater alternatives for potential entrepreneurs—self-employment can mean long hours, high risk and low pay. In developed economies there will often be waged alternatives available. Poor people with the skills for self-employment are probably also well-suited for waged employment.
- Regulatory barriers—licences for the most common types of micro-enterprise run by women such as food stalls or child care, are well-intentioned but raise the cost of entry for micro-entrepreneurs. These often do not exist in developing countries.

There is also research suggesting that the costs of delivering microfinance are likely to be higher in developed countries. Key reasons include:

- In developing countries, the task of microfinance is to judge the risk of self-employed borrowers new to formal credit. In developed economies, the task is often a harder one: judging the risk of self-employed borrowers with bad credit records.
- Lack of community cohesion and demand for borrowing makes the 'peer lending' model less applicable. Peer lending in developing countries reduces the cost of loan-making because the groups shift some of the work of screening and enforcement from the lender to the group. In developing countries, group members self-select: people know each other and screen out bad risks because they do not want to be liable for their debts. In the developed world, where peer circles are used at all, lenders often have to place strangers together in groups, losing the potential gains from self-selection and informal contract enforcement.

Of course, not all the barriers apply for all groups. Some excluded segments, such as certain ethnic minorities and former prisoners, often face discrimination in mainstream jobs, so have stronger incentives and pressures to seek self-employment. Some national and ethnic communities will also have high levels of social cohesion that make bad debt less of a potential impediment.

**Research and debate**

There remain some important unanswered questions on affordable credit. Funding research in this area could make a real difference to how government and the financial services sector behave. For instance, the dynamics of credit use are poorly understood, as is the segmentation of people excluded from credit. In addition, longitudinal evaluation of the impact of cheaper credit, including how it affects other credit use and whether it works better for different groups, could improve the allocation of resources in the sector. This might mean supporting a foundation or trust interested in financial exclusion, identifying a third sector lender seeking to try 'action research', or

funding a think tank with relevant expertise such as the **New Economics Foundation**. It could also mean funding a university researcher. The **Personal Finance Research Centre** at the University of Bristol is probably the UK's leading centre of expertise on financial exclusion. Others include the University of Salford, Liverpool John Moores University and Nottingham University.

On debate, relatively few voices have made the argument, set out above, that organisations may need to charge higher interest rates to reach the most excluded. Funding discussion of this issue among key players in the sector, including government, would be a useful contribution, and could be done through **Toynbee Hall's** Transact.

# Savings

Large numbers of people do not have any money saved up—including a particularly high proportion of people on the lowest incomes. Yet savings are very important. They can smooth lumpy income and expenditure, and provide a buffer in the case of expected and unexpected events. In doing this, savings are functionally similar to credit, but without many of the costs.

So why do people not save? It is partly to do with poverty and capability, but also to do with the social context of banking. Everyone finds it hard to save, but those on low incomes have both greater pressures on their income, and reduced support to put money aside.

There are some informal savings clubs that are accessible for people on low incomes, often geared towards Christmas, but these do not always offer a lot of protection or a good deal. Other options include 'normal' savings accounts, hamper or voucher schemes, supermarket saving schemes and credit unions.

The government has recently become a lot more focused on this area. The Saving Gateway is the latest big initiative that, with the Child Trust Fund, looks promising—provided that it captures the financially excluded.

The most straightforward way that a donor could promote savings would be to support a credit union, perhaps by helping a credit union to market its services to financially excluded people. A donor could also support organisations that combine savings with other services, such as supplying credit or facilitating debt repayments. Finally, there is room for new product development in this area, to make it easier for people on low incomes to put money aside.

## Savings and financial exclusion

'Saving money' has two meanings. It is about intentionally putting money aside to be used at some point in the future. But it is also about avoiding spending money, for example, by buying the cheaper of two shirts. Putting money aside can actually save people money, if it prevents them using expensive credit or if it earns interest.

Not everyone who fails to save is financially excluded. Rather, exclusion describes those who do not have the skills or opportunity to save, as well as people who save in informal

or insecure ways, like in a jam jar or under a mattress. These people are disengaged from a particular strand of financial services. It means that they may not be making the most of their income, and they are not financially secure. What is more, if people are financially excluded in other ways (for example, if they use expensive credit), they are less likely to have spare cash to put aside in savings.

The most recent Family Resources Survey found that, in 2005/2006, 28% of households had no savings, rising to 43% for households earning less than £300 per week.<sup>13</sup> A 2006 FSA baseline survey suggested that the numbers of people without savings may be even higher, finding that 43% of all households have no savings at all, with a further 15% only having savings of less than half their monthly income.<sup>15</sup>

This lack of savings is not always because of a lack of motivation. The 2004/2005 Family Resources Survey found that around a third of households would like to save at least £10 a month, but they cannot afford to do so. For those with incomes in the poorest fifth, this rises to almost two thirds.<sup>116</sup>

So a large proportion of Britain does not save much, with a particular problem among the poorest. But these figures need interpreting with some caution as they are likely to fail to capture all the saving that goes on amongst people on low incomes. Some studies only class what goes into formal savings accounts as savings, and there is an interesting issue of language. People do not always recognise that their '*putting money aside*' is in fact saving.

People who do save approach it in several different ways. A study of the behaviour of low-income savers has identified a five-fold typology:<sup>117</sup>

- non-savers;
- passive savers, who have assets not resulting from saving (such as a bequest);
- long-term savers, saving towards an aim such as retirement or education;
- instrumental savers, saving for a particular short-term purpose; and
- rainy-day savers, who save for a non-specific future change in circumstances.

This chapter focuses mainly on instrumental saving and rainy-day saving. Passive saving is not relevant to everyone on low incomes, and long-term saving is for many a step up from the shorter-term instrumental saving and rainy-day

Two thirds of the poorest households would like to save at least £10 a month, but cannot afford to do so.

## Having savings benefits individuals' sense of worth, control and security.

saving. It also tends to involve more complex products, such as pensions. For people on low incomes, saving is initially about putting aside small amounts in order to manage spending, protect against crises and provide for expensive events, like Christmas.

### Why does it matter?

Savings provide a financial buffer, smoothing income and expenditure that fluctuate day by day, and acting as a safety net in an emergency. Having savings makes it easier to cope with unexpected drops in income or unexpected expenses, such as a washing machine breaking down. Savings also make it easier to plan for Christmases, birthdays and holidays.

In all this, savings protect people against having to borrow too much and reduce the need for expensive credit. Savings thus insulate people against the risk of over-indebtedness.

And savings provide people with psychological, as well as actual, security in financial matters.<sup>103</sup> By getting into the habit of saving, people feel more in control and confident with their money. They become more financially included, growing more familiar with financial concepts and institutions.<sup>63</sup>

Some research has found that savings have quite profound effects on personal lives, correlating with reduced relationship breakdown and job loss. However, when researchers at the Personal Finance Research Centre subsequently tried to replicate this analysis, they did not get the same strong results. They did find, however, that having savings seems to benefit individuals' sense of worth, control and security.<sup>118</sup>

Finally, getting into a savings habit matters because it can help with the accumulation of assets in the long term and increased financial stability.

### So why do people not save?

The most obvious reason perhaps is **affordability**. Research by the National Consumer Council and Opinion Leader has found that not having spare cash to save is the most common complaint of non-savers.<sup>119</sup>

But this explanation alone is inadequate. In particular, it cannot explain very well why, among very similar low-income households, some save and others do not. Nor does it explain why some middle-income households do not save.

A basic **lack of financial capability** is sometimes advanced as a reason for people not saving. It seems plausible that some people do not see the importance of saving or do not have the budgeting skills or discipline to set money aside for a rainy day. But this is in

part inconsistent with survey data that most low-income households do recognise the importance of saving.<sup>119</sup>

Nevertheless, knowing that you should do something may not provide enough motivation to do it, even if it is for your own benefit. Most people know that they should eat more fruit and vegetables, but sometimes it is easier not to. Recent research in behavioural economics has suggested a more nuanced explanation than a simple lack of financial capability for why people do not save: it stresses the importance of psychological and institutional factors in influencing saving.<sup>48</sup> These include the habits that people acquire through experience—for instance, a parent saving. They also include individuals' personal finance 'defaults', as ABCUL highlights: *'Convenience of savings is incredibly important. Our experience with low-income employees is that because of the power of payroll deduction they can accumulate savings quickly and painlessly. It seems this is more powerful than a standing order where you "see the money" first.'*<sup>43</sup>

These insights are important because it seems likely that the environment in which low-income households operate puts them at a double disadvantage relative to those on middle incomes. Firstly, they have more urgent claims on their money. Secondly, they operate without the support structures that make saving easy and natural. Key factors include:

### Perception of the savings market

Treasury Select Committee chair John McFall MP has described the savings market as being seen as *'a middle-class market'*.<sup>120</sup> As with other mainstream financial products, people on low incomes can see savings products as *'not for people like us'*, and some people simply do not trust institutions with their money.

### Social context

Average income households follow pathways that offer a clear route into savings almost as a default option (for example, a graduate bank account into a savings account). Those on low incomes are not subject to the same pressures.

### Lack of products

There are limited product options available for people who want to save small amounts. People may not have bank accounts, and even when they do, they stand to benefit less from tax breaks than higher income groups. People on low incomes are less likely to have savings accounts. They may well be paid in cash. All of this matters because, collectively, people on low incomes have fewer 'commitment devices' to get them automatically to set money aside than those on middle incomes.

This is reflected too in the kind of products that are popular with those on low incomes (eg, Christmas clubs). Key features include:

- the ability to save small amounts;
- a specific purpose for saving; and
- a lock-in (or disincentives to use the money) to insulate savings from other pressures.

## Saving options

What then are the saving options open to people on low incomes?

### Informal savings

Research from the Personal Finance Research Centre has found that relatively small numbers of low-income households add money to formal savings products, but many more save up in a range of informal ways. These include putting loose change in jars, giving money to someone outside the home (often mothers), overpaying on prepayment meters, and letting Child Benefit payments build up in an unused bank account.<sup>121</sup>

There are also more organised, but still informal, ways of saving, which tend particularly to be geared towards saving for Christmas. For example, many butchers, toy shops, social clubs and even pubs organise Christmas saving clubs. These are local and convenient, and the emphasis on Christmas is a big feature of low-income saving, as Box 33 shows. But informal schemes offer no financial return on savings. They are sometimes vulnerable to fraud, mismanagement or collapse, and there are several more secure formal saving mechanisms available to low-income families.

### Mainstream savings accounts

One obvious place to save is in a savings account from a bank or building society. Plenty of these accounts have no minimum deposit, no requirement of regular payments, and instant access to the cash—all of which are important features for many people on low incomes. It has been argued that some savings accounts are not suitable for people on low incomes, when withdrawals require a notice period, or no withdrawals are allowed all year. But, as discussed, these features too are popular with some low-income savers, who like to lock money in away from other pressures. So why do more low-income people not have mainstream saving accounts?

On the supply side, not much money is spent marketing savings accounts to low-income consumers, many of whom may only have basic bank accounts. With deposits unlikely to be very large, they have not been seen as attractive customers given the fixed costs in sustaining an account. On the demand side, unlike informal

schemes, money saved in formal accounts is not tied to a particular purpose so may not seem very relevant to potential customers. Also, as the chapter on banking argued, there are both psychological and physical access barriers that stand between some people and banks, which is why many people on low incomes turn to non-mainstream options.

### Credit unions

In the debate surrounding financial exclusion, credit unions usually appear in the discussion of access to affordable credit, which has had a much higher profile than access to savings products. Yet credit unions are as much concerned with promoting savings as they are with providing access to affordable credit. Indeed, member savings are fundamental to the stability of the credit union business model, and many credit unions still require members to save a certain amount or for a certain length of time before they can borrow.

As noted in the chapter on affordable credit, British credit unions tend to aim for a mixed model rather than focusing exclusively on the needs of the financially excluded, and questions are sometimes posed about their reach. However, they often serve people who are outside the financial mainstream, and have some success as a vehicle for promoting very

People save informally by putting loose change in jars, giving money to someone outside the home, and overpaying on prepayment meters.

#### Box 33: The Collapse of Farepak and the importance of Christmas

In October 2006, the Christmas hamper firm Farepak collapsed, losing thousands of families their yearly savings. By the beginning of 2008, more than 113,000 claims had been made to the administrators, amounting to £39m. But payments made to hamper schemes are, in legal terms, prepayments for goods rather than savings deposits, so customers are not covered by the FSA's Financial Services Compensation Scheme. Farepak's administrators estimated that creditors, including customers, would only receive around 5p for each pound owed—just £17 for the average customer.<sup>124</sup>

The scale of losses received high-profile coverage in the press. It spurred a formal Department of Trade and Industry inquiry, and the chair of the Financial Inclusion Taskforce, Brian Pomeroy, was asked to look into Christmas hamper schemes. Pomeroy recommended that secure arrangements be put in place to protect customers' prepayments.<sup>123</sup>

Following the review, the hamper industry has agreed to protect consumers' savings through secure, ring-fenced accounts, the operation of which will be monitored by a new trade body, the Christmas Pre-payments Association.

Pomeroy found that hamper scheme customers are often looking for peace of mind by paying for Christmas in advance, rather than going into debt. But the Farepak experience caused lots of savers to lose confidence in the hamper industry and even in saving altogether, and it highlighted the financial struggle that many low-income families face at Christmas.

Perhaps one good thing has come out of the collapse of Farepak. It has stimulated several new entrants into the Christmas savings industry, where before there were few competitors. For example, three building societies are for the first time offering Christmas saving accounts, in which savings earn high interest and are locked in until November. And while there were some credit unions offering Christmas-branded accounts before 2006, an increasing number entered the market in time for Christmas 2007.

low-level saving. Jackie's story in Box 34 shows how important it is for someone on a very low income to have a secure place to save small amounts.

Research into credit union membership from the Personal Finance Research Centre (PFRC) has found that the biggest reason given for saving with a credit union is its convenience.<sup>103</sup> People can save with them by payroll deduction, Benefit Direct accounts, PayPal, local collection points and outreach collection (eg, in Sure Start children's centres). But some people save with a credit union simply so that they can increase their access to credit: the PFRC research found that half of community-based credit union members identified the ability to borrow from the credit union as a reason for saving, and more than 70% of members use their credit union both to save and to borrow. This is not necessarily a criticism of the model. Savings may not be displacing credit use in every case, but credit unions can promote financial inclusion by encouraging a relationship between saving and borrowing.

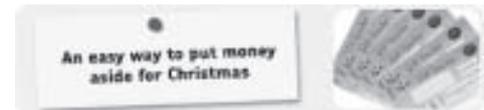
There is evidence that, where they have coverage, credit unions are encouraging people to save who would not otherwise be saving. Almost half of the low-income members surveyed by the PFRC said that they had no other savings except their credit union account.

However, regulatory barriers to credit union growth remain a serious impediment to their expansion as a way of increasing saving. In particular, the membership requirement of a common bond probably makes it harder to acquire customers. It has also been suggested that the credit union name is not always that helpful and that they should re-brand as 'community banks' or 'credit and savings unions'.

### Post office

For years, the post office has been offering saving stamps and generic high street vouchers

to its customers as a way of saving. Now, following government encouragement after the collapse of the hamper firm Farepak (see Box 33), the post office has launched a Christmas savings club in time for people to start saving for Christmas 2008. The post office seems likely to be a particularly valuable provider of savings products for financially excluded people. It offers a trusted and accessible local network, and, through the popularity of the Post Office Card Account, the post office has shown that it can successfully target some of the poorest and most financially excluded people—particularly the unbanked.



The new Post Office Christmas Club is advertised as 'a way to put money aside that's easy and flexible'. Money can be paid into any post office branch, as regularly as the saver wishes. From 1 November, the money saved can be spent in participating high street stores using the Club Card or One4all Gift Vouchers. The money is therefore locked in, concerning both when and how it can be spent. But it is not completely inaccessible—savings can be withdrawn if the account is closed, with a penalty fee of £5. As well as the lock-in feature being appealing to many low-income savers, they are rewarded with a loyalty bonus booklet at the end of the year, to get discounts with participating retailers.

### Hamper and voucher schemes

The hamper market is a way of saving for Christmas. Throughout the year, local agents collect regular, small payments from customers, who are saving to purchase hampers, gifts from catalogues, or high street vouchers. The goods or vouchers are distributed in the weeks before Christmas. (Vouchers now predominate in the market, although the method of saving still tends to be referred to as the 'hamper industry'.)

Since the collapse of Farepak, only two remaining companies specialise in hamper schemes—one of which (Park Group) has more than a 90% share of the market. A number of other firms, including home credit and dairy companies, also sell hampers and vouchers as a secondary business. There has been little research into the hamper market, but industry data suggests that it is used by around 70,000 households. A recent review found that its customer base is very similar to the home credit market, albeit much smaller. This means that there is probably a large overlap with financial exclusion, including some people who have very low and volatile incomes, and little in the way of mainstream financial products.<sup>123</sup>

#### Box 34: 'They have saved our Christmas.'<sup>122</sup>

Jackie was devastated after the collapse of Farepak's Christmas savings club left her £435 out of pocket. She had been saving as much as she could all year to give her family a fun Christmas: 'When my money was lost, I thought our Christmas was gone forever. Even my kids realised it was a disaster.'

At her children's Sure Start play centre, Jackie picked up a leaflet about the local Ipswich and Suffolk Credit Union. It urged anyone who lost money in the Farepak scandal to get in touch. So Jackie met with the credit union, showing her Farepak payment card and two proofs of identity in order to borrow before she had saved with the organisation. She received a cheque for £500 that day.

To repay the loan, Jackie made weekly cash payments at the Sure Start centre. She worked hard to pay off the loan after a few months, then continued to pay money in to save for the next Christmas. 'It is a similar arrangement to Farepak, but there are safeguards to make sure your money is safe.'



Photograph supplied by Esther de Jong

Saving for Christmas through a hamper or voucher scheme has several benefits for people on low incomes who struggle to save:<sup>123</sup>

- **'Double lock-in' on customers' money:** Firstly, it is difficult to access the savings before November, and there can be a penalty charge. Secondly, when Christmas comes, the money returns in the form of goods or vouchers, which insulates it from other financial pressures and removes the temptation to spend it on something else.
- **Home service:** Having a local agent come to the home is convenient and encourages the discipline of regular saving.
- **Social aspects:** Some families have saved with hamper schemes for generations.
- **Suitable for people who mistrust mainstream financial services.**
- **Saving for a specific purpose:** this can be a focus and discipline for those who struggle to save.

However, there are various disadvantages to this kind of saving. Some customers have raised concerns that hampers and other goods saved for are poor value for money, and others complain that vouchers can only be redeemed in a narrow range of shops. Another downside is that no interest is paid by these schemes, although customers seem to be aware of this and tend not to mind.<sup>123</sup>

### Retailer schemes

A number of large retailers, including ASDA, Morrisons and Sainsbury's, run card or stamp-based saving schemes, usually to help customers spread the cost of Christmas. These schemes are convenient for shoppers, who can top up their savings at the checkout, and they usually have the added attraction of financial incentives. For example, ASDA's card pays a bonus in mid-November, depending on the value on the card: £49 on the card receives a £1 bonus; £97 on the card receives a £3 bonus.

Such financial incentives encourage people to save for Christmas, but these schemes do not have the formal lock-in of hamper schemes, as the card can be used to pay for shopping at any time. A particular risk of retail saving schemes is that if the card is lost or stolen, the money can be lost with it, so it is often a relatively insecure way of building up savings.<sup>123</sup> In consumer workshops held for the Treasury's review of Christmas saving schemes, users of retail savings cards reported wanting better protection for money held on these cards, and tighter restrictions on using the card before the Christmas period—that is, a tighter lock-in.

### Government action

Over the last ten years, the government has introduced several initiatives to encourage saving among people on low and moderate incomes. Two such initiatives—the Individual Savings Account (ISA) and the Child Trust Fund—have had a particular impact on the savings market.

## Individual Savings Accounts (ISAs)

The government launched ISAs in 1999 as a replacement for Personal Equity Plans (PEPs) and Tax-Exempt Special Savings Accounts (TESSAs). More than 17 million people (one in three adults) now have an ISA, and they have had higher levels of take-up among lower-income groups than their predecessors.<sup>71</sup> However, it seems unlikely that ISAs are playing a large part in tackling financial exclusion, both because their tax relief benefits are of little use to those on the lowest incomes, and because they can be difficult to understand.

## Child Trust Fund

The government launched the Child Trust Fund in 2005, as a tax-free savings account into which all newborn children are automatically enrolled. Every child born after September 2002 receives at least £250 from the government, plus another £250 at age seven. Lower-income families receive double this amount. Family and friends can contribute up to £1,200 per year to the account, and money can only be withdrawn by the child, when he or she turns 18.

By 2007, around 2.5 million children had a Child Trust Fund account, and there were 120 providers and distributors of Child Trust Funds, including banks and credit unions.<sup>71</sup>

## The impact of these initiatives

Through the introduction of ISAs and the Child Trust Fund, many low-income families have

been reached. The theory behind them is also good—encouraging saving in a positive way and doing it on a universal basis rather than by stigmatising means-testing.

However, there is not a lot of evidence to show that either initiative has encouraged a savings habit amongst financially excluded families who did not previously save. The most positive piece of information comes from Children's Mutual, which estimates that a quarter of children from low-income families are benefiting from additional private contributions. Arguably, the tax-free nature of the schemes is a weak incentive for the poorest families who do not pay income tax. And Child Trust Funds in particular, while an excellent idea for building up an asset for children living in low-income households, have suffered from lower than expected proactive take-up. In 2006, nearly half a million households—a third of eligible families—had not used their vouchers, possibly due to the complexity of the market. Children in these families do not miss out though, because there is a default account for vouchers that are not proactively invested.

In a 2006 report, the Treasury Select Committee concluded that *'savings, and the problems of making saving worthwhile and beneficial for those on lower incomes, are integral to any effective strategy on financial inclusion'* and that saving ought to be accorded a higher priority in the government's financial inclusion strategy.<sup>63</sup> The government has responded to this by prioritising an idea that was first piloted in 2002: the Saving Gateway.



Photograph supplied by istockphoto



Photograph supplied by Esther de Jong

## Saving Gateway

The Saving Gateway is a scheme for people on low incomes, in which the government provides a cash contribution to match individual savings. Its objectives are two-fold:

- *'Kick-start a saving habit among people on lower incomes by providing a strong incentive to save through matching; and*
- *Promote financial inclusion through encouraging people to engage with mainstream financial services.*<sup>125</sup>

The scheme has been piloted twice, both times administered by Halifax. In the first pilot, beginning in 2002, 1,500 people in particular areas were eligible to open a Saving Gateway account if they were of working age and receiving certain benefits. They could save up to £25 a month, and savings could be withdrawn with no notice. When the account matured after 18 months, the government made a contribution by matching the highest balance attained during the lifetime of the account, at the rate of £1 for £1.<sup>126</sup>

An evaluation of the pilot from researchers at the University of Bristol was positive. After the accounts had matured, a high proportion of participants said that they felt more in charge of their life and more secure financially. Compared with non-participants in a reference group,

Saving Gateway participants were more likely to have become *'rainy-day savers'* or to *'save to spend'*, after originally describing themselves as non-savers. And several months after maturity, more than nine in ten participants still had a savings account of some kind, with four in ten still saving regularly.

The second Saving Gateway pilot was much larger in scale than the first, with nearly 22,000 participants. Depending on the area, the match rates ranged from 20p to £1 for every £1 saved, and the contribution limit ranged from £25 to £125 a month. The eligibility criteria were also much broader, including families with an income of up to £50,000.

The results from this second pilot were much more ambiguous. The 22,000 participants did make the most of their accounts, saving a total of around £15m, and earning a total match of more than £5m. However, very few of them were new to saving, and a robust evaluation by Ipsos MORI and the Institute for Fiscal Studies concluded that it was likely that these savings displaced money that the participants would have saved elsewhere:

*'There is no discernable evidence that SG2 accounts led to higher overall "net wealth". Among the higher income group there is statistically significant evidence that balances in other financial assets were reduced at the*

*same time that balances in saving accounts were increased, suggesting a diversion of funds between assets.’<sup>127</sup>*

There were some associated results. This pilot did introduce some people to saving for the first time (around 9% of participants), and many of these commented that the accounts helped them to get into the habit of saving. Some also said that it made it easier to plan for the future. However, there was very disappointing take-up of training and education that was offered alongside the Gateway.

The biggest problem with the second Saving Gateway pilot seems to have been its failure to reach the financially excluded: if success means kick-starting a saving habit, then this cannot be achieved for the majority of participants who were already in the saving habit. The evaluators found: *‘Those who were more likely to open accounts tended to be those with high levels of education and numeracy, those in work, owner occupiers and those who owned other investments, and those with no long-term health problems ... we found little evidence of pre-existing financial exclusion among account openers.’<sup>127</sup>*

The government seems partly to have disregarded the weaknesses of the second pilot, giving the findings a rather generous interpretation. It has focused on the success of matching as an incentive to save, and the possibility of attracting new savers.<sup>71</sup>

In the 2008 Budget, the Chancellor announced that the Saving Gateway will be rolled out from 2010. In line with the success of the first

pilot and the drawbacks of the second pilot, it will only be available to people on the lowest incomes, in receipt of certain benefits. This gives a potential eligible population of around eight million. The monthly match limit is likely to be £25, and the match rate has yet to be decided. Savers will be able to access their money (but not the match) at any point during the two-year life of their account. And on maturity, the account will roll over into an ISA.

From the evidence that NPC has seen on the Saving Gateway pilots and other research on the saving behaviour of low-income households, a national Saving Gateway could have potential to draw in new savers who are otherwise financially excluded. The incentive is clear and easy to understand; the money is accessible; and the maturity period is fairly short. However, as the second pilot highlights, the biggest challenge will be in targeting the most financially excluded individuals—that is, those who stand to benefit the most. There will need to be more careful partnering with accessible intermediary organisations, including mainstream banks and, for those who mistrust such institutions, third sector organisations such as credit unions, Citizens Advice Bureaux and social housing providers.

### ‘Save Xmas’ campaign

The government’s final initiative to increase saving among financially excluded households is a £1m ‘Save Xmas’ campaign, launched in 2007 after the collapse of Farepak (see Box 33). This is an awareness-raising consumer education campaign, to help consumers decide how to make sure they can pay for Christmas.



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The Office of Fair Trading has produced materials, including leaflets and a short film, and it is working with charities and community groups to help them to help consumers, by explaining the options available for Christmas saving. The government has reported some positives from the campaign. For example, *'70% of attendees at campaign events reported being unsure about their options for Christmas saving before attending the events; over 90% of attendees reported knowing more about their options, and where to go for more information, after these events.'*<sup>62</sup> This is encouraging. However, it is not yet clear that the events have actually led to changed behaviour or that they have reached enough people. Government is funding the Office of Fair Trading to continue the campaign.

### Other financial inclusion initiatives

Finally, it is worth mentioning that the government's work to support financial capability initiatives and increase access to affordable credit—particularly through supporting credit unions—should have a knock-on effect for the savings of low-income households. More financially capable individuals will be more likely to save, and those who spend less on expensive credit will have more spare money to put aside.

### What is the role of donors?

Government interest in savings is increasing, with the Saving Gateway in particular having the potential to tackle financial exclusion in this field. However, it remains to be seen how far this initiative will be successful in reaching the most excluded people, and how far it will create a savings habit in those it does reach.

More than two in five British households have no savings whatsoever, and many more have very little in the way of savings. Even with the implementation of the Saving Gateway from 2010, plus the other saving options open to people on low incomes, it looks like more will need to be done to tackle this element of financial exclusion.

Any donor activity to reduce poverty, increase income and tackle other aspects of financial exclusion will help, by freeing up money for financially excluded people to save. Supporting the take-up and use of bank accounts is also an indirect route into creating opportunities to save.

### Supporting bank accounts

Donors can promote bank accounts and electronic payment of wages—people with bank accounts are more likely to access other products including savings accounts, because it means they already have a relationship with



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a financial institution. Also, electronic payment of wages increases the security of money and reduces the risk of cash in hand 'celebration' spending. Any activity then to promote take-up of accounts may improve saving as well.<sup>39</sup>

But there are also some targeted options open to donors.

### Supporting providers of savings products

The obvious third sector contenders here are credit unions, many of which might benefit from quite engaged donor involvement. This could be around capacity-building or helping a credit union with marketing and targeting the most financially excluded people, bearing in mind that most credit unions have a mixed customer base—they do not only serve the financially excluded. And helping a credit union to attract more savers will have the knock-on benefit of increasing that organisation's capital, which can then be used to increase the supply of affordable credit.

Less obviously, donors could also support organisations that combine savings with other activities, such as loan or debt repayments or rent payments.

### Saving alongside loan or debt repayments

Perhaps the most promising way of supporting saving alongside other services is by funding organisations that provide savings facilities alongside (or following) loan or debt repayments.

This is an approach that policy-makers have somewhat shied away from on the understandable logic that interest on a loan or debt is likely to be higher than that payable on savings, and so debts should be paid off before putting money into savings.

This is certainly a valid consideration. However, if saving over the long term is a learned habit, there may be a case for encouraging it. And where savings are set aside as part of a debt management plan, interest in any case tends to be frozen.

The upside of the model is that it can transform behaviour, with positive effects (for example, making the transition from effectively paying

for Christmas after it happens to paying for it in advance). This reduces the chance of people needing to borrow even more, and acts as a cushion to avoid future trouble.

The Community Development Finance Institution **East Lancs Moneyline** (ELM) is partnering with HBOS (Halifax Bank of Scotland) to give borrowers the opportunity to save alongside their loan. Most of ELM's customers are financially excluded (which is why they are accessing a third sector loan) and the CDFI found that only a tiny proportion of its first customers had any money put aside: of the first 2,000 customers, fewer than ten had savings. A customer survey found that borrowers were interested in finding a way to put money to one side, so ELM formed a partnership with HBOS.

The savings account can be opened by ELM staff, who have the ability to approve identity and address documents in-house. There is no minimum saving amount, and interest is paid four times a year. Withdrawals can only be made twice a year, at seven days' notice, and ELM has found that customers really appreciate this 'lock-in', with many only making one withdrawal a year, at Christmas. ELM has opened more than 700 savings accounts.

As ELM has found, to maximise success, any saving element should last beyond the lifetime of a loan. Credit unions have a strong model here, because they encourage borrowers to save as they repay their loan, and continue saving once the loan is paid off.

Incorporating a savings element into debt repayments is increasingly a feature of debt management plans (DMPs). The agencies that administer these plans consult an over-indebted person's creditors and usually persuade them to freeze interest and charges. After creditors have agreed reduced payments, DMPs allow the borrower to make one regular affordable payment to the agency, which is then distributed by the agency to all creditors.

Some debt management agencies factor savings into people's repayment plans, so they build up an asset while they get out of over-indebtedness. These plans usually last several years, so any savings habit gained is likely not to be trivial. Models have also emerged that seek to ensure saving endures beyond the lifetime of the DMP. The debt advice charity **Christians Against Poverty** (CAP) offers each client a personal account, through which a single payment is distributed to creditors, and a small amount put aside for savings each week or month. This account can be kept after debts have been paid off, as a savings and bill payment account (see Box 35). By supporting the work of CAP, donors can support a service that is more holistic than debt advice or savings work alone.

### Box 35: Christians Against Poverty

Christians Against Poverty (CAP) helps people on low incomes to overcome serious money problems. It offers in-depth face-to-face debt advice through a national network of 72 centres.

After a debt counsellor has visited the client to go through paperwork and work out a budget, CAP negotiates with creditors to freeze interest, stop charges and make sure the repayment amount is affordable. Clients can then manage repayments through a unique tool—the CAP Account. While they get used to this tool, clients usually stay in touch with their local debt counsellor. Then all but the most vulnerable are 'migrated' to a phone-based caseworker from CAP's Client Support Unit in head office.

The CAP Account is a way of administering a debt management plan. Individuals make a single payment into their personal account, either weekly or monthly, which CAP then relays to multiple creditors on their behalf. Unlike other debt management providers, CAP's system includes priority debts (such as rent payments) as well as secondary debts (such as credit cards).

The CAP Account also offers a savings facility. Building savings into debt repayment is widely acknowledged to be a worthwhile approach, because it can start to break the cycle of debt. However, it rarely happens in practice. CAP advisers build provision for savings into their clients' budgets, and all clients end up putting some money aside in their CAP Account, even if it is just a total of a few pounds. The average is £107. Before having a CAP Account, most of these people did not have savings, and would draw on credit for Christmas or emergencies. But CAP has heard many stories of people using their savings to pay for their first debt-free Christmas.

CAP's model looks towards sustainable poverty relief. The process that clients have to go through—learning about budgeting, good debt and bad debt—is educational. And importantly, 80% of clients continue to use their CAP account after debts are paid off, both as a simple bill payment service and as a way to continue saving. This financial cushion can spark a lasting change in the way that CAP clients think about money, and reduce the impact of future crises.



Photograph supplied by istockphoto

Scaling further the use of savings in DMPs depends on credit providers accepting that putting money aside for saving should be included in assessments of a household's minimum required disposable income. There are some indications of this happening. The **Consumer Credit Counselling Service** (CCCS), a large debt advice charity, is currently investigating introducing saving into DMPs. This would be a very significant step forward since the charity deals with a high proportion of the UK's unsecured debt.

Also important, **Citizens Advice** has argued in evidence to the Treasury Select Committee that the Common Financial Statement (an initiative from the **Money Advice Trust** and British Bankers' Association) could be amended to include provision for savings as standard, when budgeting for people in debt. The Common Financial Statement is used in negotiations between debt advisers and creditors. It is a standard tool, showing income and expenditure to work out the money available to service debt.

### Saving with rent

A slightly different model is a scheme whereby social landlords collect money for savings at the same time as the rent payment. The great advantage is that, like repayments on credit, people can get into a habit. Also, social landlords can reach some of the most financially excluded people.

But very few social landlords offer such schemes, and they are often geared towards buying the property rather than everyday savings. Some potential savers might be put

off because they do not want their landlord to know how much they have in savings. Another complication is that, if tenant savings increase to over 1% of the housing association's turnover, it would need to be authorised by the FSA as a deposit-taker.<sup>63</sup>

Another option here is for donors to help to foster close links between social housing providers and credit unions.

### Developing new products

As well as supporting provision of savings products for people on low incomes, there may be a role for more engaged donors to play in developing new products. Research from the National Consumer Council has highlighted a gap here: *'we need to look at ways of making it easier for people to contribute savings on a regular basis.'*<sup>119</sup> Donors could get involved by exploring alternative delivery channels and partnerships, perhaps through community organisations and charities. However, product development and developing product delivery are rarely easy options, and they would require careful research.

### What kind of products could be created?

Some interesting ideas have emerged in international policy that could potentially be replicated in the UK, perhaps most notably the *'Save More Tomorrow'* initiative. This is a scheme developed by two behavioural economists to overcome people's natural tendency, despite good intentions, to put off saving more. It works by allowing individuals to commit portions of their future gains in income

(such as wage increases) to saving. Early reports from the US are that, where this model has been tried, it has increased savings rates, including among low-income workers.<sup>128</sup> It is not clear how applicable it would be to those subsisting on benefits, but it is certainly an option to explore further.<sup>48</sup>

An even simpler idea is to pilot attaching a savings vehicle to basic bank accounts. This is based on the idea that people engage in what economists call *'mental accounting'*, compartmentalising wealth and spending into distinct budget categories, such as savings, rent and entertainment.<sup>39</sup> Policy-makers overseas have noticed that people show different degrees of willingness to spend from these accounts. It has been argued that simply by labelling part of the money going into an account 'savings', people hold on to it and let wealth accumulate. This is part of the thinking behind the Child Trust Fund of course. But it has not been tried in relation to basic bank accounts.

In Puerto Rico, Banco Popular's *Acceso Popular* account has been successful in extending savings accounts to low-income unbanked people.<sup>129</sup> The account looks rather like an enhanced basic bank account that charges a \$1 monthly fee. It has no minimum balance, free ATM transactions, and electronic bill payment. But it is really distinctive in that, to encourage savings, *Acceso Popular* has a savings 'pocket' into which small sums (initially \$5 per month) are automatically transferred from the *Acceso Popular* transaction account. The savings pocket pays modest interest. Funds may only

be withdrawn by seeing a cashier and account holders must pay a fee to see a teller more than once a month to discourage withdrawals. Banco Popular opened nearly 60,000 such accounts in 2001, with half of those activating the savings pocket in their accounts.

### Educating consumers

Finally, donors could focus more on addressing the demand side of the problem. The products available may not be perfect, but there are some (such as credit unions), and potential savers need to be persuaded that saving is worth it. Once persuaded, they also need information and advice to be able to make sensible choices about products, knowing the risks and benefits of what is available. They may also need support to access services (as **Toynbee Hall's** SAFE programme does for banking, for example).

However, evidence here is mixed. The Saving Gateway had education offered alongside it through either a free DVD or classes, but there was very low take-up. The biggest reason was that account holders simply did not feel that they needed financial training. This was true across all incomes.

Stimulating demand may involve raising awareness and providing information about saving in general, perhaps through a money education charity such as **Credit Action**. Or it may involve raising awareness of particular providers and products, such as credit unions and their Christmas savings accounts.



Photograph supplied by Credit Action

# Insurance

Insurance provides security and protection in the event of a crisis. Yet only half of the poorest households are insured against theft or damage to their property, risking real hardship following a burglary, fire or flood.

Individuals can find it difficult to understand, access or afford insurance. However, although price seems to be the most important of these obstacles, lowering cost alone does not appear to be enough to increase take-up. There are wider issues of poverty and deprivation at play.

Until recently, access to insurance had a low profile on the financial exclusion agenda. Most activity is now coming from the industry itself, prompted by government, the Financial Inclusion Taskforce and social housing providers.

But gaps remain, including: lack of appropriate products for various target markets; where appropriate products do exist, lack of geographical coverage; and where there is coverage, lack of take-up.

The main third sector organisations playing a role in relation to insurance are housing associations—primarily through insurance with rent schemes. Some Community Development Finance Institutions (CDFIs) and credit unions want to provide a full range of insurance products, but plans are not always very well developed.

The wider charitable sector influences demand for insurance by tackling poverty and providing financial education. It also influences product supply by lobbying financial service providers. But overall, insurance is relatively neglected. The opportunities for donors to fund ‘off the shelf’ are limited to funding research or third sector lenders to try product innovation.

As with other fairly technical aspects of financial exclusion (such as banking), this is an area that could benefit from engaged donors bringing charities and financial service providers together. Donors can also help by providing financial expertise. Finally, those who see insurance exclusion primarily as an issue of poverty may wish to fund lobbying to increase incomes and to tackle urban deprivation.

## What is insurance exclusion?

Considering what financial exclusion means in relation to insurance poses a definitional problem.

It is possible to get insurance to protect against a wide range of risks, including burglary, flood, crashing a car, losing income, or even damaging a body part. People clearly do not have to take out every insurance policy going in order to be financially included, and the absence of some does not necessarily imply exclusion.

For example, motor insurance is a legal requirement for drivers but irrelevant for those not using a car; travel insurance is only important for those who travel; only a minority of people at any income level buy income protection insurance—not having it ‘includes’ one in an unprotected majority.

This section concentrates on home contents insurance as the most basic, important and relevant insurance for people at all income levels. NPC accepts the consensus view that, without it, a household is potentially financially excluded because home contents insurance meets a crucial test: average-income households generally have it but low-income ones do not. And, as Peter Kenway at the New Policy Institute argues: *‘If the scope is restricted to products that [meet this test], it is unclear whether anything apart from contents insurance actually qualifies.’*<sup>130</sup>

The other reason to concentrate on the absence of home contents insurance as the key indicator of exclusion is latent demand for it. Research from the Association of British Insurers (ABI) has found that, among those living on low incomes, home contents insurance is one of the most wanted and least accessed types of insurance.<sup>131</sup>

## Why does it matter?

Insurance provides security and protection in the event of a crisis. Without it, people who have very little disposable income or savings will find themselves struggling to cope if they experience a burglary, fire or flood.

What is more, insurance brings families peace of mind, and the uninsured can suffer from anxiety, knowing that they cannot protect themselves against risk, whether or not a crisis happens.<sup>132</sup>

Insurance provides security and protection in the event of a crisis. Without it, people who have little disposable income find themselves struggling to cope if they experience a burglary, fire or flood.

People living in deprived areas are the least likely to be insured against a crisis and the most likely to experience a crisis.

The consequences of not having home contents insurance were brought to public attention in the aftermath of the summer 2007 floods. Estimates suggested that as many as one in four flooded properties was uninsured.<sup>133</sup> The ABI suggested that flooding cost the insurance industry £3bn.<sup>134</sup> It is likely then that the cost of uninsured property amounted to millions of pounds—possibly hundreds of millions—with much of this borne by poor households.

### Who is affected?

Over half of Britain's poorest households lack home contents insurance, compared with just one in five of those on average incomes and one in ten of the richest households.<sup>16</sup>

Households with low incomes, few savings, and facing financial difficulties are disproportionately likely to be uninsured.<sup>132</sup> There are particularly low take-up rates of home contents insurance in economically and socially deprived areas.<sup>135</sup> This means that the people with the least disposable income or savings are the people who are least likely to be insured against a crisis.

Moreover, they are more likely to face difficulties than households on average incomes, because they live in the riskiest areas. We know, for instance, that households without home contents insurance are three times more likely to be burgled than those with insurance.<sup>13</sup>

In addition, certain groups of people often struggle to access insurance because of personal circumstances that make them a perceived or actual high risk. Several charities that advocate on behalf of ex-offenders, older people and people with health problems, for example, have argued that insurers unfairly exclude those client groups from affordable insurance, on the basis of incorrect assessments of risk. Box 36 and Box 37 look into this in more detail.



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## Causes of insurance exclusion

As with other areas of financial exclusion, low take-up of insurance reflects a mix of different factors including financial capability, product design and delivery, and poverty. It seems likely that the most important is the last of these. However, the evidence is somewhat contradictory, and the debate bears close scrutiny.

A starting point is to think about it from the perspective of an individual who is uninsured. From this point of view, it is possible to imagine several practical reasons for not taking out insurance. Some poor households:

- cannot get insurance, because no one offers it in their area;
- do not want insurance, because they do not think it is important or cannot see its value;
- do not want insurance, because they do not trust financial institutions and there are few 'default' pressures on them to take it out;
- cannot afford insurance, because it is too expensive.

It is possible to weigh the evidence against these hypotheses, although in truth, data is fairly scarce and does not give a complete picture. However, the information that is available suggests that the third and fourth of these propositions offer a better explanation than the first two. Taking them in turn:

### Access barriers

Campaigners sometimes complain about insurance companies 'redlining' particular neighbourhoods (that is, excluding them completely from sales). But research from the 1990s suggested that the extent of redlining was very limited, and it is not a subject that has been given much publicity in recent years.<sup>63</sup> In addition, the ABI has found that outright refusal by insurance companies to cover customers is a minor issue—only 1% of low-income groups surveyed had ever been refused home contents insurance or life insurance.

Another type of access barrier that looks more pertinent is that most insurance companies require payments to be paid by monthly direct debit, which excludes people who do not use a bank account, and can also make things difficult for people who prefer to budget on a weekly basis.

### Demand barriers

Independent financial advisers classify insurance as an 'aversion product'—many people do not take it out because they do not like to think about bad things that might happen, and people do not gain anything concrete by paying for it.

Yet the ABI has found that demand for home contents insurance is nearly as high amongst low-income households as it is amongst average-income households. Even though fewer than half of the poorest households are insured, 79% still believe that insurance is important.<sup>131</sup> Of course, what people say and do are not always the same, but this does give lie to the simple view that low take-up is a question of awareness.

### Trust barriers and spending priorities

Social networks play a large part in explaining why some people do not have a particular financial product. They often have family and friends who also lack that product. Social norms are important in determining behaviour. People tend to stay with the default option, so if there is no social pressure to take out insurance, or a common mistrust of financial institutions, people in these networks are unlikely to break away from the norm.

There is also an argument that some individuals could buy insurance if they wanted to, but they judge (or misjudge) the risks that they are subject to and find that it is not worth it. Other people arguably have the wrong spending priorities.

This is a fairly controversial explanation, and some parts are more compelling than others. Charities strongly argue against wrongly prioritised spending, suggesting that most spending goes on urgent needs. However, the public as a whole is bad at predicting risk so it would be unsurprising if people on low incomes valued it incorrectly.

There is likely to be a broader problem with poor information. Individuals exhibit confusion about the (undeniable) complexity of products available. This also has a supply-side dimension. The doorstep distribution network (*'the man from the Pru'*) no longer exists as firms have switched to cheaper sales channels. Relatively little marketing from mainstream insurers is aimed at people on low incomes and only modest amounts are aimed at the uninsured. Rather, insurance companies target those who are already insured, to persuade them to switch supplier.<sup>132</sup>

### Affordability barriers

On affordability, cost does seem to be a barrier to take-up: 63% of uninsured poor households say that their *'budget does not stretch'*.<sup>131</sup> This chimes with anecdotal feedback heard by NPC from both charities and financial services firms.

Attributing lack of take-up to affordability makes intuitive sense. But it leaves as much unanswered as it explains. In particular, why is it that low-income households cannot afford insurance? Possible explanations include:

## Box 36: Health and insurance

### Tracy's story<sup>136</sup>

*'When I was 17, I was diagnosed with Hodgkin's Lymphoma. Five years later I finished my treatment and have never had a recurrence. I'm 40 now.*

*I've travelled all over the world and never bothered telling insurers about my earlier diagnosis. I just didn't think it was relevant. But when my father collapsed while on a cruise and had to make a claim, it shook me—he could have been left with a massive bill if the company had decided not to pay out.*

*So a year later when I was going to France, I decided to declare my childhood diagnosis. I ended up having to call a number of insurers for cover and was shocked at the size of the premiums I was offered. Some were almost double the normal amount. A lady at one well-known insurer told me I was such a high risk that she nearly had to refuse me insurance.*

*Hearing that my cancer was still considered a risk after 23 years was distressing. But I knew that there was very little chance of my previous Hodgkin's being a problem and had the confidence to dispute this with the woman. She went away and spoke with the underwriters who agreed that my cancer history was of very little risk. The premium the company then offered me was far more reasonable.*

*Many people are not as lucky as me. Many don't have the confidence to question when given an insurance quote. I know people that just think, "sod it" and travel uninsured.'*

Since 1996, the Disability Discrimination Act has made it unlawful to refuse insurance or charge higher premiums to someone with an illness or disability, unless the insurance company can show that the condition results in statistically higher risks.

Yet charities have found that people with disabilities, illnesses or mental health problems are far less likely than the general population to be insured. This is partly because of an overlap with poverty—people on low incomes in general are less likely to be insured. But it is also because disability prevents some people from accessing financial services, and many are being illegally discriminated against.

**Macmillan Cancer Support** has done some research into travel insurance being a problem for people who have had cancer.<sup>136</sup> It found that even people who have been free of cancer for many years can find it extremely difficult to get travel insurance. Two in five people affected by cancer are quoted higher premiums for travel insurance, and one in seventeen is refused insurance altogether.

People taking part in Macmillan's research also reported insensitive treatment by customer service centre staff, saying that it makes the whole process even more harrowing. *'I went to several companies. Some were ok, but many were insensitive, talking about the "immovable object". It was very upsetting.'*

Macmillan now provides a list of companies that specialise in providing travel insurance for people affected by cancer, as part of its Better Deal campaign. And the FSA has funded a financial capability toolkit aimed at Macmillan's network of professionals to provide information on money issues for people affected by cancer.

Mental health charities are also active in this space. **Mind** receives many calls and letters from people who have, or have had, mental health problems and cannot get insurance cover.<sup>137</sup> It provides guidance for these people and signposts them to appropriate providers. There are now a few insurance schemes in this area. For example, **MDF The Bipolar Organisation** set up the first travel insurance scheme for people with manic depression or bipolar disorder, liaising with brokers to arrange travel insurance for its members.

## Households without home contents insurance are three times more likely to be burgled than those with insurance.

- The product being too expensive—mainstream insurance is uncompetitive or mis-priced.
- Households being too poor—it is not that people could afford insurance if they were better informed, and products were a bit cheaper. Rather, households cannot afford it at any market price.

The evidence on these explanations is incomplete, but they raise some intriguing questions.

### Products

It is clear that insurance is more expensive in absolute terms for people on low incomes than those on middle incomes. Insurance providers tend to argue that this is because of objective factors. In particular, they point to the risk profile of poor households—those on low incomes often live in areas with higher rates of crime and accidents—which is reflected in higher premiums.

It is difficult to second-guess this argument: insurance firms hold most of the data and, as a New Policy Institute report points out, it has not been subject to independent verification.<sup>130</sup> Critics say there is a lack of competition for low-end customers and that risk assessment is cruder than it need be. But if this were true, one would expect new providers to move into this space as they would with any other untapped market. Emerging third sector attempts to provide insurance will help to establish whether there is a competitive failure here.

A slightly different argument can be made on the cost of products, namely that the way they are currently designed means that they are more expensive than they otherwise need to be to meet the needs of low-income people. For example, the minimum value of property insured is usually around £15,000 to £20,000, which is more than the possessions of many low-income households are worth. Some policies have an excess that is more than a person could afford in the event of a claim.

This does sound like a reasonable argument. It seems likely that products with cheaper features could be offered at a lower price. However, all financial products have a fixed cost and a variable element. It is not clear how much of the price of insurance is inherent in the design features that make it 'gold-plated' for the needs of low-income households. Products with less expensive features may be priced only slightly lower. Again, third sector efforts will help establish the evidence base here.

### Poverty

It has already been suggested that poverty indirectly affects insurance premiums through area deprivation—poor areas are higher risk.

But there is also a broader theoretical argument and some supporting analysis that poverty is important.

On the one hand, conventional economic theory would predict that people without much money have very strong incentives to protect what they have by taking out insurance (since they are least able to cope with losing it). On the other though, people on low incomes face two countervailing forces. First, they may have few (or low value) possessions. Second, with little disposable income, the demands of day-to-day spending weigh heavily. Together, these may lead people to value the benefit of current cash in hand over the potential future cost of larger losses. There is some evidence for this view reported by charities. And the ABI has found that 22% of people on low incomes believed they had '*nothing worth insuring*'.<sup>138</sup>

This feeds into a broader debate. In *The Persistence of Poverty*, the US philosopher and economist Charles Karelis points out that, contrary to standard economics, '*people who don't have much*' give less weight to risks they face than '*people who have a lot*'.<sup>139</sup> A lot of writing on insurance and financial exclusion seems to find this surprising, pointing out, as above, that the poor need insurance most as they have least money and other resources with which to cope in a catastrophe. Karelis offers an explanation for why people on low incomes do not seem to think like this: people who already have many problems have less incentive to avoid new problems.

### Conclusion

So of all these barriers to people having home contents insurance, which is the most important?

The evidence available is not conclusive but it seems likely that it is a combination of the factors suggested above, with poverty a particularly important influence. Demand is also important, but this is more about trust and social influence rather than awareness or stated demand. There is a barrier when it comes to translating demand into behaviour.

Some excluded people will be likely to respond to better access and making products cheaper. But others will not and are, failing an increase in their income, unlikely to take out insurance.

### Government action

Despite being named as a priority aspect of financial exclusion in the government's very first activity in the area (the 1999 Policy Action Team 14 report *Access to Financial Services*), insurance has only recently become a focus for financial inclusion policy. Now as then, half of the poorest households are uninsured.

In 2007, the government asked the Financial Inclusion Taskforce to gather and analyse evidence on financial inclusion and insurance. The Taskforce established an insurance working group (IWG) with members from the insurance industry and the ABI, to advise government on supply and demand barriers, and how these barriers might be overcome.

The IWG found that people living in rented accommodation are particularly at risk of insurance exclusion, so the government is focusing its policy response on home contents cover for this group, distinguishing between those in privately- and socially-rented housing. In response to the IWG's recommendations, the Department for Work and Pensions plans to establish a 'financial inclusion champions' initiative, with £12m funding from the Financial Inclusion Fund. *'This will provide dedicated members of staff with experience in working on financial inclusion to work with local authorities, social landlords and other potential financial inclusion intermediaries.'*<sup>62</sup>

As well as providing these members of staff, the government intends to promote and support insurance schemes offered by social landlords, although it is not yet clear what this entails in practice. Also, so that people in privately-rented accommodation are not forgotten, the government wants the Financial Inclusion Taskforce *'to ensure that appropriate low-cost home contents insurance products are available for people living on low incomes in privately-rented accommodation.'*<sup>62</sup>

## Industry action

Represented by the ABI, the industry has said it will partner with the government to promote appropriate products to low-income consumers. To date, it has helped develop 'insurance with rent' schemes for social housing tenants and published good practice guides with the Housing Corporation. This has involved working closely with housing associations.

Insurance with rent schemes are more suitable for many low-income tenants than mainstream home contents insurance policies, for several reasons:

- They are tailored to their target market by using social landlords as a specific distribution channel. They bring together the private and third sectors.
- The insurance premium is collected alongside rent, so there is no hassle, and a bank account is not required.
- They provide low levels of minimum cover, and premiums are cheap—typically £1 or £2 a week.
- There are often no minimum security requirements for the property, and no excess for claims.

### Box 37: Ex-offenders and UNLOCK

The Ministry of Justice has identified 'finance, benefit and debt' as reasons for re-offending. As a result, this is one of its seven pathways in its reducing re-offending action plan.<sup>140</sup> The Ministry's findings are supported by recent research from the Legal Services Research Centre (LSRC), which has found that the relationship between financial exclusion and prison sentences is 'compelling'.<sup>141</sup> The LSRC's work examined the effectiveness of money advice in different outreach locations, such as family centres, housing associations and prisons. It found that:

- 40% of prisoners reported having no current account or other financial products, compared to 5% of non-prison interviewees.
- 90% of prison interviewees reported not receiving any advice about their financial difficulties, compared to 31% of non-prison interviewees.
- 38% reported that their debt problems had got worse since being in prison, and 12% reported falling into debt since being in prison.

One significant area of need for ex-offenders on leaving prison is insurance. All prisoners leave prison with an unspent conviction, while they are still in their 'rehabilitation period'. This typically ranges from five years for a fine to forever for prison sentences over 30 months. Disclosure of unspent convictions almost always means total refusal for cover, or unaffordable premiums, both for ex-offenders and for the households to which they return on leaving prison. This is a barrier to resettlement. Families have to forfeit their buildings and home contents insurance. Non-disclosure is illegal, and will invalidate insurance or lead to prosecution.

UNLOCK, 'the national association for reformed offenders', was the first organisation to identify the insurance-related problems that prisoners face. Before the charity got involved, no insurance company would provide any sort of insurance for ex-offenders, other than in rare cases where it would be at a very expensive premium. But in 1999, UNLOCK managed to convince a Lloyd's Syndicate to offer reasonably-priced insurance to ex-offenders. There is now a panel of nine brokers. So far, the providers have had no fraudulent claims.

UNLOCK publicises the service to its members, and stimulates demand by raising awareness in the media and giving people direct information and advice.

Recently, UNLOCK established a partnership with the British Insurance Brokers Association to set up a national forum on unspent convictions. This will engage senior representatives of large insurance companies, and will publicise the availability of insurance to reformed offenders through a jointly-branded booklet. UNLOCK also has a relationship with the ABI, which has accepted that the industry is failing to risk-price adequately when it comes to ex-offenders.

UNLOCK campaigns and delivers services to help prisoners and ex-offenders to reintegrate into society. Around 80% of its work relates to financial exclusion. As well as tackling insurance exclusion, UNLOCK makes bank accounts more widely available to prisoners and ex-offenders, and it trains prison educators and other third parties in how to deliver financial education to prisoners.

These features address some of the barriers to insurance take up. But it is not yet clear that they are an adequate answer to insurance exclusion. This is for three reasons:

- First, they only relate to social housing—missing private renters and low-income homeowners.
- Second, the coverage of insurance with rent schemes is still patchy.
- Third, the actual take-up of schemes has not been impressive to date. It is unclear

## The main third sector activity to tackle insurance exclusion comes from housing association insurance with rent schemes.

whether this is because of delivery issues like marketing and awareness, because it is early days and schemes need to reach maturity, or for more fundamental reasons.

On the first of these points, half of the poorest 10% of households do not live in social housing.<sup>142</sup> Many of these individuals live in areas of high crime and low security. They may have short-term housing tenure, and they can be excluded by prohibitively high minimum levels of cover. Research indicates that there is demand here—for example, the ABI found that a third of private renters would be likely to take up the option of buying home contents insurance through their local authority, if it was offered.<sup>131</sup> But very little is available to meet their needs. The Financial Inclusion Taskforce has recommended that *'the insurance industry take immediate steps to develop simple products that meet the needs of private tenants'*,<sup>62</sup> but it remains to be seen what action will be taken.

On the second point, coverage of insurance with rent schemes within social housing, there is better news. The National Housing Federation has recently launched the scheme *My Home* in conjunction with Jardine Lloyd Thompson Tenant Risks, available to all its members (1,300 housing associations). However, there is not yet any data on how many social landlords have adopted *My Home*. Norwich Union underwrites 100 insurance with rent schemes, and Royal and SunAlliance underwrites 200.<sup>71</sup>

On the third point, take-up of insurance with rent schemes, the track-record is not encouraging. ABI research has found that half of social renters say that they would be likely to take up insurance if it was offered by their local

authority.<sup>131</sup> But where housing associations have offered such schemes, they report far lower rates than this in practice.

The reasons for this are unclear. It may be that the schemes are too new. It may be that they have been inadequately marketed. Some analysts have argued that there is a lack of awareness of specific schemes, and social landlords, government and insurers need to promote them with greater vigour.<sup>143</sup>

Alternatively, it may be that there is a more fundamental problem. Charles Karelis, cited earlier, suggests that there need to be quite large gains in income for the poorest households to start becoming more risk averse. If the underlying problem is one of poverty, incomes may need to be increased, or insurance schemes subsidised well below cost to increase take-up.

### Charitable activity

The main activity by third sector organisations to tackle insurance exclusion comes from housing associations offering insurance with rent schemes.

More widely, some CDFIs and credit unions are moving into this space. Most credit unions offer life savings and loan protection insurance at no cost to the member and some have developed a range of wider products as well. But third sector lenders face constraints here, similar to the constraints that they face when providing credit. Most notably, there is a lack of finance for product development, and (sometimes) inadequate skills and capacity to market and distribute products at scale.



Other charitable activity to tackle insurance exclusion is modest. The majority seems to take place with reference to discrete kinds of exclusion facing particular groups, rather than exclusion among low-income households as a whole. For example, many ex-offenders, older people and people with health problems (such as cancer and HIV) have struggled to get particular kinds of insurance in the past.

As Box 36 and Box 37 show, charities here tend to be involved in highlighting market failure, campaigning for change, and advising excluded individuals.

## What is the role of donors?

The challenge for donors interested in tackling insurance exclusion is two-fold. First, it is not precisely clear what the problem is—there is a series of hypotheses and incomplete data rather than a specific problem with established

ways of tackling it. Second, there are relatively few ‘entry points’ (ie, things to fund) for an interested philanthropist.

What donors should do arguably depends on how they define the problem. Table 9 suggests a framework for thinking about what kind of activity is worth supporting.

Its starting point is to think about the problem of insurance exclusion slightly differently, inverting the question ‘*why aren’t people insured?*’ and asking instead, ‘*why aren’t insurers selling to uninsured people?*’

Table 9 shows that there are three different groups of people making up the excluded: those who could be insured profitably with mainstream products; those who could be insured profitably with alternative products; and those who cannot be insured profitably at all.

**Table 9: Why insurers do not insure some people**

Issue	Underlying problem	Solution	Role of the third sector
<b>There are lots of people who are not insured but could be, profitably, with existing mainstream products and marketing.</b>	A market failure. Firms have strong incentives to sell their wares if they can do so profitably. There is likely to be a barrier of information or delivery channels.	Make market forces work.	<p>Provide information to firms or build a business case by research.</p> <p>Develop better risk management tools.</p> <p>Help deliver products by partnering with insurance firms.</p> <p>Fund support to bridge trust barriers.</p>
<b>There are lots of people who are not insured but could be, profitably, with alternative, cheaper products and marketing.</b>	A market failure concerning innovation or information. Firms have strong incentives to create new products. It is likely that they do not understand different parts of the market or they face barriers around reputational risk.	Make market forces work.	<p>Help deliver products by partnerships with insurance firms (eg, insurance with rent schemes).</p> <p>Enter the market as a social enterprise or charitable provider (eg, new CDFI schemes).</p> <p>Provide information to firms.</p> <p>Build a business case through research and demonstration projects, showing that there is a market.</p> <p>Fund support to bridge trust barriers.</p>
<b>There are groups of people who cannot be profitably insured at all.</b>	The risks are so high and incomes so low that they are not profitable—even with redesigned products and marketing.	<p>A non-market solution. The options are:</p> <p>Subsidise insurance or offer it on a ‘social’ basis;</p> <p>Tackle the factors that make customers unprofitable (such as risk, low income or skills).</p>	<p>Lobby government to regulate or fund.</p> <p>Area regeneration, anti-poverty initiatives, education.</p>

Broadly speaking, most third sector activity and thinking on insurance has seen exclusion as relating to the first and second groups. The thinking behind insurance with rent schemes is that the market can, ultimately, be made to work if people on low incomes are served more sensitively.

As noted above, however, the challenge for donors is that, to date, the potential market for cheaper products has not yet been established—take-up of alternative products remains low. We do not really know why this is—it could plausibly be because of implementation problems. Or it could be because of reasons less susceptible to change.

NPC's view is that it is important to try and make insurance with rent approaches work. Donors should support activity that maximises the availability, coverage and publicity of insurance to serve that part of the 'excluded' market that is sensitive to price.

The main options here include:

- designing new products;
- tailoring existing products to new audiences;
- expanding coverage of existing products, perhaps as a way of pooling risks; and
- increasing awareness of existing products.

Philanthropists could bring financial expertise as well as funding to the area of insurance exclusion. But there are few straightforward funding options here, and any of these suggestions might require a more engaged donor. The easiest approach is probably to fund third sector lenders to develop insurance products of their own and to promote these products. Alternatively, a donor could try to develop partnerships between charities and financial institutions, both to develop suitable products and to improve the promotion of these products to the people who would benefit most.

What we do not know is how big this market is in practice, and what proportion of the group of people who do not have insurance will respond to cheaper, better products. For those who will not, a non-market solution is needed. Here, options include:

- Supporting lobbying organisations that try to reduce poverty: there are few points of entry, but an engaged donor could work with existing lobbying charities.
- Reducing risk: premiums are driven up by properties being insecure and high crime rates. It is possible for donors to take action here, by improving security and tackling crime.



Photograph supplied by istockphoto

# Over-indebtedness

The UK has high overall levels of consumer debt and, within that, significant amounts of problem debt. This falls disproportionately on those with low incomes, including the financially excluded.

By volume of charities, there is a large sector in place to help over-indebted people, especially through debt advice, where there are around 1,000 providers. Yet funding is under pressure—at a time when changes in the wider economy may be increasing demand for debt services.

The good news on debt advice is that its (short-term) impact is well evidenced. Donors can make a difference by expanding and improving activity. There are particular challenges in relation to encouraging people to seek help early and making debt advice more preventative. There is a gap in post-debt advice guidance to help people stay out of debt.

In the long run, a key question facing the sector is financial sustainability. We do not yet know what the right level or mix of services is. But whatever it is, long-term costs should mainly be borne by the financial services industry and the government. There is a role for donors in supporting lobbying and campaigning to deliver greater financial security.

## Over-indebtedness and financial exclusion

As the chapter on affordable credit discusses, credit is a useful tool. It helps people to manage their money, provides access to cash in an emergency, and makes it possible to spread out the cost of assets, such as property, over time.

But some people get into trouble with their credit. Debt can become a burden and even spiral out of control, reducing income and causing anxiety. Problem debt, or ‘over-indebtedness’, occurs when people struggle to repay what they owe, suffering real hardship as a result.<sup>17</sup> In the worst cases, consumer credit debt sits alongside ‘priority debt’ such as rent arrears and Council Tax arrears.

Not everyone with problem debt may be classed as financially excluded. Indeed, as Malcolm Hurlston from the **Consumer Credit Counselling Service** argues, perhaps the over-indebted are ‘over-included’, having accessed financial services inappropriately.<sup>144</sup> Nevertheless, debt is an integral part of the financial exclusion picture.

Over-indebtedness is often an indicator of financial exclusion. For example, severe debt problems can ruin people’s credit history, excluding them from mainstream credit. If they need credit in the future, they may turn to expensive sub-prime lenders, where the high cost of credit makes them more prone to over-indebtedness. Arrears on priority debts can have grave consequences, including threat of prison and repossession of homes.

Poor financial capability—often one element of financial exclusion—can cause debt troubles through unwise use of credit. And when people do get into financial trouble, financial inclusion means being able to find a way out of it.

So over-indebtedness may not necessarily be a symptom of financial exclusion, but the two are often closely connected. And there are pragmatic reasons to include problem debt in this report: debt advice charities are some of the biggest players on the financial exclusion scene.

## The over-indebted

UK personal debt is growing by £1m every five minutes. At the end of April 2008, it stood at £1.4 trillion, with a growth rate of 8% over the last year. Average household debt, excluding mortgages, was £9,223.<sup>145</sup>

Such growth in personal borrowing is not necessarily to the detriment of consumers, and it does not necessarily cause over-indebtedness. However, it stands to reason that problem debt increases as total debt increases.

There is no magic number that defines over-indebtedness. Indicators can be objective (including debt-income ratios and late payments) or subjective (that is, how individuals judge their own situations). Both types of evidence suggest that over-indebtedness is suffered by a significant minority of consumers. For example, on objective measures:

- An average of 292 people are declared bankrupt or insolvent every day.<sup>18</sup>
- 14,000 homes were repossessed in the first half of 2007—almost 30% higher than the year before.<sup>17</sup> This rise may be down to the tightening credit conditions that have now become a credit crunch, with lenders wanting to take fewer risks with customers who are falling behind with payments.
- 7% of households are at least two months behind on at least one credit or bill payment.<sup>17</sup>

UK personal debt is growing by £1m every five minutes. 292 people are declared bankrupt or insolvent every day.

Debt can become a burden and spiral out of control, and people suffer real hardship as a result.

It is changing personal circumstances — not irresponsible borrowing — that is the most common trigger of troublesome debt.

The poorest households are most likely to experience debt as a burden, yet it is these households that are least able to manage with such a burden.

The way that people consider their own debt is also an important subjective measure of over-indebtedness. The government's fourth annual report on over-indebtedness in the UK reports that there has been little change in people's view of their ability to pay their credit commitments, despite large increases in borrowing.<sup>17</sup> Nevertheless, the number of people who claim to struggle is not insignificant. The report found that 13% of households contain someone who identifies credit or bill repayments as representing a heavy burden. The FSA baseline survey published in Spring 2006 found that 1.5 million people were falling behind with bills and credit commitments. A further three million found it 'a constant struggle to keep up with commitments'.<sup>12</sup>

A final indicator of the scale of over-indebtedness comes from the numbers who seek debt advice from **Citizens Advice Bureaux**. In 2007, debt became the number one issue advised on in bureaux, accounting for a third of all enquiries. This amounts to 6,600 new debt problems every day.<sup>146</sup>

So who is over-indebted? The millions of people having trouble with debt certainly include people from all walks of life, but there are several characteristics that appear to be correlated with over-indebtedness. Over-represented groups include tenants, lone parents, younger adults and families where the head of household is not working full time.<sup>147</sup>

The most important factor, however, appears to be low income, which overlaps with the groups mentioned above. Poorer households have a disproportionate share of people who believe their debt to be a burden. A report from the Personal Finance Research Centre has found that more than half of all households with problem debt have incomes of less than £7,500 a year.<sup>148</sup> The government's latest report on over-indebtedness found that the lowest-income households show the largest percentages satisfying each of its indebtedness indicators.<sup>17</sup> The relationship between problem debt and poverty means that levels of arrears are strongly associated with deprived areas and the experience of hardship.<sup>147</sup>

## Why does it matter?

### It is expensive

The previous section shows that the poorest households are the most likely to experience debt as a burden, yet it is these households that are least able to manage with such a financial burden. Being over-indebted is expensive, with interest and charges mounting up, potentially in excess of the original amounts borrowed. The poorest families can find this hard to cope with on an already tight budget and with few savings to fall back on. Like the use of expensive sub-prime credit, excess debts can exacerbate poverty.

### It is stressful

Problem debt is bad for health, causing stress, anxiety, guilt, and loss of self-esteem—often at a surprising degree of intensity. Research from the Legal Services Research Centre (LSRC) has found that 89% of the debt advice clients it surveyed report worrying about their money problems 'most' or 'all' of the time. '48% of clients described the impact of problems on their health as "great", and 43% felt that their health had suffered "to some extent". Around three in five clients reported having received treatment, medication or counselling as a result.'<sup>21</sup> On this evidence, the majority of people who seek help for their debt problems are experiencing significant mental or physical health problems as a result of their over-indebtedness.

### It causes relationship problems

Related to the stress of over-indebtedness is the relationship problems it causes. A survey from AXA in 2006 found that more than ten million people suffer such problems because of money worries.<sup>149</sup> The LSRC research found that debt problems were isolating, with people being ashamed of their situation, as well as not being able to afford to go out socially. Almost half of debt advice clients stated that problems had a negative effect on relationships with partners, and qualitative interviews revealed particularly distressing impacts on parents' relationships with their children.<sup>21</sup>

### It is bad for employment

Again related to the stress that it causes, over-indebtedness has been found to have a negative effect on people's working life. Some people worry about moving from benefits into work because of the income gap it would leave in the interim. Others work very long hours to try and ease financial pressures. And a surprising number have taken time off or left work altogether because of debt worries. Of the debt advice clients that the LSRC surveyed, 12% suggested that debt problems led to them giving up their job, 19% had taken time off work because of money worries, and 15% worked longer hours. It is likely that a further group will have experienced diminished productivity because of debt problems.

### It has procedural consequences

Over-indebtedness can lead to disconnection of utilities, the bailiffs coming round, or bankruptcy. It can involve being taken to court and can even end in homelessness. In 2007, The Council of Mortgage Lenders reported that 27,100 homes were repossessed by lenders after people fell behind with repayments.<sup>150</sup> There is a possible crossover with financial exclusion here: a 2007 BBC investigation that looked at 7,000 court

hearings found that lenders that specialise in sub-prime mortgages represent over 70% of repossession cases.<sup>151</sup>

### It may have wider social costs

Though the causality is hard to unpick, debt is linked to child poverty. Debt problems can cause families to live below benefit levels and cut back on essentials, affecting health, education and leisure opportunities. It also interacts with offending. Almost a fifth of prisoners experience problems with rent arrears, unpaid bills and fines.<sup>152</sup> Finally, debt plays a large part in causing homelessness and blocking routes out of homelessness—again, often because of rent arrears.

### Causes of over-indebtedness

As the stories in Box 38 show, debt problems arise for many different reasons, and attributing responsibility is not always straightforward.

#### Financial exclusion

The previous chapters have shown that not having access to basic financial products such as bank accounts, insurance and cheap credit makes life more unstable, stressful and expensive. Financial instability, inflated costs, and lack of a security can soon lead to money troubles.

#### Changing circumstances

Contrary to the widespread assumption that over-indebtedness is usually a result of irresponsible borrowing, the most common trigger of troublesome debt appears to be changing personal circumstances.<sup>21</sup> Losing a job, becoming ill, separating from a partner or having a baby can all be a big financial shock, particularly for the poorest people, and make affordable repayments unaffordable.

#### Poor money management

Of course, there are times when the fault lies with the borrower. One study has found that one in ten households with financial difficulties says that over-commitment is the cause of their debt problems.<sup>148</sup> Some people knowingly take on excessive debt, and others are unaware of their responsibilities or do not consider the implications of their borrowing.

However, irresponsible borrowing may not arise from moral failure. It can be a result of poor financial literacy, a lack of sensible budgeting skills, impulsive shopping or even gambling problems. Sometimes it comes out of desperation and an immediate need for cash, despite knowing that it will be a struggle to repay. For example, charities have told NPC of people using credit cards to pay their mortgages.

### Box 38: Debt and financial exclusion

When Gemma had an accident and had to give up work, she decided that the most sensible thing she could do was to be proactive in contacting her creditors and ask them to reduce repayment levels so that she could keep up with her credit commitments. So Gemma went to see her bank to organise a longer repayment period for a personal loan. After she explained the situation, the bank manager agreed to lower the repayments from £128 a month to £87. But he also said that Gemma was now considered a higher risk. Despite the fact that she had acted responsibly and had not missed a payment, the interest rate was increased from 7.4% to 19.5%.<sup>1</sup>

Barry went to his Citizens Advice Bureau in Scotland after getting into trouble with £3,000 of credit from three different companies, which he had been given despite being on incapacity benefit for ten years. Barry had no means of repaying these debts. He suffered from mental health problems, which were made worse by the resultant financial stress and harassment from his creditors.<sup>38</sup>

A Citizens Advice Bureau in Lancashire reported that Donna, a lone parent in receipt of income support, owed over £12,000 to four creditors. The bureau discussed bankruptcy with Donna, but she could not afford to raise £250 for the deposit fee. Although the bureau had negotiated token payments of £1 per month to her creditors, at this rate it would take her over 250 years to repay the total debt. As a consequence, Donna had to deal with unpleasant calls from debt collection agencies acting for one of the creditors, which she found very distressing.<sup>38</sup>

### Poverty

As discussed above, the poorest households are over-represented when it comes to problem debt. Low income may be a cause of over-indebtedness, as families borrow to make ends meet, adapt to changing circumstances, or pay for existing debt.

### External factors

The cause of over-indebtedness does not always rest with the situation or behaviour of the borrower. Market changes and interest rate rises can lead to personal debt getting out of control. So too can creditor behaviour, including practices such as automatic increases in credit limits and inappropriate marketing.

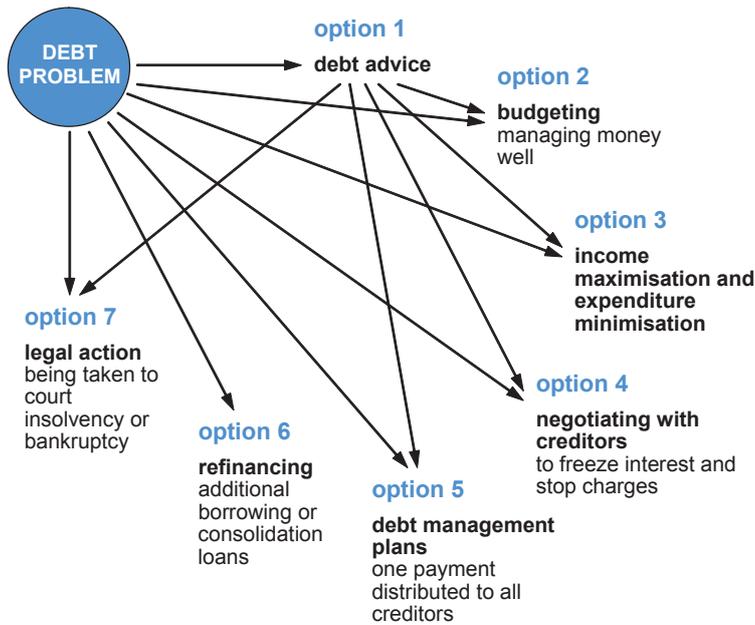
Charities are reporting that, in the wake of the credit crunch, there has been a surge in demand for debt advice services—though not always from financially excluded people. Increasing numbers are struggling with their mortgages or being threatened with repossession.<sup>153</sup>

### Solving over-indebtedness

The best way to solve debt problems is of course to prevent them from happening in the first place. This would involve making sure that the causes listed above do not occur, by eradicating poverty, making people's lives more stable, helping people to manage their money better, insisting that creditors lend responsibly, and ensuring that the economy is stable. As one government report puts it: *'The fundamental*

In the wake of the credit crunch, there has been a surge in demand for debt advice services.

Figure 9: Options for getting out of debt



Adapted from diagram in the Griffiths Commission on Personal Debt (2005) *What price credit?*

Note: there is no path from 'debt advice' to 'refinancing' because this is rarely an option that advisers will recommend. In most cases, refinancing only serves to increase the amount owed.

*requirements for minimising problem debt are a stable, well-managed economy and an efficient, well-regulated market for personal credit in which lenders lend responsibly and borrowers borrow responsibly, with access to appropriate information and advice.*<sup>117</sup>

This is no simple list of demands. Some of these things are obviously easier to control than others, and despite the good work of money education and anti-poverty charities, debt remains a big problem in Britain. Most existing work to tackle over-indebtedness focuses on solving the problem after it has occurred, taking the form of money education and self-help for those who are already in trouble, and debt advice. Figure 9 illustrates the steps that can be taken to solve problem debt.



Photograph supplied by Citizens Advice

## Self-help

While it is surely optimal for people to manage their money well to prevent debt crisis, education is still important once a crisis has occurred, both to solve the current situation and to prevent it from happening again. This report's chapter on financial capability goes into this in more detail.

Many organisations produce materials and websites aimed at helping people to organise their finances, budget and negotiate with creditors to agree manageable repayments and frozen charges. For example, the national money education charity **Credit Action** has two core guides to help people make their money go further and take control of their debts. These 'Moneymanuals' are good quality, clear and pitched at a basic level. They are supported by two websites.

Yet fundamental questions have been raised about the extent to which people can help themselves out of debt trouble, and the effectiveness of borrowers trying to negotiate directly with creditors. Such negotiation is usually crucial to getting out of debt, because it ideally leads to charges and interest being frozen, preventing the debt from escalating.

Citizens Advice research found that 'although half the debt clients had tried to negotiate reduced payments with creditors themselves before seeking advice from the bureau, most had not received sympathetic responses from their creditors.'<sup>138</sup>

## Debt advice

When people are beyond the point of helping themselves to get out of debt, they need to seek advice from elsewhere and turn to debt advice providers.

Services come in many different forms, both free and fee-charging, and from light-touch to in-depth. Help typically revolves around a debt adviser who offers, crucially, an independent view.

Services can include budgeting advice, income maximisation (such as benefits checks) and expenditure minimisation (such as finding a cheaper energy supplier).

Often the debt adviser will also liaise with creditors to try and reach an agreement on affordable repayments and to freeze interest and charges. As mentioned above, creditors appear to be more likely to cooperate when a third party is advocating on behalf of the borrower. Advisers can also offer legal help, including information on court action, Individual Voluntary Arrangements (IVAs), bankruptcy and County Court administration orders.

**Box 39: Does debt advice work?**

Debt advice has two sets of outcomes. One, getting someone out of a debt crisis; and two, preventing future trouble. The available evidence suggests that it works for the former goal, but it is unclear whether or not it works for the latter. (Friends Provident Foundation has commissioned Warwick University to fill this gap.)

Establishing that debt advice works has been surprisingly difficult. Though lots of charities measure the number of clients they see, their satisfaction, or the amount of debt they reschedule, they have not tracked clients over the long term and there has been no counterfactual evidence. It is possible to argue that people would have got out of trouble anyway.

The Legal Services Research Centre and the Ministry of Justice have recently tried to fill this gap, through four studies that made up the *Impact of Debt Advice Research Project*.<sup>21</sup> One of the studies had a control group and, although it had small samples and possible selection bias issues, its findings are promising. It seems that debt advice:

- **Gets people out of difficulty**—The randomised control trial demonstrated, at a 20-week follow up, that those who received advice had significantly improved financial circumstances compared to those who did not receive advice. The study that followed people up after a year found that average debt levels had fallen from £19,000 to £11,000.
- **Reduces stress and improves health**—The number of those worrying ‘all’ or ‘most’ of the time reduced from 89% at initial advice to 59% at six months and just 31% at twelve months. The longitudinal study found that 69% of participants reported improved health a year after receiving debt advice. Such reduced stress is likely to have a financial benefit to society: NPC has heard reports of GPs ‘prescribing’ debt advice for stress, instead of medication.
- **Prevents procedural consequences**—At six months, 74% believed that the advice they received had helped them to avoid legal action. This decreased to 54% after 12 months.
- **Improves financial knowledge, skills and confidence**—84% of those receiving advice reported feeling more in control of their finances as a result of advice, and the same percentage felt more knowledgeable about financial matters.

However, the picture on the long-term impact of debt advice is less clear. We do not yet know whether debt advice:

**Bolsters financial independence**—Few clients in the *Impact of debt advice research project* studies said that they would handle problems themselves if they got into financial trouble again. Almost three in four said that they would go back to their adviser for help. This does not necessarily mean that the advice has failed to improve their financial capability, although that is a possibility. It does at least reflect confidence in the service they received, but may also be an indication of the vulnerability of the advice agency clients that the study surveyed.

**Prevents people from getting into trouble again**—The National Debtline found that 43% of its clients who received debt advice no longer had a debt three years later.<sup>154</sup> This is reflected in other longitudinal studies. However, it may be giving a misleading impression. First, there is no counterfactual evidence for people who did not get debt advice; some of them will have addressed their own problems. Second, the sample has other problems: it describes people potentially living under payment arrangements, who are managed so that they cannot borrow money. Third, the figures relate to everyone, not only to people who are financially excluded.

Finally, some debt advice agencies draw up and administer debt management plans (DMPs) on behalf of the borrower. After creditors have agreed reduced payments, DMPs allow the borrower to make one regular affordable payment, which is then distributed by the agency to all creditors.

**Delivering debt advice**

There are various delivery channels for debt advice. Telephone and internet advice are usually the most efficient options, being quickest and cheapest. For example, the **Money Advice Trust’s** telephone helpline, National Debtline, offers a service that costs £24 per call. Phone and internet advice can give the borrower the reassurance of confidentiality and anonymity, and it can overcome access problems for people with mobility impairments.

Rather different is face-to-face debt advice, which is the focus of much financial exclusion policy. Debt advice charities providing the service argue that it particularly suits vulnerable people who may have literacy, numeracy or financial capability problems, or those who want

someone to look at their bills and statements. It works well in outreach locations—especially health settings, prisons, credit union offices and housing offices.<sup>21</sup> Face-to-face help also has a therapeutic dimension, providing personal support in a very stressful situation.

The key drawback of face-to-face advice is that it tends to be more time-consuming, more in-depth, and therefore more expensive than online or phone advice. The **Citizens Advice Bureaux** that NPC analysts visited reported that the Legal Services Commission pays a fixed fee of around £200 for each debt case—and that this amount is at times insufficient.

Box 39 looks in detail at the impact of debt advice.

**Government response**

The government has several strands of activity to tackle over-indebtedness.

It has an overall debt action plan, derived from the 2003 Consumer Credit White Paper. The Department for Business, Enterprise

“I would pay whoever was frightening me the most. I was frightened every time the phone rang and every time someone knocked at the door.”<sup>3</sup>

“The burden you have to carry with all this debt just makes your depression worse. There doesn’t seem to be any light at the end of the tunnel and you just get more and more trapped in poverty.”<sup>7</sup>

and Regulatory Reform (BERR, the then Department of Trade and Industry) reports on it annually. The White Paper also introduced a series of regulatory changes, including making advertising and consumer credit agreements more transparent, as well as provisions realised in the Consumer Credit Act 2006, which sets a tougher fitness test for credit licences and makes it easier for consumers to challenge unfair credit agreements.

On funding, the government supports debt advice in a number of different contexts:

- BERR provides general funding to **Citizens Advice** and also supports the phone-based debt advice service offered by the National Debtline.
- Debt advice is also funded by central government as part of Legal Aid. The Legal Services Commission (LSC) supports advice agencies to help over-indebted people on means-tested benefits to get casework legal support from specialist advisers. Debt cases are the largest source of volume of cases through the civil courts. The LSC funded 83,790 debt cases during 2006/2007. More than 250 Citizens Advice Bureaux have contracts with the LSC.
- Finally, the government has made expanding face-to-face debt advice a priority under the Financial Inclusion Fund. It put £47.5m into increasing the supply under the first round of funding, later increased to £50m. Because funding was back-loaded, this worked out as £17.5m in 2006/2007, and £31m in 2007/2008. The LSC has also been given £6m from the Financial Inclusion Fund to pilot money advice outreach, for example, in GP surgeries.

Of these initiatives, the FIF money in particular seems to be making a difference to activity levels. It has paid for 16 partnerships of debt advice agencies to increase the availability of advice, aiming to be targeted at particularly financially excluded communities and social groups. It has increased debt advice capacity by around 350 new debt advisers, who saw nearly 12,000 clients in the first year. Centre managers reported that this funding significantly increased the number of clients they could offer advice to, and there were examples of significantly reduced waiting times for debt advice, such as from six to two weeks.<sup>155</sup> However, NPC has not seen any data so far on the demographics of the groups reached. If the last couple of years have been boom time for debt advice, the main concern now is its sustainability. In 2006, for example, a number of witnesses to the Treasury Select Committee worried that *‘the short-term nature of the funding offered so far places those debt advisers at risk of redundancy almost as soon as they have developed their expertise’*.<sup>63</sup> Since then the government has announced an extra

£76m for face-to-face debt advice between 2008 and 2011, about a sixth less per year not adjusted for inflation.

This alone would constitute a substantial cut, but the tightening of the Financial Inclusion Fund sits alongside reforms to reduce legal aid bills—most notably by the introduction of a fixed fee system. Civil legal aid is being integrated with local authority funded advice to form jointly-funded services.<sup>156</sup>

Collectively, these changes are significantly impacting the debt advice sector at a time when demand is likely to grow.

Many advice agencies have integrated use of both Financial Inclusion Fund and LSC money, using the latter for those clients who meet the Legal Aid means-test and the former for those who do not. The impact of the funding squeeze is that some clients are now unfunded. Moreover, advice given as LSC-funded casework is increasingly strictly defined in terms of what it can and cannot cover. People who have debt problems often have a wide range of other needs. Charities report that a greater emphasis on volumes seen is driving advisers to exclude broader welfare issues and personal support.

It is worth noting here that other tiers of government also fund debt advice. Councils play an important role. However, there is not good data on how much councils are spending. We do know that just under half of councils (44%) provide it—often through more than one channel. Around half of these do so through Citizens Advice Bureaux, and nearly half do so within their own benefits department. Others provide money advice within housing departments or agencies like **Shelter**.<sup>157</sup> There is anecdotal evidence from debt advice agencies that NPC visited that council funding for debt advice is under a lot of pressure as local authorities focus on other commitments.

## Industry response

Banks offer some debt advice to their customers but counselling incurs a charge and banks only advise their own customers. Banks therefore often refer to charitable providers such as the **Consumer Credit Counselling Service (CCCS)**. In the year to September 2007, CCCS got 88,000 referrals from lenders, representing almost half of the total referrals it received.<sup>158</sup>

Most creditors pay what are known as *‘fair share contributions’* to CCCS and some other organisations, donating to the charity a proportion (usually 10%) of whatever debt the charity helps clients to repay. CCCS raised almost £15m this way in 2006.

The 2008 Banking Code includes a promise to be *‘sympathetic and positive when we consider any financial difficulties you may have’*.

Banks also provide some support under CSR initiatives. For instance, in 2001 the RBS group embarked on a six-year, £3.7m partnership with the national charity, **Money Advice Trust**. A lot of bank spending in this regard though tends to be on financial capability work rather than debt advice *per se*.

## The charitable debt advice sector

By spending and by number of organisations, most charitable activity to tackle financial exclusion in the UK occurs in the debt advice sector. According to the **Money Advice Trust**, there are around 1,000 different organisations offering advice in the UK.<sup>42</sup> Most are quite

small, giving advice face-to-face or over the phone. There is also a large private sector advice industry that charges fees and includes insolvency practitioners and debt consolidation companies.

As already discussed, most funding for free debt advice comes from local and national government, grant-making bodies, and, through 'fair share' schemes, financial services institutions.

But not all debt advice focuses on financial exclusion. Much will be provided to broader groups, including some who are well-off or on middle incomes.

Table 10: Free-to-client debt advice providers

Agency	Type of advice	Number of clients	Relevant income
<b>Citizens Advice</b>	Mainly face-to-face, with some phone	The 433 bureaux received 1.7 million debt enquiries in 2006/2007, accounting for a third of all enquiries. <sup>146</sup> 2 million clients in total in 2006/2007. <sup>159</sup>	Citizens Advice centrally: £16m for money advice. <sup>159</sup> Total bureaux income: £141m. <sup>158</sup> If debt accounts for a third of all enquiries, we can estimate that relevant income is around £47m. Note: these figures overlap.
<b>Citizens Advice Scotland</b>	Mainly face-to-face, with some phone	90,000 new debt issues in 2005/2006. <sup>160</sup>	Total income for Scottish bureaux: £12.8m. If debt accounts for a third of all enquiries, we can estimate that relevant income is around £4.3m. Note: this does not take into account income of Citizens Advice Scotland.
<b>Consumer Credit Counselling Service</b>	Phone and internet	294,000 calls to helpline. 90,000 counselling appointments. 73,000 people on debt management plans. 10,000 people used online service. <sup>161</sup>	£15m <sup>161</sup>
<b>National Debtline</b>	Phone	90,000 clients. <sup>160</sup>	£4m <sup>162</sup>
<b>AdviceUK members (around 300 debt advice organisations)</b>	Face-to-face and phone	210,000 clients (excluding National Debtline). <sup>160</sup>	Unclear. Member income ranges from a few thousand pounds for the smallest organisations, to £3m for Christians Against Poverty. NPC estimates that relevant income is in the region of around £10m.
<b>Community Legal Advice</b>	Various	40,000 debt issues. <sup>160</sup>	Unclear. Lots of funding goes through other providers.
<b>Payplan</b>	Phone and internet	120,000 clients. <sup>160</sup>	NPC has not identified data.
<b>Local authority</b>	Face-to-face	Unclear. 33% of local authorities provide debt advice, but this is often through agencies like Citizens Advice Bureaux. <sup>157</sup>	Unclear. A lot of local authority funding goes through other agencies already covered, such as Citizens Advice Bureaux.
<b>Other organisations, such as community and faith groups</b>	Various	Unknown. There are thought to be 1,000 organisations giving debt advice. <sup>42</sup> Around 400 are Citizens Advice Bureaux and 300 are AdviceUK members, accounted for above. Of the rest, NPC estimates that fewer than 100 are dedicated to debt advice, and most provide debt advice as part of their offering.	Very approximately £22m—NPC estimate, based on 1,000 organisations having an average income of £220,000, and spending 10% of it on debt advice.
			<b>Total income: £114m</b>

**Box 40: Sophie's story<sup>3</sup>**

*'I only discovered we were in debt after the bailiffs came round. My husband, Alan, was in charge of the finances. I felt helpless and scared. At times, at the end of his wages we'd have £1 to last the week. I'd buy loaves of bread and keep them in the freezer, and we just drank water and ate toast. I thank God that my son Anthony was so young that he didn't eat very much.*

*Alan and I had just contacted CAP (Christians Against Poverty) when he left me for another woman. CAP adjusted my payments and I found paying into my CAP Account was really easy. I was able to save up enough money to take the kids on a weekend holiday for the first time ever. And when my washing machine broke I was able to buy a brand new one with the money I'd saved.*

*Now I can finally hold my head up high. I've got some self-respect, some dignity again. It's great not to dread the postman any more, or not be fearful to open my door when there's a knock.'*

Table 10 sets out some of the most important organisations in the free-to-client debt advice sector. A small number of names—including **Citizens Advice**, National Debtline and **CCCS**—dominate the field. Citizens Advice and National Debtline receive much of the available public funding for debt advice. But there are also hundreds or even thousands of smaller charities and community groups that offer some form of money advice. Many of these operate with few resources, sometimes without fixed premises, and serving a wide range of individuals.

**AdviceUK**, the UK's largest network of advice-providing organisations, coordinates and offers support and resources to many of these organisations. Members include tiny faith groups, law centres, refuges and student unions, as well as National Debtline itself. One of its member organisations, which has a national network of centres, is **Christians Against Poverty (CAP)**, worth highlighting because of its unusual and effective model (see Box 35 in the chapter on savings, and Box 40 in this chapter). CAP incorporates savings and bill payment into its debt management plans, and is one of only a handful of debt advice providers that migrate people from (expensive) face-to-face advice to (cheaper) phone advice. This



Photograph supplied by Citizens Advice

system increases efficiency and allows centre managers to focus on face-to-face counselling.

Another charity that provides start-up support and training for community organisations that want to provide debt advice is **Community Money Advice** (see Box 41).

Research by the Money Advice Trust has found that it is not known what the total volume of debt advice currently provided is or who it is provided to.<sup>160</sup> The organisations in Table 10 appear to be the most important free-to-client debt advice providers, making up the bulk of debt advice. But there are also many fee-charging providers, and NPC has not found any published data on the extent of provision. The Money Advice Trust suggests that it is significant, but does not reach as many people as the free providers do.<sup>163</sup> The charity is carrying out detailed research in this area due to be published within the next year, which should bring some clarification.

Partly as a consequence of existing information gaps, it is difficult to establish whether there is enough debt advice available. There is *prima facie* evidence to suggest that there is inadequate face-to-face provision. For instance, the Citizens Advice Bureaux that NPC has spoken to report waiting lists of between two and six weeks, as well as restricted opening hours. Few debt agencies advertise widely for fear that they would be swamped by demand.

But on phone-based advice there are differing views within the industry. In 2007, National Debtline estimated that around one in three callers never get through to an adviser.<sup>160</sup> But CCCS, the other major telephone provider, argues that the phone-based sector now has more than enough capacity to meet demand. It is focusing on deepening the kind of advice it delivers (eg, by developing a benefits advice service and by specialist provision like IVAs).<sup>144</sup>

It is clear that there are shortages of particular kinds of specialist advice. For instance, **Taxaid** is a charity that channels support from qualified advisers to people with incomes below £16,000, who cannot afford to pay for professional advice. It also helps staff in other advice agencies to deal with their clients' tax problems. Taxaid has seen a large increase in demand.

There may also be shortages of services that combine debt advice with other kinds of support. It is unsurprising that people with debt advice often have other needs, both legal and personal. There are good arguments for bundling specialist advice with other kinds of support (legal, employment, relationship) or having strong referral mechanisms. Charities have told NPC that this does not occur as widely as it should.

There are broader challenges for debt advice charities, related to the question of whether the available volume of advice is adequate. A big issue for the sector is efficiency, with widely differing performance between similar advice organisations. Clearly this is not a straightforward thing to measure (advising twice as quickly may mean an organisation is delivering half the quality rather than higher productivity). But it is something that commissioning changes—particularly with new Legal Services Commission contracts demanding higher client volumes—are forcing on organisations. Second-tier organisations like Citizens Advice, AdviceUK and the Money Advice Trust are playing an important role in supporting the sector to develop here. CCCS has also played an important role by developing an efficient online advice system, *Debt Remedy*.

### What is the role of donors?

NPC identifies funding debt advice as a continuing priority for donors. In particular, the credit crunch may lead to increased demand at a time when statutory funding is under pressure. Even though much of this will clearly be from groups that are not financially excluded, it could squeeze access to services for everyone.

Donors can make a difference by funding individual advice agencies or working with second-tier organisations. Need and demand—particularly for face-to-face advice—still far outstrip supply, so there is plenty of room for donors to increase the capacity of the sector. This is especially true when it comes to outreach advice, or advice aimed at particularly excluded groups.

The biggest advantage of funding debt advice is that it generates large quantifiable returns. Because it often has an income maximisation element, people can gain multiples of the cost of the advice itself, through increased take-up of benefits. The value of debt rescheduled will also typically be a multiple of the advice cost.

For instance, NPC's analysis of the money advice and debt counselling service provided by **Flintshire Citizens Advice Bureau** shows that it cost the charity £69,000 to reschedule £3m of debts—that is, every £1 spent sorted out £43 of debt. Also, in benefits advice work, it cost £69,000 to increase clients' income by £440,000—that is, every £1 spent led to £6.40 in increased income.

Similarly, a money advice and debt counselling service funded by Hartlepool New Deal for Communities found that project cost £204 to help each client, generating an average additional income per client of £1,200 and average debt dealt with per client of £10,600.<sup>164</sup>

This visible gain will of course not include other benefits such as improved health or strengthened relationships.

Yet debt advice also poses challenges for donors, for example:

- It is an accident and emergency function—people access it too late, and it means that they have already suffered a lot of misery.
- It is not clear whether or not it stops people getting into trouble again in the future. Few charities track repeat client numbers and there appears to be a particular gap in post-debt advice guidance to prevent recurrence.
- It is hard to target provision at financially excluded groups as other sections of the population also have debt problems. Outreach work is one way of getting round this problem, as is sensible triage to try to ensure that face-to-face provision targets the most needy.
- It is widely believed, supported by survey evidence, that excluded groups prefer face-to-face advice. But this is very expensive relative to other forms of delivery (telephone and internet). There is inadequate evidence on what the appropriate balance is, and how much face-to-face demand could be migrated to other approaches. Some providers, such as CCCS, also argue that phone advice can be deepened, with a broader range of services delivered more cheaply.
- Arguably, creditors should fund a substantial proportion of provision.

All this points donors in slightly different directions. NPC would highlight a role for philanthropists in each of the following areas:

### Make debt advice more preventative

Approaches that try to use debt advice as an opportunity to build future capability are potentially a good way of increasing the chance that it has a long-term impact.

#### Box 41: David's story

David was brought to **Community Money Advice**, Burgess Hill on his way home from hospital after having tried to commit suicide. He owed a total of £60,000 to 30 creditors.

At first he had juggled, borrowing from one lender to pay another. When the money he borrowed from family and friends ran out, he was so desperate that he turned to loan sharks. When he realised that his parents' house, which was being used as collateral, was at risk of repossession, David decided that the only way out was to end it all.

Over the following weeks and months, the debt advisers worked through masses of paperwork and invited David's creditors to visit the centre and talk things through. David made token payments of £1 per month until he was well enough to cope with facing bankruptcy. He dreaded going to court and feared reprisals from the loan sharks, but the debt advisers managed to negotiate with all the creditors to avoid further grief. They were amazed when two of the loan sharks ended up at the centre asking for advice.

I could no longer juggle my money to pay the bills, eat and keep a roof over my head. I was truly at the end of my tether.<sup>3</sup>

**Box 42: North Devon Homes<sup>102</sup>**

North Devon Homes serves more than 3,000 homes. It launched its anti-poverty strategy in 2004, in response to the high levels of deprivation and financial exclusion it had uncovered among its tenants.

All new tenants now go through a personal financial risk assessment, intended to prevent future financial trouble—particularly rent arrears. *‘We try and capture those on the financial fringes and those who are in and out of jobs and make sure they receive all their entitlements. We provide a mentor, arrange support from advice groups and arrange fresh start loans, where necessary, through the [local] credit unions.’* All credit union loans are underwritten by the housing association.

Rather than setting up new agencies, most of North Devon Homes’ financial inclusion work is done in partnership with existing organisations. Along with other housing associations, credit unions, South Coast Moneyline and advice agencies, North Devon Homes is a member of the Devon Pound community banking partnership (see Box 30). The partnership employs outreach workers to help people with banking services, budgeting advice, access to affordable credit and saving schemes.

North Devon Homes believes that its anti-poverty and financial inclusion strategy is working, and that its proactive approach to arrears management has provided business benefits. Between January 2005 and March 2006, rent arrears fell from 5.7% to 1.9%. Court actions pursued by the organisation fell from 250 to around 40 per year.

Some charities that NPC has visited might question this—they point out that people getting advice are often days or hours away from catastrophe and are not in a fit state to build their capability.

But there are some well-evidenced approaches. One is to build in savings as part of repayment of debt management plans. Research from the Personal Finance Research Centre found: *‘Other than retaining a job and avoiding using credit, only one factor emerges from this study as a potential protection against arrears. That is having money in savings.’*<sup>147</sup>

As previously mentioned, debt advice charity **Christians Against Poverty** promotes savings alongside debt repayment, with clients given an account to manage bill payment and in which to save. **CCCS** is currently investigating incorporating a savings element into debt management plans. Both these initiatives are discussed in more detail in the chapter of this report looking at savings.

**Toynbee Hall**’s SAFE programme has piloted a scheme explicitly designed to build the capability of debt advice users by giving ongoing help to encourage repayment and avoid future trouble. The scheme worked with excluded groups—84% were reliant on benefits. An evaluation of 30 users found that total debt fell by 38% over a year. Three quarters felt their debt had been reduced because of ongoing support and advice. Most had not used a budget prior to accessing debt support: Toynbee Hall’s intervention led them to change their behaviour.<sup>165</sup>

In addition to these schemes, it is possible to imagine further creative initiatives that could be explored with donor funding.

For instance, Mike Dixon of the ippr has proposed a scheme to encourage people to seek financial advice, by asking them to commit to a future appointment with a financial adviser, perhaps after their next pay rise or starting a new job. This builds on the insights of economists that people’s good intentions to take action (be it starting saving or seeking advice) get waylaid by procrastination.<sup>48</sup>

Dixon’s idea could be adapted to apply to debt advice. Seeing an adviser in a crisis might be an opportunity to schedule future meetings for when debt has started to be repaid. Appointments could be made, for instance, with the government’s proposed new money guidance service (though of course, someone would need to take responsibility for reminding clients). It is already the case that some debt advice agencies have ongoing contact with clients by administering debt management plans. Phoning people up to check on their loan repayments provides a similar opportunity, perhaps for third sector lenders, to link people into wider financial advice.

### Increase early take-up of debt advice

A key feature of debt advice is that people tend only to seek it once they are already in deep trouble. The key prompts for action on debt are an individual or household running out of cash, creditors suggesting guidance is needed or the start of debt recovery proceedings. A lot of misery and cost could be avoided if people were persuaded to seek advice as soon as problems arose or, perhaps more realistically, if agencies had the capacity to provide advice at an earlier stage.

It is unsurprising that people can bury their heads in the sand when faced with worsening financial problems. The answer perhaps is to build debt advice into other interactions that over-indebted people may have—for instance, seeking credit, starting a new tenancy or falling behind on rent.

The gold standard here might be approaches that create a structure where there is an expectation and norm for people to get advice—a financial ‘healthcheck’. NPC has not seen many examples of this. Some social landlords, including **North Devon Homes**, do a financial risk assessment of all new tenants (see Box 42). **The Roberts Centre**, a family and social housing support charity in Portsmouth, is seeking to begin a programme giving money advice to starter tenants. It already offers informal financial advice and help with budgeting.

Other than retaining a job and avoiding credit, there is only one factor that protects against arrears. That is having money in savings.

Some social landlords, like **Derby Homes**, now look for early indications of debt problems, and link tenants to debt advisers at the first sign of rent arrears. When Derby Homes residents come to the attention of housing staff because of rent arrears, they are referred to the in-house money advice team.<sup>166</sup> This could be a promising model—although there are obvious questions about ensuring trust and independence so that tenants feel confident being open about their affairs. The National Housing Federation has done some work in trying to build the business case for landlords to fund financial advice more widely.<sup>167</sup>

Various CDFIs and credit unions have teamed up with debt advice agencies or offer their own in-house service. The Connect Project has been funded by Barclays and is jointly managed by ABCUL and Citizens Advice. It has developed a number of partnerships between credit unions and bureaux and is distributing literature on best practice more widely. Lender/debt advice partnerships are also sometimes part of a one-stop-shop known as a Community Banking Partnership, mentioned in the chapter on affordable credit. **Financial Inclusion Services Yorkshire** is an organisation containing a credit union, a CDFI, and an in-house debt adviser (see Box 28 in affordable credit chapter). **Fair Finance** in east London has trained money advisers on hand to give advice to social tenants seeking a loan who are not suitable for credit (see Box 26, also in the affordable credit chapter).

A related option for donors is funding outreach debt advice. Many **Citizens Advice Bureaux** offer an outreach service in locations such as housing offices, credit unions and GP surgeries. Maureen's story in Box 43 shows that this can be a successful model. These are not quite parallel to the early intervention approach of Derby Homes in that they still rely on the over-indebted person to be proactive and take advantage of the service. But they do pick up people who otherwise would not have sought help. The pilots of money advice outreach funded by the government have shown that most outreach users lived within two miles of a bureau but 55% were not aware of it. A key element of that programme was the time and effort put into developing new partnerships with agencies that may not previously have offered debt advice.

A particular opportunity for donors is funding advice workers to partner with specialist charities dealing with excluded groups, such as victims of domestic violence or prisoners. Citizens Advice Bureaux are particularly active here, as are advisers from **Toynbee Hall's** SAFE project.

#### Box 43: Maureen's story<sup>46</sup>

Maureen is a single parent who lived on a housing estate in Glasgow. After borrowing from an illegal lender to buy Christmas presents for her children, Maureen found herself in a distressing and dangerous situation. The lender held Maureen's bank card for security and approached her every week for repayment, hitting her in front of her children.

Maureen paid back the loan many times over, and spent months living in fear. She eventually approached **Scotcash**, a Community Development Finance Institution that has two Citizens Advice Bureau employees based in its office. Her bureau worker involved the Local Housing Office and Social Work to find new accommodation for Maureen.

The family moved home in a hurry and had to leave a lot of furniture and belongings behind. So Scotcash helped out with a loan for beds and a sofa. Maureen's bureau officer said, *'When Maureen first came to see me she was demoralised and humiliated. With our assistance and her courage she has completely transformed her life.'*

#### Support activity to test boundaries between face-to-face and other kinds of advice, and to deepen advice

Most debt advice charities that NPC has visited do relatively little in terms of mixing face-to-face and phone support. They argue that the difficulties of accessing face-to-face help are enough of a barrier alone to encourage those who could use alternative means to seek them. Donors could support research or programmes first to encourage the sensible use of triage for over-indebted people, and second to explore how feasible it is to mix advice channels.

A related option is supporting efforts to deepen the service available from phone advice providers such as CCCS (which already offers a wide range). Phone advice providers are used by a lot of different kinds of people, so funding here will create benefits that are not necessarily restricted to financially excluded people. But a large proportion of problem debt gets picked up here, so reach will still probably be good.

#### Prevent over-indebtedness by other work in financial inclusion

This may be done by widening access to affordable credit to help the poorest people to spend less on what they borrow (see chapter on affordable credit). Or it may be by increasing financial education to give people the knowledge and confidence to manage their money better, and give them greater personal capacity to avoid problems (see chapter on financial capability). Finally, as noted above, donors may help to prevent over-indebtedness by encouraging people to save (see chapter on savings).

Supply of face-to-face debt advice is far outstripped by need and demand.

### Fund lobbying to make debt advice more sustainable

Where responsibility for over-indebtedness lies is a vexed issue. Individuals clearly bear some responsibility for getting into trouble. However, it is also the case that inappropriate and irresponsible practices exist in the financial services industry, and these have been well-documented by consumer groups and charities. Examples include automatic increases to credit limits, giving people credit without checking their ability to pay it back, and misleading advertising or marketing of goods such as credit cards.

One goal of policy here might be to maximise financial service sector funding for debt advice. This is arguably best implemented on the 'polluter pays' principle: irresponsible lenders should pay more and responsible lenders pay less.

A donor's role would be about funding lobbying work—perhaps to toughen disclosure requirements or to mandate particular spending levels.

However, lenders only bear part of the responsibility for over-indebtedness, and government itself should not be let off the hook. Donors could usefully support lobbying for more sustainable funding.

Like banking, debt advice should arguably be treated as a social good as much as a market one. In its absence, over-indebted people are gradually excluded from taking part in society,

and government in turn ends up bearing significant costs. Moreover, excessive debt is a risk to the long-term health of the economy, again creating a social case for intervention.

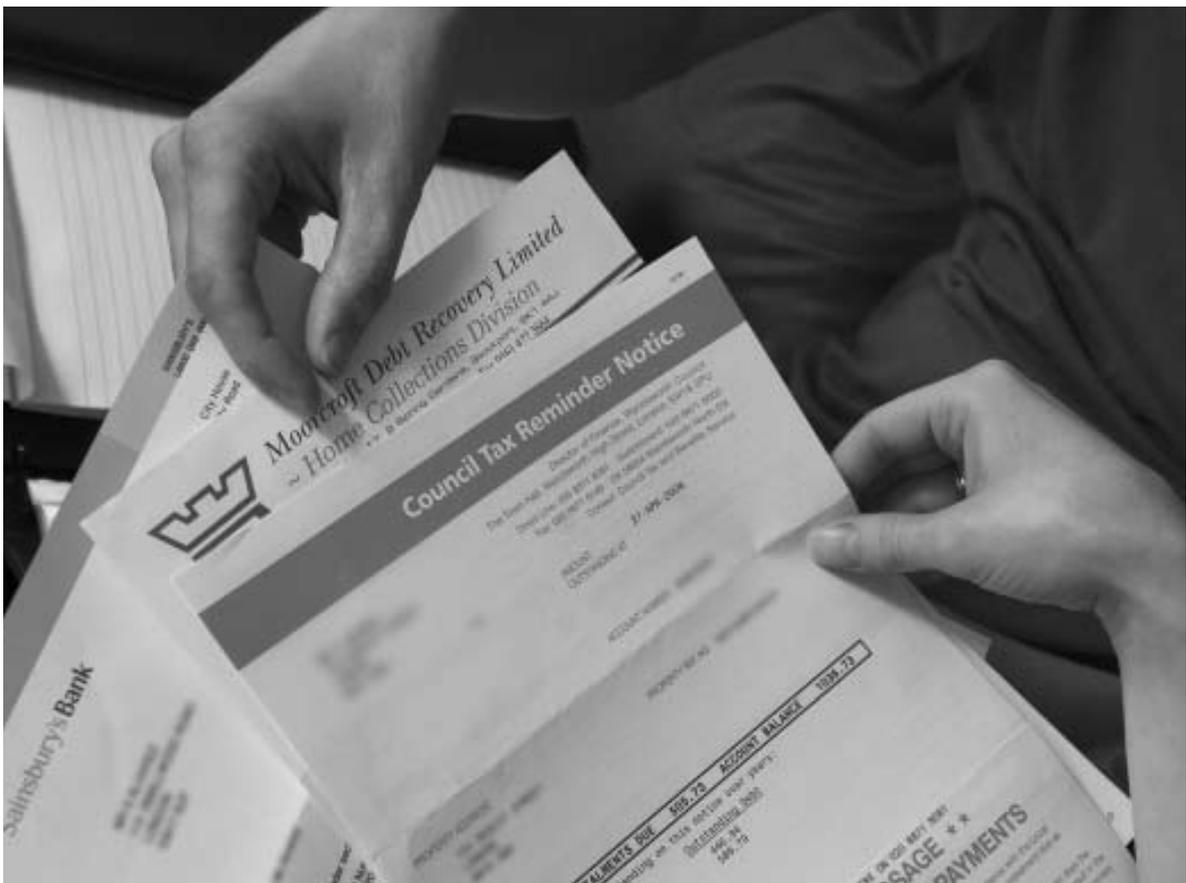
### Wider activity to curb practices or change products that lead to over-indebtedness

A final option for donors is to look upstream at preventative solutions to over-indebtedness—tackling irresponsible lending practices but also considering the kinds of products available. This might mean funding research or lobbying, perhaps to encourage product innovation.

For example, researchers in the US have proposed an interesting product for people who have struggled to use credit cards responsibly: a combined credit and debit card.<sup>168</sup> The argument here is that if 10% of an item's cost had to be paid for by debit, it would disincentivise irresponsible credit use.

The affordable credit chapter above highlights several ways that third sector lenders and charities are looking at the source of credit in order to help prevent over-indebtedness. Donors interested in tackling problem debt could consider some of the options presented in that chapter.

Campaigning, research, evaluation and product development may not be the most straightforward options for donors. But they have the potential to achieve significant system change and help to prevent some of the grief that comes from problem debt.



Photograph supplied by Christians Against Poverty

# A final word

Financial exclusion affects significant numbers of people and can be difficult to escape. Families can experience generations of operating cash in hand, saving in jam jars, and borrowing from doorstep lenders. Some people are excluded because of an unfortunate personal circumstance, such as a disability, a criminal conviction or domestic violence. Others simply lack financial capability or do not find the available products useful.

Financial exclusion is driven by poverty, a problem that makes particular groups less able to pay and more expensive to serve. And financial exclusion makes living on a low income more difficult. Life becomes more expensive, more unstable, and ultimately more stressful. Exclusion can lead to serious debt problems, family breakdown, homelessness or even mental health problems.

Despite recent progress from the government and increasing involvement from the financial services industry, financial exclusion continues to be a burden on society, slowing economic progress and worsening poverty.

Charities play an important role in helping people to overcome debt problems and in building financial capability. They are having an impact on the financial services market by providing alternative products and campaigning for change.

This report mentions many charities that are tackling financial exclusion through creative and innovative work. While the government and the financial services industry are providing some important core funding, private donors can have a considerable impact on the sector by looking at the priorities highlighted in the report, and using their money to fund effective organisations. They can help to change the lives of people like Derek, Joel and Janet, whose stories were told at the start of this report.

For many people, financial exclusion can be overcome or even avoided. With the right support, people can improve their access to financial services and make the most of their money.

By looking at the priorities in this report, private donors can help to change the lives of financially excluded people



Photograph supplied by Julie McEVer



# Appendices

## Appendix 1: Industry funding for financial inclusion

Many of Britain's major banks and building societies are funding financial inclusion work. However, it has proved difficult to estimate how much they are giving. Table 11 looks at some of this funding. Readers should be aware that these are very rough estimates that have not been confirmed by all the organisations in question. Details are taken from websites and publications but of course, not all funding is published, and where it is, different organisations have different definitions of 'financial inclusion work'. Moreover, spending is likely to vary from year to year. Where data is available, it indicates the amount donated, the type of activity funded and particular beneficiary groups. Barclays and the Royal Bank of Scotland appear to be particularly engaged donors. Where a company gives funding through its charitable trust, the amount is not included (see instead Appendix 2).

**Table 11: Industry funding for financial inclusion**

Financial Institution	Annual spend	Activity	Groups
<b>Alliance &amp; Leicester</b>	NPC has not identified data	Financial advice	
<b>Barclays</b>	£5.6m (2006)	Financial advice Financial education Third sector lenders	NEET young people Homeless people Social housing tenants Prisoners/ex-offenders
<b>Co-operative</b>	NPC has not identified data	Research	Prisoners/ex-offenders
<b>HSBC</b>	£680,000 (2007)	Financial education	
<b>Lloyds TSB</b>	£10m (unclear whether donations or loans)	Financial advice Third sector lenders	
<b>Prudential</b>	NPC has not identified data	Financial advice Financial education	
<b>RBS Group</b>	£2.2m (2006/2007)	Financial advice Financial education Products	Homeless people Social housing tenants Single parents Refugees and migrants Lesbian, gay and transgender people

This data is very limited. But on the evidence NPC has seen, the chosen approaches to funding and the selection of supported marginalised groups are relatively narrow. Giving is mainly concentrated on improving people's capability by funding advice and education. The main recipients of funding appear to be large charities, such as Citizens Advice and the Money Advice Trust.

Because of the scarcity of available data, NPC cannot estimate the spending of financial services firms on promoting financial inclusion.

## Appendix 2: Charitable funding for financial inclusion

Charitable trusts and foundations also dedicate considerable amounts of funding to financial inclusion issues, as Table 12 shows. Data for this group is more readily available than data about the spending of financial services firms, but readers should nevertheless take these figures as a rough estimate. Again, not all the information has been confirmed by the organisations in question. Where data is available, it indicates the amount donated, the type of activity funded and particular beneficiary groups. Charitable funders as a whole seem to be an engaged group of donors, with the Esmée Fairbairn Foundation and the Friends Provident Foundation having particular expertise. Readers should note that the trusts and foundations in Table 12 are far from a complete list.

**Table 12: Charitable funding for financial inclusion**

Charitable trust	Annual spend	Activity	Groups
<b>Abbey Charitable Trust</b>	£450k (2007)	Financial education Third sector lenders	Carers People with a disability
<b>Esmée Fairbairn Foundation</b>	£600k (2007)	Financial education Financial advice Third sector lenders	People disadvantaged by poverty
<b>Friends Provident Foundation</b>	£1m (2006/2007)	Financial education Third sector lenders Research	Homeless people People with mental health problems People with learning difficulties Social housing tenants Young people
<b>HBOS Foundation</b>	£900,000 (approx.)	Financial education Financial advice Debt advice	Children and young people Homeless people People with mental health problems Substance abusers Prisoners and ex-offenders NEET young people Refugees Victims of domestic violence
<b>Joseph Rowntree Foundation</b>	NPC has not identified data	Research	NPC has not identified data
<b>Lloyds TSB Foundation England &amp; Wales</b>	£110k (2006)	Financial education Debt advice Third sector lenders	Older people Migrants and refugees
<b>Northern Rock Foundation</b>	£1.1m (2006)	Financial advice Third sector lenders	Older people Offenders People with a disability
<b>Resolution Foundation</b>	NPC has not identified data	Research	NPC has not identified data
<b>Tudor Trust</b>	£500k (2006/2007)	Third sector lenders	Ex-offenders

Charitable trusts and foundations have funded with a greater focus on financial inclusion than banks themselves. Funding is spread relatively evenly between financial advice, financial education and third sector lenders. Research and evaluation have also received support, with the majority coming from the Joseph Rowntree Foundation and the Friends Provident Foundation.

The HBOS Foundation, Abbey Charitable Trust and the Northern Rock Foundation in particular are dedicating much of their funding to marginalised groups.

### Appendix 3: Improving financial capability—the size of the sector

This table sets out details of free-to-client money education work, from available data. It excludes education provided by further education colleges and schools.

Provider	Income for financial capability work	Notes
Citizens Advice	£706,000	Figure is taken from 2006/2007 accounts: the income specified for financial literacy work.
Citizens Advice Bureaux	£1,300,000	Total income of the 430 individual bureaux is £141m, <sup>158</sup> so income for the 80 or so bureaux that do financial capability work is approximately £26m. NPC estimates that on average, around 5% of their work concerns financial capability.
Pfeg, the Personal Finance Education Group	£2,600,000	Total income 2006/2007 (as this is a dedicated money education charity).
Credit Action	£330,000	Total income 2006/2007 (as this is a dedicated money education charity).
IFS School of Finance	£780,000	Total income 2006/2007 is £15.6m. NPC estimates that approximately 5% of its work concerns financial capability.
Other	£6,500,000	A very rough estimate, based on a Guidestar search of the terms: 'money education', 'financial education', 'finance education', 'money management' and 'managing money'. We eliminated obvious anomalies, grant-makers and the organisations already counted above. We calculated the approximate total income of these remaining charities, then took 5% as a conservative estimate of their spend on financial capability work.
	<b>Total: £12,216,000</b>	

### Appendix 4: Third sector lenders—the size of the sector

According to the FSA's 2006 analysis of registered credit unions:<sup>45</sup>

- There are 557 credit unions registered with the FSA in England, Scotland and Wales;
- with 548,389 adult members;
- with £498.3m in assets; and
- with a £336.7m loan portfolio.

The Community Development Finance Association's latest report on the state of community development finance found that personal loan portfolios stood at £2.7m.<sup>46</sup>

The combined loan portfolio for credit unions and CDFIs is therefore approximately £339m.

## Appendix 5: Glossary of terms

ABCUL	Association of British Credit Unions Ltd: the biggest trade association of credit unions.
ABI	Association of British Insurers
APR	Annual Percentage Rate: an expression of the total cost of credit to the borrower, taking into account interest, length of loan, frequency and amount of payments, and fees.
Bankruptcy	A legal status that usually lasts for a year, and is a way of clearing problem debts. Non-essential assets and excess income are used to pay off creditors. Bankruptcy leads to restrictions on obtaining credit and working in certain professions.
BBA	British Bankers' Association: the leading association for the UK banking and financial services sector.
CCCS	Consumer Credit Counselling Service
CDFA	Community Development Financial Association: the UK trade association for CDFIs.
CDFI	Community Development Finance Institution: a not-for-profit lender that serves deprived areas and underserved markets that cannot access mainstream finance.
Credit union	A financial co-operative that gives members the opportunity to save and borrow.
DMP	Debt Management Plan: an arrangement between someone with problem debt and his or her creditors. The arrangement is managed by a debt management company, which distributes a single monthly payment to creditors.
Financial capability	The skills, knowledge, confidence and motivation to make the most of your money.
Financial exclusion	The situation of people who cannot or do not access and use appropriate financial products and services.
FSA	Financial Services Authority: the independent body that regulates the UK's financial services industry.
Home credit	Also known as doorstep lending. Provides small cash loans to people who often cannot access mainstream credit. Repayments are collected every week by a local agent.
IVA	Individual Voluntary Arrangement: legally binding arrangement to enable someone who has problem debt to reach a compromise with creditors, through an Insolvency Practitioner.
Over-indebtedness	Debt that has become a major burden for the borrower.
pfeg	Personal Finance Education Group
POCA	Post Office Card Account: a simple account that can only be used to receive benefits, state pensions and tax credit payments.
Sub-prime lending	Lending that charges higher interest rates than those available on the mainstream market, to individuals who are considered relatively risky. They may have a bad credit history, no credit history, or a low and fluctuating income.

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# Other publications

## Community

- **Lost Property:** *Tackling homelessness in the UK (2008)*
- **Hard knock life:** *Violence against women (2008)*
- **When I'm 65:** *Ageing in 21<sup>st</sup> Century Britain (2008)*
- **Not seen and not heard:** *Child abuse, a guide for donors and funders (2007)*
- **A long way to go:** *Young refugees and asylum seekers in the UK (2007)*
- **Home truths:** *Adult refugees and asylum seekers (2006)*
- **Inside and out:** *People in prison and life after release (2005)*
- **Grey matters:** *Growing older in deprived areas (2004)*
- **Side by side:** *Young people in divided communities (2004)*
- **Local action changing lives:** *Community organisations tackling poverty and social exclusion (2004)*
- **Charity begins at home:** *Domestic violence (2003)*

## Education

- **After the bell:** *Out of school hours activities for children and young people (2007)*
- **Misspent youth:** *The costs of truancy and exclusion (2007)*
- **Lean on me:** *Mentoring for young people at risk (2007)*
- **Read on:** *Literacy skills of young people (2007)*
- **On your marks:** *Young people in education (2006)*
- **What next?:** *Careers education and guidance for young people (2005)*
- **School's out?:** *Truancy and exclusion (2005)*
- **Making sense of SEN:** *Special educational needs (2004)*

## Health and disability

- **A life less ordinary:** *People with autism (2007)*
- **What price an ordinary life?** *The financial costs and benefits of supporting disabled children and their families (2007)*
- **Don't mind me:** *Adults with mental health problems (2006)*
- **Valuing short lives:** *Children with terminal conditions (2005)*
- **Ordinary lives:** *Disabled children and their families (2005)*
- **Out of the shadows:** *HIV/AIDS in Burundi, Democratic Republic of Congo and Rwanda (2005)*
- **The hidden assassin:** *Cancer in the UK (2004)*
- **Caring about dying:** *Palliative care and support for the terminally ill (2004)*
- **Rhetoric to action:** *HIV/AIDS in South Africa (2003)*

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- **Striking a chord:** *Using music to change lives (2006)*

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- **Turning the tables:** *Putting Scottish charities in control of reporting (2008)*
- **On the bright side:** *Developing a questionnaire for charities to measure children's well-being (2008)*
- **Trading for the future:** *A five-year review of the work of the Execution Charitable Trust and New Philanthropy Capital, sharing experiences with donors and funders (2007)*
- **Funding success:** *NPC's approach to analysing charities (2005)*
- **Surer Funding:** *Improving government funding of the voluntary sector (2004, published by acevo)*
- **Full cost recovery:** *A guide and toolkit on cost allocation (2004, published by NPC and acevo)*
- **Just the ticket:** *Understanding charity fundraising events (2003)*
- **Funding our future II:** *A manual to understand and allocate costs (2002, published by acevo)*

## Environment

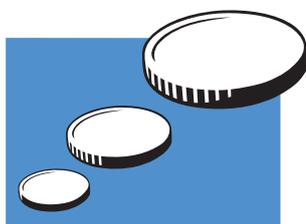
- **Green philanthropy:** *Funding charity solutions to environment problems (2007)*

## International

- **Philanthropists without borders:** *Supporting charities in developing countries (2008)*
- **Going global:** *A review of international development funding by UK Trusts and Foundations (2007)*

## Forthcoming research

- *How to fund (2008)*
- *Campaigning (2008)*
- *Child mental health (2008)*
- *Young offenders (2008-2009)*
- *Sport (2008-2009)*
- *Substance abuse (2009-2010)*
- *Degenerative diseases (2009-2010)*



# New Philanthropy Capital

New Philanthropy Capital (NPC) helps donors understand how to make the greatest difference to people's lives. We provide independent research and tailored advice on the most effective and rewarding ways to support charities.

Our research guides donors on how best to support causes such as cancer, education and mental health. As well as highlighting the areas of greatest need, we identify charities that could use donations to best effect.

Using this research we advise clients (including individuals, foundations and businesses) on issues such as:

- Where is my support most needed, and what results could it achieve?
- Which organisation could make the best use of my money?
- What is the best way to support these organisations?

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