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Developing a vision for financial inclusion

Elaine Kempson and Sharon Collard



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Friends Provident Foundation is a grant-making charity working to create the conditions throughout the UK for improved access to appropriate financial services for those who are currently excluded, particularly those on low incomes or otherwise vulnerable to market failure. It particularly wants to encourage thinking that deals with the causes of the problem. Established as part of the demutualisation of Friends Provident Life Office in 2001 and the flotation of Friends Provident plc, it is independent and has its own board of Trustees.

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Executive summary

Developing a vision for financial inclusion

This study reviews the UK's progress towards financial inclusion, and develops an evidence-based vision for achieving financial inclusion over a ten-year timeframe. The Personal Finance Research Centre, in close collaboration with Friends Provident Foundation, conducted the research.

Financial inclusion policy and practice has come a long way since Policy Action Team 14's landmark report in 1999. Other countries, in Europe and elsewhere, continue to look to the UK as a leader in this field. We cannot afford to be complacent, however. Financial exclusion remains an issue in the UK for a sizeable minority of people, worst affecting those on low incomes who may also be vulnerable in other ways.

Financial services are an essential part of everyday life. People who face difficulties accessing and using financial services experience real detriment – in terms of the monetary costs of financial exclusion, but also the social and psychological costs of feeling excluded from mainstream society.

People need financial services that enable them to manage **day-to-day** financial transactions, such as receiving income, paying bills and buying goods. In addition there are a number of different needs that financially excluded people may have to deal with periodically. The first of these is the need to meet **one-off expenses that can be anticipated**, such as family holidays and Christmas expenses. The second relates to **less predictable expenses or events**, such as burglary or white goods breaking down. Finally, there is a need to be able to manage financially following **the loss of an earned income**, for example through ill health, job loss, or on retirement.

Our vision for financial inclusion

Everyone should have access to, use and retain:

- an appropriate account, or equivalent product, into which income is paid, can be held securely and accessed easily;
- an appropriate method of paying, and spreading the cost of, household bills and other regular commitments;
- an appropriate method of paying for goods and services, including making remote purchases by telephone and on the Internet;
- an appropriate means to smooth income and expenditure.

They should be able to use these transaction services without the risk of losing financial control or incurring excessive or unexpected charges. These services do not necessarily need to be provided in a single account.

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People should not be expected to borrow to make good an income that is inadequate to meet everyday needs. The minimum wage should provide an adequate standard of living and general taxation should provide:

- adequate income replacement in cases of job loss, disability or ill health;
- an adequate minimum income in old age that is not means-tested;
- a safety net of interest-free loans and grants for people on very low incomes who need to meet a major expense or to cover major expenditure in a crisis;
- free health and dental care at the point of use.

To help individuals meet *periodic* needs, our vision is that there should be:

- sustainable lower-cost alternatives to commercial sub-prime lenders;
- savings accounts that are secure, accessible and protect savings from inflation;
- a promotion of regular saving and its material and psychological benefits;
- universal access to basic, appropriate and affordable home contents insurance;
- free-to-client budgeting and debt advice services.

This requires a shift away from a heavy reliance on credit, towards a more balanced mix of saving, borrowing and insurance.

Our vision also requires that:

- everyone has the confidence and knowledge to make appropriate use of financial services for both day-to-day and periodic needs;
- any charges for the provision of services should be proportionate and fair;
- there is assertive enforcement of appropriate consumer protection legislation and guidance and a system of redress (where charges are excessive or unfair or access is denied unreasonably) that is accessible, informal and free to the consumer at the point of use.

Regular monitoring should be carried out to identify and report on progress towards financial inclusion and threats to its realisation – including the erosion of state-provided social welfare.

Some elements of this vision will require investment (from government and others), at least in the short term. Over the longer term, sustainable solutions should be developed on a national basis, which will be largely self-financing and not require significant subsidy.

Realising our vision for financial inclusion

Realising our vision for financial inclusion requires that the state, through general taxation, ensures that everyone has an adequate income whatever their circumstances, and that health care is free at the point of use. In the event that any of these safety nets are reduced, greater responsibility will be placed on the individual to save, insure or borrow. Efforts to realise our vision are likely to be

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seriously undermined by a reduction in the adequacy of working age income replacement benefits as a result of proposed social security cuts, or if essential health services ceased to be met out of general taxation.

Meeting day-to-day needs

Appropriate money transmission services are the key to accessing other financial services such as credit, saving and insurance, and are therefore vital to achieving full financial inclusion.

Developing appropriate accounts

Many of the building blocks to achieving our vision with regard to day-to-day money management are already in place. Appropriate accounts and services to enable people on low incomes to manage their money day-to-day are becoming available through a diverse range of providers who want to be in this market. Nevertheless, some important steps need to be taken, building on the services currently offered by providers.

All banks should continue to be required to make available a **basic bank account**, but there needs to be greater standardisation of the key features of these accounts, as proposed by the European Commission (2010). The minority of banks who are committed to achieving full banking inclusion should be actively encouraged to go further and develop basic bank accounts that are tailored to the needs of people on low incomes, for example by harnessing the opportunities offered by developments in information technology.

The introduction of a **credit union current account** is a major development for the sector. However, credit unions need help to enter the bank account market at greater scale, including initial investment to develop back-office functions. In addition, it will be important to create access to credit union banking for local areas that do not have a credit union. This could be achieved by the establishment of a national credit union; or by one or more existing credit unions extending their coverage and relying on access to the account at a local Post Office.

In developing its transactional banking services, there are opportunities for ABCUL to build on developments outside the traditional banking sector, both to improve the appropriateness of its account for people on low to middle incomes and to reduce the costs to the customer.

There are opportunities to harness **new product developments** in the form of de facto accounts with bill-payment facilities, which can better meet the needs of people on modest incomes. These should build on business models that aim to offer services that are free (or very low cost) to the end user. Such accounts are currently being offered or planned by new entrant banks and at least one mobile phone company.

These new product developments could also offer a model for enhancing the POCA , which would very likely require government encouragement and promotion.

Dialogue with bill originators

There is an urgent need for a dialogue with the main originators of bills, to deal with some of the difficulties faced by people who make little or no use of bank accounts. Commonly, these people have restricted access to services and incur additional charges if they do not want or are not able to pay by direct debit.

Discussions should be held on making direct debit use easier for people on low incomes who choose to pay this way. Issues such as flexible payment dates, weekly payments and, for variable direct debits, greater customer control over increases to direct debit amounts should be addressed. The coordinating body described below, together with the relevant regulators, would initiate these discussions. For energy companies, this should form part of the ongoing discussions about fuel poverty.

Encourage and facilitate account opening

The community select committees indicated that people on low incomes may 'mix and match' services from different financial services providers to give them the banking facilities they need. To be able to do this, they will require readily available information and guidance, including comparison information to help them shop around.

At the same time, there is a need to help people overcome their wariness of using new banking services, and to help those who have experienced difficulties to regain their confidence in using banking services. These roles are most appropriately played by the Money Advice Service and by local intermediaries.

Information and help is also needed at the time of account opening, to ensure that low-income customers get the most out of the service they choose. The Money Advice Service could support providers to do this.

Meeting periodic needs

Our vision for financial inclusion in relation to periodic needs requires a combination of credit, savings and insurance. It also depends on the provision of adequate state safety nets in the form of dental and health care that is free at the point of use and in cases of job loss, ill health or disability.

Credit

In the absence of commercial alternatives, **credit unions and community development finance institutions (CDFIs)** need to be able to deliver loans to financially excluded people at sub-commercial rates of interest. There needs to be a significant increase in the number of loans that are made, together with greater reach of lenders into communities.

The effective use of technology will be an important element in any modernisation programme as a means of extending services while also reducing operating costs. Here there may be scope to learn from the payday lending industry, such as the development of simple online tools for borrowers and real-time loan processing.

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Partnership working is another crucial aspect in expansion. The proposed formal link-up between the credit union sector and the Post Office network has the potential to deliver not only banking, but also credit and other financial services to financially excluded communities. Partnerships between credit unions or CDFIs and housing associations provide another model of delivering credit at sub-commercial rates to financially excluded people.

But how are essential developments to be funded? At present, the credit union and CDFI sectors are heavily reliant on central government investment to modernise and expand. In the absence of continued financial support, the likely options are to increase the cost paid by the borrower (i.e. higher APRs), to reduce operating costs further, or to borrow commercially. Other opportunities to fund growth are the extension of the Community Investment Tax Relief scheme for personal lending CDFIs, and the creation of a Big Society Bank (effectively a wholesale bank for social investment) that cites financial exclusion as one of the social issues within its proposed remit.

The future of the **Social Fund** is of great importance, given its central role in meeting the periodic needs of people on the margins of financial services. While the proposals for reform of Budgeting Loans have the potential to ensure their continued availability to people who need them, those for the devolution to local authorities of Community Care Grants and Crisis Loans, and the loss of an independent review service, are of greater concern.

There has long been a need to address the issue of problem borrowing. The creation of a new body (**the Money Advice Service**) with responsibilities covering both financial capability and debt advice offers a real opportunity to fill this gap. Government and other major creditors should jointly provide financial support for budgeting and debt advice services.

It has proved difficult to identify appropriate ways to **help financially excluded people who are refused credit**. Some people may be responsive to offers of debt advice, but it will not be the solution for all. Alternatives might include credit repair, budgeting advice or referral to a grant-giving charity. In the longer term this is an issue that should be investigated further by the Money Advice Service.

Saving

The greatest potential to increase savings amongst people on low incomes seems to lie with non-mainstream providers and intermediaries such as credit unions and CDFIs, the Post Office, PayPoint and social housing providers (and partnerships between these).

Targeted social marketing (i.e. marketing with a social purpose) through popular media such as television, radio and social media is one means to achieve this. Encouraging children and young people to start saving and develop a saving habit, for example through national school-based schemes working with partners such as credit unions and other providers, is another important aspect.

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The DWP Growth Fund (which supported credit unions and community finance organisations to increase their lending in financially excluded communities) highlighted the possibility of linking saving to loan repayment, which was most successful where credit unions used 'soft compulsion' to encourage people to include an amount for saving when they first took out a loan.

To get people on lower incomes saving, it is important to 'start from where they are' by linking saving to goals or events such as Christmas, a family holiday, a new baby, or to buy a new car. Partnerships to promote this idea might include providers or intermediaries (such as PayPoint) working with travel agents to promote saving for holidays. Credit unions and other providers could offer things like 'car accounts' that encourage people to save up for a car by offering a year's free breakdown cover. The Money Advice Service, other advice providers and local intermediaries could play a role in helping people to set savings goals and to budget in order to reach their goals.

A range of opportunities exists to extend access to saving facilities among people on lower incomes. These include possible schemes by PayPoint and the proposed link-up between the credit union sector and the Post Office to allow Post Office branch staff to accept and pay out savings. There is also scope for credit unions to work more closely with employers to encourage low-income earners to start to save, for example through payroll deduction.

In terms of national government, even though the Saving Gateway was not rolled out as originally designed, serious consideration should be given to an account that incentivises regular saving over a fixed period of one to two years.

Insurance

More than half of low-income households still lack home contents insurance. The key challenge in realising our vision is its promotion and take-up. Although both the Chartered Institute of Housing and Association of British Insurers have done work in this area, these efforts may not result in a significant increase in take-up. Other options include using an opt-out model, where all new tenants are automatically signed up for contents insurance unless they decide to opt out; and block policies where a landlord purchases a block policy for all tenants who would then be covered.

In the past the Financial Inclusion Champions have played an important role in promoting both the provision and take-up of insurance with rent schemes. We therefore welcome the continuation of funding for this function, at least for the next few years.

Consumer protection

Consumer protection is important for new users of financial services, particularly where they have limited choice, or use products that are outside mainstream regulatory control.

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Consumers must have the same level of protection regardless of how their provider is licensed, and any charges for new banking products aimed at people on low incomes must be proportionate and fair.

Assertive enforcement of responsible lending, arrears management and debt recovery legislation and guidance in the high-cost sub-prime credit market is essential. Interested parties should also monitor for new forms of potentially exploitative lending, and there needs to be a continued clamp-down on illegal lending by the specialist illegal money lending teams.

Any savings schemes that are developed and targeted at people on low incomes must also be covered by regulation, to ensure the security of people's savings.

There should be a system of redress for people who are unreasonably denied access to banking, savings or insurance facilities or are subject to unfair charges. This role seems most appropriately filled by the Financial Ombudsman Service working with regulators, but local advice agencies also have an important role to play.

Oversight and coordination

Finally, a coordinating body to monitor and encourage the development and promotion of appropriate financial services for those on the margins is vital to achieving our vision. Its activities should also include checking for new developments that have the potential to promote greater inclusion and, just as important, that pose a threat to inclusion – including groups of people being left behind by general developments in financial services or the impact of charging for transactional banking services, should this be introduced generally in the UK. This should include periodic review and refreshing of a vision for financial inclusion.

HM Treasury and the Financial Conduct Authority working together are almost certainly the most appropriate bodies to take on this coordinating role, which was formerly undertaken by the Financial Inclusion Taskforce reporting to HM Treasury. It is likely to need inputs from a range of experts.

Conclusion

Most of the potential building blocks to achieving our vision for financial inclusion are either currently available or in development. But they require promotion and coordination, and new developments that can enhance financial inclusion will need to be harnessed. These are roles that would be most appropriately played by HM Treasury working with the Financial Conduct Authority and (at present) the Office of Fair Trading. In addition, there is likely to be a continuing need for the regional and sector-based work that has been undertaken by the Financial Inclusion Champions and also for local intermediaries who have played an important role in promoting financial inclusion.

There is also a real need for targeted work on various aspects of financial capability, including:

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- information on choosing and using appropriate products;
- guidance on using transaction banking services and maintaining control over one's finances;
- help for people who cannot gain access to credit;
- promoting both a saving culture and a shift from borrowing to saving and insuring where it is appropriate to do so.

This is a clear role for the Money Advice Service as well as local advice agencies and other organisations working with people who are on the margins of financial services.

However, just as there will be new developments that have the potential to enhance financial inclusion, there will be ones that could undermine it. These include developments that have the potential to leave certain groups of people behind as well as reductions in state provision that form the bedrock for meeting periodic needs. These and other threats to financial inclusion will require careful monitoring.

1 Introduction

SUMMARY

There have been significant positive developments in financial inclusion policy and practice over the last decade. Even so, financial exclusion remains an issue in the UK for a sizeable minority of people, worst affecting those on low incomes who may also be vulnerable in other ways.

The conclusion of the Government's Financial Inclusion Taskforce and the end of the Financial Inclusion Fund in March 2011 marked a watershed for financial inclusion policy in the UK. Friends Provident Foundation commissioned this research as an opportunity to take stock of progress towards financial inclusion and to develop an evidence-based long-term vision for financial inclusion over the next ten years.

The research focused on four areas: banking (including bill-payment), credit, saving and insurance. The influence of financial capability and over-indebtedness on levels of financial inclusion was also considered. The research comprised: an evidence assessment; round-table meetings and telephone interviews with financial services providers and other professionals; and community select committees with people on low incomes.

Financial services are an essential part of everyday life. People who face difficulties accessing and using financial services experience real detriment – in terms of the monetary costs of financial exclusion, but also the social and psychological costs of feeling excluded from mainstream society.

The term 'financial exclusion' was coined over ten years ago to refer to people who have little or no access to financial services. Since that time there have been substantial developments in policy and practice, with a shift in emphasis from financial *exclusion* to financial *inclusion*. A significant body of research has helped to inform these developments and evaluate their impact.

The development of a national financial inclusion policy began with the work of the HM Treasury-led Policy Action Team 14 on access to financial services, which reported in 1999. The Financial Inclusion Taskforce was set up in 2005 to take this work forward, and in particular to oversee developments and advise government ministers on three areas: banking, credit (and the development of credit unions and community development finance institutions, or CDFIs, in particular) and debt advice to people with limited access to financial services. With the extension of the Taskforce for a further three years (2008–11), this remit was extended to include insurance and savings. The Scottish Executive and Welsh Assembly Government also developed financial inclusion strategies for their respective countries.

While no attempt has been made to quantify the overall level of investment in financial inclusion policy and practice, it is likely to be significant. The largest single injection of funding came through the Government's Financial Inclusion Fund, which

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invested £250 million in banking, credit and debt advice over the period 2004–11. Other major investors in financial inclusion include local authorities, housing associations, the financial services industry and charitable foundations.

Progress and challenges

Over the life of the Financial Inclusion Taskforce, there was progress in a number of important areas of financial inclusion:

- The number of people living in households without a transaction bank account more than halved (Financial Inclusion Taskforce 2010a).
- Government investment through the DWP Growth Fund resulted in considerable growth in the availability of lower-cost credit to financially excluded people living in deprived communities, through credit unions and CDFIs.
- Face-to-face debt advice services expanded significantly.
- And, although the service was not rolled out nationally due to subsequent budget cuts, the Saving Gateway clearly demonstrated that people on low incomes could be encouraged to save, given the right type of scheme (Kempson et al. 2005; Harvey et al. 2007).

The development of new products and services aimed at promoting financial inclusion facilitated this progress, including basic bank accounts; credit union current accounts; credit union loans offered without a requirement to save first; Christmas savings accounts; insurance with rent schemes; and bill-payment facilities for people who do not want to use direct debits (or have no access to them). So too did the rolling out of financial inclusion policy and practice on the ground through delivery organisations such as housing associations, local authorities, advice agencies, community organisations and financial services providers, directed and supported by their respective trade associations and professional institutions. A national forum for financial inclusion was also established (Transact), with a membership of around 1,600 organisations and individuals.

Challenges remain in the field of financial inclusion, however. There is evidence that access to banking can generate costs as well as benefits for lower-income account holders. The demand for lower-cost credit continues to exceed supply, and a significant minority of low-income borrowers rely on illegal moneylenders. We lack an effective national scheme to encourage people on lower incomes to save. And, despite the development of low-cost insurance products that better meet the needs of tenants living in housing association and local authority homes, a significant proportion of them remain without home contents insurance.

At a strategic level, the end of the six-year Financial Inclusion Taskforce and Financial Inclusion Fund in March 2011 marked a watershed for financial inclusion policy in the UK. With the conclusion of the Financial Inclusion Taskforce (and with it the end of HM Treasury oversight for financial inclusion policy), we face the challenge of consolidating policy gains while not losing ground because of the atomisation of financial inclusion policy across government departments. There is also the question of government investment in financial inclusion. In March 2011, the Government announced its plan to invest £73 million in a three-year credit union

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modernisation and expansion programme. It also funded the continuation of face-to-face debt advice for a further year, until March 2012. Government investment over the longer term remains uncertain, however. The desire expressed by HM Treasury, for example, is that face-to-face debt advice should be industry-financed.

A final challenge is the effective co-location of financial inclusion and income adequacy (in the form of minimum income and welfare benefit levels) as interconnected policy areas, something that has long been evident on the ground but has received comparatively little attention in policy terms.

Developing a vision for financial inclusion

Financial inclusion policy and practice has come a long way since Policy Action Team 14's landmark report in 1999. Other countries, in Europe and elsewhere, continue to look to the UK as a leader in this field. We cannot afford to be complacent, however. Financial exclusion remains an issue in the UK for a sizeable minority of people, worst affecting those on low incomes who may also be vulnerable in other ways. We must also be alert to new forms of financial exclusion and marginalisation.

Friends Provident Foundation commissioned this research as an opportunity to take stock of progress towards financial inclusion and to develop an evidence-based long-term vision for financial inclusion over the next ten years. The Personal Finance Research Centre, in close collaboration with Friends Provident Foundation, conducted the research. The vision set out in Chapter 2 represents our joint vision for financial inclusion.

Research methods

The research focused on four areas: banking (including bill-payment), credit, saving and insurance. The influence of financial capability and over-indebtedness on levels of financial inclusion was also considered. The research comprised five stages:

- 1 An evidence assessment with a particular focus on recent publications.
- 2 Initial round-table meetings with for-profit and not-for-profit providers and other professionals to discuss banking and bill payment, credit and savings and insurance.
- 3 Telephone depth interviews with for-profit and not-for-profit providers and other professionals to follow up particular issues from the round-table meetings and so refine the vision for financial inclusion.
- 4 Community select committees with people on the margins of financial services to obtain their views about different options for meeting their day-to-day needs.
- 5 A final round-table meeting with for-profit and not-for-profit providers and other professionals to discuss the vision that we had developed, and next steps.

Details of the research methods are provided in the Appendix.

Who is financially excluded?

The first major study of financial exclusion in the UK was carried out in 1999 (Kempson and Whyley 1999) and has not been repeated since. This showed that 7 per cent of households lacked any mainstream financial products. A more recent estimate of financial exclusion, based on 2003 data, indicated that 6 per cent of adults in the UK did not have any type of bank account, any form of savings products or any revolving credit (European Commission 2008). The 2009/10 Family Resources Survey found that 5 per cent of households and 7 per cent of adults lack any form of savings or a bank account. There are some important regional differences, ranging from 12 per cent of households in Northern Ireland and 8 per cent in Scotland to just 2 per cent in the south of England.

Above all else, financial exclusion is a function of poverty. Those most likely to be on the margins of financial services – making little use of banking, savings, insurance or credit – include people who are unemployed; those unable to work through sickness or disability; single pensioners and lone parents; and people in African-Caribbean, Pakistani and Bangladeshi households. Financial exclusion is concentrated on local authority or social housing estates, especially those in areas of high deprivation, and is higher in Scotland and Wales than it is in England (Kempson et al. 2001). The 2009/10 Family Resources Survey indicates that the same types of people have above-average levels of exclusion from transaction or savings accounts, although the extent to which they are more excluded than others has fallen considerably.

Despite evidence of considerable gains in inclusion, concerns remain that some groups of people face specific difficulties accessing and using financial services. These include older people, who may be particularly adversely affected by changes to banking and bill-payment services, such as increasing automation of services (Age UK 2011).

Banking

Taking stock of the current situation in relation to the financial products that were the focus of this project, we see that in **banking**, 0.89 million people in 0.69 million households do not have access to a bank account of any kind. A greater number, 1.75 million people in 1.28 million households, do not have access to a transactional bank account that allows them to make and receive payments. Lack of a transactional bank account is concentrated among people in the bottom of the income distribution, and includes single-person and lone-parent households, people who are unemployed and retired, and social housing tenants (Financial Inclusion Taskforce 2010a).

Credit

In relation to **credit**, it is estimated that three million people borrow from a high-cost commercial lender every year (Financial Inclusion Taskforce 2010b). The types of people most likely to lack access to lower-cost mainstream credit include households with no earned income or only occasional or part-time earnings. A proportion of them will be credit impaired, with either a history of bad debt (such as a County Court Judgment or Individual Voluntary Arrangement) or an adverse credit rating (Collard and Kempson 2005). Use of illegal lenders is generally concentrated in the most

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deprived communities. Users tend to be women in their thirties and forties, bringing up children as a single parent and on a low income (Policis 2006).

Savings and insurance

A quarter (25 per cent) of lower-income families do not **save** at all over the course of a year (either formally into a savings account or informally), and a further 38 per cent save only informally, usually in the form of loose change at home. Within this low-income group, attitudes to saving were the most important determinant of people's propensity to save. Income stability was also important (Kempson and Finney 2009).

All other things being equal, people of Asian or Asian British origin are less likely to have a formal saving account than other ethnic groups. Remitting money abroad and a preference for alternative forms of financial provision (such as investing in property, micro-business and gold) help to explain the low rates of saving among some minority ethnic (and migrant) groups (Kempson and Finney 2009).

Finally, over half of households (52 per cent) in the bottom fifth of the income distribution do not have **home contents insurance**, equivalent to around 2.6 million households (Parekh et al. 2010). A large proportion of those without cover are social housing tenants.

About this report

Chapter 2 sets out our vision for financial inclusion. Chapters 3 and 4 provide an overview of the current situation, upon which the vision is based. Chapter 5 outlines what needs to be done in order to realise this vision.

2 A vision for financial inclusion

SUMMARY

The purpose of developing a future vision for financial inclusion is to help guide policy and practice. The evidence review highlighted the different day-to-day and periodic personal finance needs that financially excluded people have.

Their day-to-day needs include receiving income; spreading the costs of household bills and other commitments; paying for goods and services, including buying over the telephone or on the Internet; and being able to smooth income and expenditure. Our vision is for financially excluded people to be able to meet these needs in ways that do not disrupt their finances or result in unexpected or excessive charges.

Periodic needs include anticipated events such as holidays as well as unexpected situations such as job loss. Our vision here is based on the ongoing provision of state safety nets to support adequate living standards in and out of work (for example, in the case of job loss, disability, old age or emergencies) and free health care at the point of use. To help individuals meet other periodic needs themselves primarily requires a shift away from a heavy reliance on consumer credit to a more balanced mix of appropriate credit, saving and insurance products.

Our vision also requires access to advice services; ensuring that low-income consumers pay proportionate and fair charges; and that they are effectively protected by consumer protection legislation and have access to redress if things go wrong.

There is a solid foundation in the UK for developing a more financially inclusive society. The purpose of developing a vision for financial inclusion is to help guide policy and practice going forward. This is particularly important in a period of economic austerity and cutbacks that are likely to impact heavily on lower-income households and at a time when central coordination through HM Treasury and the Financial Inclusion Taskforce has come to an end.

In developing our vision for financial inclusion, we started by exploring the personal finance needs of financially excluded people. The advantage of this needs-based approach (compared with, say, a product-based approach) was that it allowed us to think creatively about the wide range of needs that people have and how these might best be met, either through existing financial products and services, new entrants to the market or through other means such as state provision.

The evidence review highlighted a set of key personal finance needs that financially excluded people may potentially have, which relate both to day-to-day money management and also to needs that occur periodically. To be considered financially included, people should be able to meet these needs in an appropriate way.

Day-to-day needs

Research consistently shows that financially excluded people would like to be able to:

- receive income and hold money securely and be able to access it easily;
- spread the cost of bills and other regular payments;
- buy goods and services securely using remote channels;
- smooth income and expenditure to make ends meet.

Moreover, they should be able to do all of these things without the risk of disruption to their finances or incurring unexpected or excessive fees.

Periodic needs

The evidence review highlighted a number of different needs that financially excluded people may have to deal with periodically.

The first of these is the need to meet one-off expenses that can be anticipated, which includes:

- the ability to meet predictable lumpy expenditure and financial outlays such as the costs of Christmas, birthdays, and clothing;
- the ability to acquire goods and services that in the UK we consider necessary for social inclusion, such as family holidays, children's outings, leisure activities and consumer goods like a TV or other forms of home entertainment.

Another relates to less predictable expenses or events, including:

- the ability to meet smaller, less predictable financial outlays, such as the replacement of white goods and children's shoes;
- the ability to cover major unpredictable expenses, for example the loss of possessions following burglary, fire or flood;
- the need to access dental and health services when required (which may also be predictable).

Finally, there is a need to be able to manage financially following the loss of an earned income, for example through ill health or job loss, or on retirement.

A vision for financial inclusion

Our vision for financial inclusion incorporates the different needs that financially excluded people may have and indicates how these might be met in an appropriate way. Only when financially excluded people are able to meet these needs can this vision for financial inclusion be said to have been achieved.

Our vision for financial services for meeting **day-to-day needs** is that everyone has access to, uses and retains:

A vision for financial inclusion

- an appropriate account or equivalent product into which income is paid, can be held securely and accessed easily;
- an appropriate method of paying, and spreading the cost of, household bills and other regular commitments;
- an appropriate method of paying for goods and services, including making remote purchases by telephone and on the Internet;
- an appropriate means to smooth income and expenditure.

They should be able to use these transaction services through a regulated provider, without the risk of losing financial control or incurring excessive or unexpected charges. Although there is a need for all these services to be met, they do not necessarily need to be provided in a single account.

The modern welfare state was built on principles of universal welfare rights that date back to the post-war consensus. Successive Governments have committed to, and built on, a welfare system that at the very least aims to provide a 'minimally decent standard of living' (Hasnas 2005). Our vision for **periodic needs** reflects those principles and incorporates the ongoing provision of adequate state safety nets alongside personal responsibility. People should not be expected to borrow to make good an income that is inadequate to meet everyday needs. The minimum wage should provide an adequate standard of living and general taxation should provide:

- adequate income replacement in cases of job loss, disability or ill health;
- an adequate minimum income in old age that is not means-tested;
- a safety net of interest-free loans and grants for people on very low incomes who need to meet a major essential expense, or to cover major expenditure in a crisis;
- free health and dental care at the point of use.

The individual would be responsible for meeting periodic needs such as: predictable lumpy expenditure and financial outlays; acquiring goods and services to ensure social inclusion; smaller unpredictable financial outlays; and covering major unpredictable financial outlays.

To help individuals fulfil these responsibilities, our vision is that there should be:

- widespread availability of appropriate, sustainable lower-cost alternatives to commercial sub-prime lenders;
- widespread availability of appropriate savings accounts that are secure, accessible and protect savings from inflation;
- the promotion of regular saving and its material and psychological benefits;
- universal access to basic, appropriate and affordable home contents insurance;
- free-to-client budgeting and debt advice services.

This would also require a shift away from a heavy reliance on credit to meet most or all of these needs, towards a more balanced mix of saving, borrowing and insurance.

A vision for financial inclusion

Finally, our vision for day-to-day and periodic needs requires that:

- Everyone should have the confidence and knowledge to make appropriate use of financial services for both day-to-day and periodic needs.
- Any charges for the provision of services should be proportionate and fair.
- There should be assertive enforcement of appropriate consumer protection legislation and guidance and a system of redress (where charges are excessive or unfair or access is denied unreasonably) that is accessible, informal and free to the consumer at the point of use.

There is also a need for regular monitoring and scenario-planning to identify and report on progress towards financial inclusion and threats to its realisation. This has to include any erosion of state-provided social welfare.

Some elements of our vision will require investment (from government and others), at least in the short term. Over the longer term, our vision is that sustainable solutions are developed on a national basis, which will be largely self-financing and will not require significant subsidy.

The following two chapters describe the evidence we have drawn upon to develop this vision for financial inclusion for day-to-day needs (Chapter 3) and periodic needs (Chapter 4).

3 The current situation: Day-to-day needs

SUMMARY

Basic bank accounts are widely available but vary greatly in terms of account features. As people generally do not shop around when opening an account, they risk opening one that is not wholly appropriate to their needs. Few high street banks demonstrate any strong commitment to serving people on low incomes.

People on low incomes who are banked often incur bank charges because they find it difficult to manage facilities such as direct debits. This in turn deters them from using their account. For people in this situation, and those without an account, bill payment services provided by organisations such as PayPoint are attractive because they allow tight control over finances and avoid the risk of penalty charges.

A number of interesting developments have the potential to meet the day-to-day needs of people on low incomes. In particular, some new entrants offer banking facilities without the need for a traditional bank account. These include 'jam jar' accounts (which generally combine an account to pay bills and a prepaid card) and mobile wallets, which provide access to a range of services via a mobile device. The community select committees with people on low incomes indicated that 'mixing and matching' services from different providers might be an attractive alternative to using a bank account.

Even though considerable progress has been made towards full banking inclusion, around 1 in 20 households still lacks a transaction account and there is evidence that many people who are newly banked (i.e. those who have recently opened a new bank account) struggle with some of the facilities that these accounts provide. Direct debits are particularly problematic. Consequently, large numbers of low-income consumers use the bill-payment facilities provided through local Post Offices and PayPoint outlets. For people who are unbanked (i.e. without access to transactional banking facilities), these are the principal ways of paying bills.

The nature of banking is being challenged by a range of new entrants who are developing de facto current accounts that are structured differently from traditional accounts. These have many features that will be attractive to low-income consumers who want to retain close control over their finances. Although in their infancy, they have the potential to play an important role in achieving full financial inclusion.

In considering the current situation we have therefore looked at

- the current and future transaction services provided by:
 - banks and building societies;
 - Post Office;
 - credit unions;
 - PayPoint;
 - new entrants;

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- the research evidence on:
 - the experiences of the newly banked;
 - the situation of the unbanked;
 - what ideal financial transaction services might look like.

The supply of financial transaction services

A range of providers meet low-income consumers' needs for facilities to manage their day-to-day finances. The main providers are the banks, although one building society also provides a basic bank account, as do a growing number of credit unions.

Banks and building societies

Since October 2002, 15 banks and one building society have offered a basic bank account that, unlike conventional current accounts, cannot be overdrawn either with or without authorisation. All of them also offer the facility to withdraw cash at a local Post Office. Since they cannot be overdrawn, in theory such accounts should be available to people even if they have an impaired credit history; only people with a history of fraud should be declined one. In practice, only two banks (Barclays and the Co-operative Bank) have a basic bank account that is available to people regardless of their credit record. When basic bank accounts were first introduced, research carried out through 'mystery shoppers' (researchers posing as customers) by the (then) Banking Code Standards Board found wide variation between banks in the extent to which they offered them to customers for whom they would be appropriate. The Banking Code provisions were strengthened and by 2008 these problems had largely disappeared. Where they existed they were isolated examples; there was no evidence of any bank failing to meet its obligations under the Code (Banking Code Standards Board 2008). Similar conclusions were reached by mystery shopping conducted for the Financial Inclusion Taskforce (Glazier et al. 2010).

The British Bankers Association publishes information – available on the Money Advice Service website – that compares the features of these 16 basic bank accounts (Money Advice Service 2011; see also Talati and Kinloch 2008). This shows a very wide variation in the features that these accounts offer. Some of the key differences are summarised in Box 1. The European Commission has published a Recommendation that sets out the features of basic bank accounts (European Commission 2011).

Box 1: Summary of basic bank account features (November 2011)

- Only 8 of the 16 accounts offer a Visa debit card; a further 4 offer a Maestro or Electron card, where the balance is checked before a payment is passed. Not all retailers have facilities to process Maestro and Electron cards. Four accounts offer no debit card at all.
- Most accounts offer free access to ATMs in the LINK network. Five accounts only offer free access to their own ATMs – with three banks adding this restriction during 2011.
- Four accounts place minimum limits (ranging from £100 to £300) on the sums of money that can be withdrawn at a branch – effectively denying access to branch withdrawals to people on low incomes for whom these accounts are intended. In addition, First Trust Bank does not have a branch network.
- Only 7 accounts have a buffer zone – in 5 cases of £10 – to allow the account holder to access the last few pounds in their account at an ATM where the minimum withdrawal is £10 and a withdrawal would, otherwise, be blocked if the account contains less than this amount. The remaining two set it at £6, which is sufficient only where ATMs dispense £5 notes.
- Nine accounts allow cash withdrawals at a Post Office but not deposits. The rest allow both.
- Charges for unpaid direct debits or standing orders vary widely from no charge at all to £42. Three banks close a basic bank account if any direct debit or standing order is refused three times. Following an inquiry and legal challenge to bank charges, the amounts charged for failed transactions have fallen for at least some banks. Nine now have a flat charge that is £10 or less and in some cases that charge may cover more than one failed transaction in a single day.

http://www.moneyadvice.service.org.uk/_assets/downloads/pdfs/your_money/a5_guides/basic_bank_accounts.pdf

This wide variation in the features of basic bank accounts is of some concern since there is strong evidence that people do not shop around when opening a basic bank account (Millward Brown 2006; Sood and Hollings 2010). It is, therefore, a matter of luck whether or not they get an account that best meets their needs. Indeed, some of the accounts appear quite unsuited to the needs of the people that basic bank accounts are intended for. The First Trust Bank basic bank account does not offer a debit card and only allows money to be withdrawn free of charge at its own ATMs. It has no branch network and only permits withdrawals (not deposits) at local Post Offices. It charges £35 for a failed direct debit transaction and, unlike the other 15 accounts, does not permit standing orders. It does, however, have a £10 buffer zone. The Santander account, likewise, offers no debit card, it only allows withdrawals of more than £300 at a branch (which effectively means that low-income account holders cannot routinely obtain cash at a branch); it does not allow deposits at a local Post Office; it has no buffer zone and the charge for a failed direct debit or standing order is £25 (Money Advice Service 2011).

Despite much discussion about the need for a separate bill-payment account linked to a basic bank account (see below and also Future Foundation 2007; Social Finance 2011), 15 of the 16 banks do not offer one, preferring instead to offer direct

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debits and standing orders. The exception is the Royal Bank of Scotland, but their bill-payment account is only offered to existing customers who are in default with a loan, credit card or overdraft with the bank. It is not available generally nor is it advertised.

Some retail banks are now offering text messaging for basic bank accounts, alerting the account holder to the fact that the balance is low or that a regular payment is about to be made. This facility might help to alleviate the difficulties (described below) that many people who are new to banking experience with direct debits (see also Office of Fair Trading 2010a; O'Reilly 2006).

The telephone interviews with providers and other stakeholders that were carried out for this research identified a wide variation in the banks' interest in, and commitment to, serving those who are unbanked and marginally banked (i.e. they have an account but largely operate a cash budget). Most offer a basic bank account either because they are required to do so or because they consider it to be part of their corporate responsibility. They are happy to leave others – the Post Office or credit unions for example – to meet the needs of people who are on the margins of banking. Frequently (but not invariably) this is reflected in the features offered by their basic bank accounts. Only a minority of banks have a real interest in serving those who are unbanked and marginally banked and consider there to be a business case for doing so. It is likely, therefore, that over time an even greater variation in the features offered by basic bank accounts will evolve, as a minority of providers develop their accounts taking advantage of technological advances, while others leave their accounts unchanged and increasingly out of date.

Credit unions

A small but growing number of credit unions offer a current account that matches the best of basic bank accounts in its features and access. Credit unions decided to charge a modest monthly fee (typically £3 to £5) and not levy charges for failed direct debits or standing orders (although they do pass on charges levied by the originator to account holders). The appropriateness of this approach was confirmed by research with potential account-holders (Jones 2008). There is an arrangement with the Post Office so that credit union current accounts can be used at a local Post Office for both withdrawals and deposits. During 2010, credit unions also began offering a pre-paid card (a card onto which money is loaded for spending at a later date). ABCUL (the main credit union trade association) has plans to develop backroom services that would allow a more rapid expansion of current accounts to other credit unions.

Post Office

The local Post Office has traditionally been the place where many recipients of social security benefits or the State pension accessed their payments – without the need for an account. Consequently, the Post Office offers services to allow people to pay their bills in cash at local Post Offices too, including facilities to charge key meters for gas and electricity. When the Government made electronic payment of social security and State pensions the norm, banks were persuaded to allow cash withdrawals from their basic bank accounts at local Post Offices and, in addition, were asked to finance the development of the Post Office Card Account (POCA).

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This is, in effect, a stored value card onto which benefits and State pension payments are loaded so that money can be withdrawn at a Post Office as and when it is needed. The POCA has no functionality over and above this. For example, it is not possible to load other types of payment on to the card, such as earned income or benefits paid by other government departments, and it cannot be used either to withdraw cash at LINK ATMs or to pay for goods and services.

A government review of the Post Office's role in banking was published in 2010 (Department for Business, Innovation and Skills 2010). This proposed that the Post Office should offer a new mass-market current account in association with the Bank of Ireland (building on an existing relationship between these two bodies). It also stated that the Government intended to make a weekly budgeting account available through the Post Office and had begun discussions with utility companies about the role they might play in its development. No timescale was given for the introduction of this new account. Our telephone interviews indicated that there were no plans either to offer a Post Office basic bank account or to develop the functionality of the POCA, at least for the foreseeable future. Instead, the Post Office seems likely to remain a provider of bill-payment services and a distributor of basic bank account services on behalf of banks, credit unions and others.

The Postal Services Act 2011 allows for the mutualisation of Post Office Ltd and sets out a broad framework under which mutualisation could be achieved. Having commissioned a report exploring options for the mutualisation of the Post Office (Co-operatives UK 2011), the Department for Business, Innovation and Skills launched a consultation 'to assist with the further appraisal of the case for and shape of a mutualisation, building on the recommendations made by Co-operatives UK' (Department for Business Innovation and Skills 2011). The consultation closed in December 2011 and, at the time of writing, the outcome of the consultation has not been published. If mutualisation were to occur, this could change the role the Post Office has to play in relation to banking services for people on low incomes.

PayPoint

PayPoint was established to offer an alternative network for bill-payment services (including charging keys for pre-payment meters) for those wishing or having to pay in cash. It operates through local retail outlets, with its costs being covered by the bill originators. There are a number of ways in which it is developing and expanding its bill-payment service. It offers cash payment facilities for people who want to buy goods or services online and do not have (or do not want to use) a debit or credit card. It has developed services with credit providers (for example mail order companies and credit unions) to allow their customers to make cash repayments at a PayPoint outlet. And in the case of mail order companies and online merchants, it also offers a facility for collecting and returning goods. It is exploring similar links with savings account providers and currently has an arrangement for credit union members to deposit money into their account at PayPoint outlets. It also has facilities for reloading stored value cards and pre-payment mobile phones.

From 2012, PayPoint will have a contract with Citibank for the default cash payment of social security benefits and State pensions for those unable to use either a basic

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bank account or a POCA. This will be a card-based 'account' with withdrawals only possible at local PayPoint outlets.

PayPoint offers a range of transaction services that overcome the cost and inconvenience of not having a bank account. Unlike the new entrants that we describe below, PayPoint has no current plans to develop a de facto 'bank account', however.

New entrants

In addition to these existing suppliers of banking services, a range of new entrants have begun offering services that mirror those of a traditional bank account (see Social Finance 2011 for more details). These new entrants are quite diverse and include mobile telephone companies and companies that have developed from fee-charging bill-payment services, often targeted on those in financial difficulty.

The developments of greatest interest for achieving financial inclusion are those based on a de facto account that meets most, if not all, of the needs we have identified for day-to-day money management. Moreover, those most likely to offer an alternative to a basic bank account from a bank, building society or credit union are ones where the fees are very modest.

'Jam jar' accounts

The basic design of this new generation of banking services involves two linked 'accounts':

- **An account to pay bills** (either a bank account or an escrow account where all clients' funds are held together) into which a regular sum of money is deposited and from which bills and other regular commitments are paid on standing order or direct debit. The size of the regular deposit is agreed between the customer and an account manager to ensure that sufficient funds are always in the account when bill payments are due.
- **A prepaid card** onto which any remaining money is transferred. This card can be used to withdraw cash from an ATM or to pay for goods and services. Most of these are MasterCards, which incur ATM charges.

These types of accounts are often referred to as 'jam jar' accounts as they mimic the practice common among lower-income households of setting money aside in a number of jam jars or similar containers for specific purposes.

Three companies currently offer an account of this kind to the general public: Secure Trust Bank (Prepaid Account), Spectrum Payment Services (CardOne Banking) and Think Banking (Think Banking Account). Each has its distinguishing features. The Secure Trust account is notable for its rewards scheme, which helps to offset the account charges when customers use their prepaid MasterCard card (see below); CardOne Banking is distinguished by its sophisticated text messaging service, while Think Banking assigns each of its customers a personal money manager.

It is estimated that around 150,000 people use one of these three accounts, with most referred by a debt management company – typically a company that manages

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the finances of customers in financial difficulty for a fee (Social Finance 2011). It is estimated that up to nine million people could potentially benefit from having an account of this type (Social Finance 2011).

The major advantage of these types of accounts over conventional bank accounts is the much greater degree of financial control that they give the customer, ensuring that bills are paid on time and preventing customers from spending more money than they have.

Providers of these accounts may have a full banking licence (for example in the case of Secure Trust Bank); others operate with an e-money licence, which imposes a limit on the amount of money that can be paid into the 'account' over the course of a year.

The current business model means all the 'accounts' that are currently in the market place have a monthly charge (typically between £12 and £15 a month) and often a range of other fees, including fees for ATM withdrawals.¹ Taken together, these charges can be high relative to the incomes of people who are unbanked or marginally banked. Some companies offer ancillary services that can help offset these charges. For example, the Secure Trust Bank account offers a reward scheme linked to its prepaid card that can be used at a wide range of high street retailers, with 4 per cent cash back on purchases made at over 35 retailers. Although the monthly fee for the Secure Trust Bank account is £12.50 and each ATM withdrawal costs a further £0.50, in practice account holders who use the reward scheme pay on average £8.95 a month for the use of their account. This is rather less than some banks charge for a single failed transaction on their basic bank account.

Mobile wallets

At least one telecommunications company (O2) is applying for an e-money licence and is developing a 'mobile wallet' (i.e. a means of accessing a range of financial services via a mobile device such as a phone or tablet) that provides an alternative to traditional bank accounts. This will enable people to undertake all the basic transactions available with a traditional bank account, plus some additional ones that are only available with a 'mobile wallet'. These include being able to:

- receive electronic payments (including social security payments) into a stored value account;
- load funds from a range of sources into a stored value account;
- access these funds using a virtual Visa card for online transactions and a linked physical Visa card for purchases and for cash withdrawals at ATMs;
- set up standing orders (but not direct debits);
- make peer-to-peer transactions (for example transferring small sums of money between family members or friends).

¹ New entrant banks can themselves be charged higher fees than traditional banks for arrangements to use the branch network of banks, the Post Office or PayPoint.

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Like the 'jam jar' accounts, the 'wallet' will enable people to segregate the money in their account into several 'purses' – for example, to pay bills, set money aside for Christmas or as savings.

Because it is based on the mobile phone, the 'wallet' allows people to undertake banking transactions while on the move – a feature that may particularly appeal to younger people. Importantly for those on a low income, it will enable them to manage and monitor their finances using their mobile phone and it will not be possible to overdraw the account, avoiding the risk of unexpected fees.

Charges and fees for the 'mobile wallet' will be minimised and, if possible, the service will be completely fee-free to the customer. When this product comes to market in the second quarter of 2012, it will represent a marked change in terms of its business model and make the account particularly appropriate for people who are unbanked or marginally banked.

With the introduction of Near Field Communications (NFC), the 'mobile wallet' could in future also include mobile ticketing, such as concession transit tickets, and voucher redemption. Although no social security benefits are currently paid in the form of vouchers, these could be accommodated using this service.

Demand-side issues

Regular monitoring by the Financial Inclusion Taskforce, using data from the Family Resources Survey, shows that considerable progress has been made towards bringing people into banking. The most recent figures show that only 1 per cent of households lack access to a bank account, although 5 per cent still lack a full transaction account (Financial Inclusion Taskforce 2010a). Paying benefits and State pensions electronically has undoubtedly played an important part in increasing the proportion of the population that has a bank account. However, the existence of the POCA clearly acts as a barrier to further banking inclusion (Finney and Kempson 2009; Sood and Hollings 2010).

The development of basic bank accounts has also played an important role, along with the shared goal developed by major banks and the Government to halve the number of people without a bank account. Basic bank accounts are particularly attractive to lone parents, people who are unemployed, those unable to work as a result of ill health or disability and people who are from Black, Pakistani or Bangladeshi communities. They are also popular in Scotland and, as a consequence, the proportion of households in Scotland with a transaction account is now the same as the rest of Britain. The proportion in Northern Ireland continues to lag behind Britain and here a higher proportion of households only have a POCA.

On the whole, the same groups of people remain unbanked as in the past, despite some dramatic increases in their banking engagement in that time (Finney and Kempson 2009; Family Resources Survey 2009/10; Kempson and Whyley 1999). As a result, those who are unbanked are concentrated among people on the lowest incomes and include above average proportions of people who are lone parents, unemployed, unable to work through disability and people from some minority ethnic groups (Bangladeshi and Pakistani people in particular). They are also

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disproportionately drawn from young people aged 16–24. Even so, the differential between these groups and the average level of banking exclusion has narrowed considerably.

Compared with those who are newly banked, who bear a close resemblance to other low-income bank customers, those who remain unbanked tend to be poorer and show more signs of disadvantage (Ellison et al. 2010). There is, however, a much higher level of churning among bank customers than there appears at first sight.

Newly banked

It is clear that third-party requirements are still a key driver in account opening. This includes needing an account for the receipt of wages or social security payments, but also the fact that some services, such as satellite and cable television, are only supplied if payments are made by direct debit from a bank account (Ellison et al. 2010; Millward Brown 2006).

Other important motivations for opening a current account or basic bank account included security, esteem and convenience, both in terms of accessing cash and paying for goods and services. The potential cash savings available from paying utility and other bills by direct debit was much less important (Ellison et al. 2010).

The key reasons why people had opened a basic bank account rather than a traditional bank account were threefold. The largest group (50 per cent) had done so because they wanted to keep tight control of their finances. These people tended to make the greatest use of their accounts. Even so, many were resistant to using direct debits. The next largest group (30 per cent) were people who had an impaired credit history and consequently had been unable to open a traditional current account. The third and smallest group (20 per cent) were people who needed an account for the receipt of social security payments and had been told about basic bank accounts. They tended to make the least use of their account (Barclays Bank 2010).

Few of the people who were newly banked had shopped around for the best account for their needs (Millward Brown 2006; Sood and Hollings 2010). On the whole, they found it easy to open an account (Barclays Bank 2010; Millward Brown 2006), with many fewer cases of people being unable to provide suitable proof of identity than in the past (Banking Code Standards Board 2008; Glazier et al. 2010).

The exception to this general picture was people with a seriously impaired credit history who (as we note above) are likely to be declined by the majority of basic bank account providers. People in this situation encountered greater difficulty opening an account and, consequently, needed to shop around (Banking Code Standards Board 2008; Citizens Advice 2010; Ellison et al. 2010; Glazier et al. 2010).

There was a high level of satisfaction among those new to banking, but they used their accounts cautiously. Fear of overdrawing and penalty charges was widespread and use of direct debits for bill payment was often seen as risky (Barclays Bank 2010; Devlin and Gregor 2008; Ellison et al. 2010; Kearton 2009; Sood and Hollings 2010). Problems arise with direct debits as a result of inappropriate timing and

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frequency and lack of control over the amounts deducted (Financial Inclusion Taskforce 2008; Social Finance 2011). People on low incomes who are paid weekly or fortnightly often struggle with monthly direct debits. Those with fluctuating incomes find automated payments difficult to manage, especially where the amount varies with service use. There are also problems where direct debits are based on estimated usage. Although Ofgem (the energy industry regulator) has taken action to ensure prompt refunding of over-payments (Ofgem 2009), there are still difficulties with people under-paying for their gas and electricity and finding themselves in arrears (Anderson et al. 2010). Participants in the community select committees described how these difficulties generally stem from the originators of the direct debit, not from the account provider or direct debits *per se*. They also identified a problem with unexpected changes to direct debits to cover increased subscription charges for services from some cable and satellite television providers.

As a result of these types of difficulties, it is estimated that around 4 in 10 of newly banked people withdraw funds from their account and manage their finances entirely in cash; only a quarter use their account to manage their money, the remainder operate partly in cash but using some banking facilities (Barclays Bank 2010; Ellison et al. 2010). In such circumstances, bills are paid either at a local Post Office or a PayPoint outlet (Hamlyn 2006).

It is estimated that between 50 and 60 per cent of people new to banking had at least one direct debit (Barclays Bank 2010; Ellison et al. 2010; Millward Brown 2006) and a sizeable minority of them had experienced bank charges. Three in 10 of people opening a basic bank account had a payment of some kind refused in the first 12 months after opening their account (Millward Brown 2006) and 2 in 10 of those who were newly banked had incurred a penalty charge over the past year (Ellison et al. 2010; Millward Brown 2006). Moreover, 15 per cent of those who were newly banked had either closed or stopped using their account because of the charges they had incurred (Ellison et al. 2010). Indeed, 7 per cent had done so within 12 months of opening it (Millward Brown 2006).

The Office of Fair Trading has calculated that, in 2006, 23 per cent of active transaction accounts had incurred at least one penalty charge, and that the average amount incurred in charges in a year was £205 (although fee levels have fallen since this time). The likelihood of incurring charges was greater among those on low incomes. Moreover, almost 6 in 10 people incurring charges in 2006 had also incurred them the previous year (OFT 2010a). It has been estimated that the average saving by paying utility bills on direct debit is about £125 and that the 3 in 10 people who are newly banked and have experienced penalty charges have an average of 5.6 such charges over the course of a year (Ellison et al. 2010). For five of the existing basic bank accounts, this number of penalty charges would exceed any savings made on utility bills by between £43 and £110 a year. Therefore, it is not surprising that users of credit union current accounts were attracted by the certainty associated with a monthly fee, instead of incurring bank charges for failed direct debits (Jones 2008).

There is more movement in and out of banking ('churning') than snapshot figures would seem to indicate. In fact, many of the people considered newly banked have

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had prior experience of banking. Around a third of people who had recently opened either a current account or a basic bank account were either unbanked but had previously had a bank account or had another account that they were not using (Ellison et al. 2010). This is almost certainly because they were attracted to the features of basic bank accounts and when faced with the need to have an account they had chosen to open one instead of reactivating an existing, dormant, current account. Consequently, almost half of people opening a Barclays basic bank account had another bank account (Barclays Bank 2010), and 8 in 10 people opening a basic bank account across a range of providers said it was their main account for dealing with day-to-day finances (Millward Brown 2006).

Unbanked

The level of churning among people who were unbanked was even higher. Indeed, 6 in 10 of them had previously had an active account, but had either closed it because they had experienced penalty charges and financial difficulties, or had left it dormant because they feared losing control of their finances (Ellison et al. 2010; Hamlyn 2006, Sood and Hollings 2010). This proportion has barely changed since the late 1990s (Kempson and Whyley 1998).

The reasons for not having an account differ between those who were previously banked and those who had never been banked – and these too remain largely unchanged over the past decade. While people who were previously banked were deterred by a fear of bank charges or loss of control over their finances, those who were never banked simply believed that they had no need for an account and were happy to manage their finances in cash. Few of those who had never been banked had applied for an account and been turned down (Ellison et al. 2010; Sood and Hollings 2010).

The majority of those who were unbanked relied on the POCA for the receipt of social security payments or the State pension (Ellison et al. 2010) and reliance increased the further people lived from a bank branch (Hamlyn 2006). They used either PayPoint or Post Office bill-payment facilities, often in combination with key meters for gas and electricity, using these outlets to re-charge their keys. Services such as cable or satellite television that require payment by direct debit were paid for using someone else's bank account. They paid for everything else in cash (Hamlyn 2006). In the community select committees held for this research, people in this situation (and particularly older people) said they were very content with this way of managing their finances.

There is clear evidence that the POCA is a significant barrier to people becoming banked (Finney and Kempson 2009; Sood and Hollings 2010). Nevertheless, even though they have opted to open a POCA rather than a bank account, unbanked users would like the POCA to have greater functionality. Most had opened a POCA because of the link with the Post Office, not because they were attracted to the functionality of the card (Sood and Hollings 2010). They would like to be able to deposit money into the account (other than the automatic payment of social security benefits and the State pension); to be able to withdraw money through bank and building society ATMs; and to have a cash card to use to make purchases (Bates et al. 2010; Ellison et al. 2010; Hamlyn 2006, ICM Research 2009).

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Perhaps as a consequence, a significant minority of unbanked people have expressed real interest in opening a bank account, particularly one that is better designed for their needs than traditional current accounts (Bates et al. 2010; Ellison et al. 2010; Hamlyn 2006). Those most attracted were the people with dormant accounts or who had previously held an account.

What would ideal transaction services look like?

With such a high level of churning in and out of existing bank accounts, entry to banking appears to be something of a revolving door. Several studies have sought the views of people who are unbanked or marginally banked about what an ideal account would look like (Bates et al. 2010; Future Foundation 2007; Hamlyn 2006; ICM Research 2009; Kempson and Whyley 1999; O'Reilly 2006; Social Finance 2011). The conclusions are remarkably consistent, across studies and over time, and include the following facilities:

- deposits;
- withdrawals at ATMs and also at local Post Offices and PayPoint outlets;
- a payment card for purchases and use at ATMs;
- a small buffer zone to permit balances of under £10 to be accessed at an ATM;
- ability to check exactly how much is in the account at will and mobile phone text alerts when the balance is getting low or a major payment is due and there are insufficient funds to meet it;
- a new type of automated payment facility that puts more control in the hands of the account holder than direct debits. As noted earlier, a number of studies have explored the potential for 'jam jar' accounts that emulate the way people who operate cash budgets set money aside at home for different purposes (Social Finance 2011; Sood and Hollings 2010).

Such an account would be more attractive to people on low incomes than either a basic bank account or the POCA (Bates et al. 2010) – and indeed could replace the POCA entirely (Social Finance 2011).

For this research, participants at our community select committees heard details of four quite different 'accounts' for managing their money day-to-day. They had the opportunity to question the providers directly and then to discuss the merits and disadvantages of the four accounts without the providers being present. The four accounts they discussed included two basic bank accounts (the Barclays Cash Card account and a credit union current account with a monthly fee), the Secure Trust Bank Prepaid account and the mobile wallet currently being developed by O2. All the community select committee participants were either unbanked or marginally banked (that is, they had an account but largely managed a cash budget). Details are provided in the Appendix.

Their discussions demonstrated a high level of conservatism, among both unbanked and marginally banked people. Most participants were quite happy with their current arrangements and, as in previous studies, stressed that a cash budget enabled them to maintain control over their finances. That said, they included some people who

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were attracted by the Barclays Cash Card account as well as a minority of people who were attracted to each of the three other accounts.

Providers

There was a clear preference among our community select committee participants for using well-known companies. This made the Barclays account (and other basic bank accounts) potentially attractive, but levels of awareness of such accounts were very low. The idea of using a locally based credit union that served its community was appealing but credit unions were not (yet) seen as part of mainstream banking. There were also concerns about access and the portability of credit union accounts. On the whole, participants were more interested in obtaining loans or saving with a credit union than opening a credit union current account. There were concerns in relation to new entrants regarding the security of transactions and participants wanted reassurance about universal access and usability of these types of accounts. It has been noted that limitations with regard to profile and branding are holding back the use of existing 'jam jar' accounts (Social Finance 2011).

Account services

The idea of being able to allocate their money into separate 'purses' or 'wallets' (i.e. separate sections of their account) was quite attractive to participants, and they could see the advantages of having a purse or wallet for bill payment, as long as the existing difficulties with direct debit originators could be resolved. Participants preferred push payments such as standing orders (i.e. where the account holder sets the payment amount) to pull ones such as direct debits (i.e. where the payment amounts may vary). A prepaid payment card was not seen to have any disadvantages compared with a Visa debit card, unless there were restrictions on where prepaid cards could be used or charges associated with using them. The potential to make automated person-to-person cash transfers was particularly attractive to participants under the age of 40, and some of this age group said they were attracted to opening a mobile wallet account when they become available.

Aids to budgeting, such as an allocated personal money manager or fully itemised banks statements (for example, showing summaries of the amounts spent on different categories of purchases) were less of a draw than expected. Some participants thought they would be ideal for young people or people struggling to manage their money but no one admitted to needing them themselves. Text messaging to aid account management was more attractive. Previous research has found that people divided into two groups: those who would like to be alerted to every transaction and those who only wanted to be alerted if there was likely to be a payment problem on the account (O'Reilly 2006; Social Finance 2011).

Fees and charges

In the UK, banking services are widely perceived as being free for people who keep their accounts in credit. But as we note above, charges for failed transactions and unauthorised overdrafts are commonplace among people on low incomes. The issue of fees and charges was, therefore, discussed in some detail at the community select committees and there was clearly a preference for (in credit) free banking services. Indeed, as previous research has found (Social Finance 2011), the charges levied on existing 'jam jar' accounts are a major deterrent to their use. Participants thought that a modest monthly charge might be acceptable, if bank charges could be

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avoided, but other fees, especially for using ATMs, would be a deterrent. It was difficult to identify what level of monthly charge might be acceptable. It was clear that £12.50 (the current monthly charge levied by Secure Trust Bank) was considered too high; £5 (the credit union charge) was thought better but even so there was no enthusiasm for it, especially if charges from the originators of (failed) direct debits were passed on. This accords with research conducted for ABCUL, which found that fewer than half of people who were not credit union members considered a small weekly or monthly charge acceptable, even if it did avoid charges from the credit union for failed direct debits (Jones 2008).

In the community select committees, the one exception to participants' resistance to paying monthly charges was if someone were in financial difficulty and wanted assistance to keep up with payments. In this situation, participants felt that a fee was justified, especially if the account offered a personalised service. One participant was a Think Banking customer for this reason, although she planned to open an account without a monthly charge once she had resolved her financial problems.

As noted above, the Secure Trust Bank account currently offers a reward card, which can be used at a wide range of high street retailers to mitigate the charges on its account. To cover the monthly account charge of £12.50 and a total of £2 in fees for four ATM cash withdrawals a month would require something like a weekly spend of £81.50 at the supermarket and £23 elsewhere. Community select committee participants considered that this level of spending was only feasible for someone in work.

In the case of the proposed mobile wallet being developed by O2, it is possible that some or all of the costs will be covered by fees paid by partnering companies (in much the same way as PayPoint covers its costs). Unsurprisingly, this found favour with participants. Even so, there was a degree of scepticism that all the costs could be covered in this way.

No ideal account

It was clear, however, that the community select committee participants were not looking for the ideal account and would be inclined to 'mix and match' services that best met their needs to give them all the banking facilities they required. They seemed unlikely to use a single account for all their day-to-day financial transactions. That said, there were people who found each of the accounts discussed at the community select committees very attractive. Consequently, there is a potential for a range of providers to meet the needs of those currently on the margins of financial services.

Financial capability

Community select committee participants were surprised to learn that there are alternatives to the traditional current account and agreed that these needed much better promotion. Previous research has found that 3 in 10 people who were unbanked had never heard of a basic bank account (Hamlyn 2006) and lack of awareness is holding back the take-up of existing 'jam jar' accounts (Social Finance 2011).

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In addition, the community select committee participants and the stakeholders who attended the banking round-table identified a need for clear information and guidance about managing money with an account for anyone opening an account, as well as better education for young people on using transaction banking services. Again this accords with previous research (Jones 2008; O'Reilly 2006).

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SUMMARY

Many people on low incomes rely heavily on unsecured consumer credit to meet periodic needs. Their credit options are generally limited to higher-cost providers in the credit market such as home credit, goods bought on credit from mail order catalogues or rental purchase shops. There are serious concerns about consumer credit regulation, with repeated calls for a cap on the cost of credit. At the extreme, people living in very deprived communities may resort to using completely unregulated illegal moneylenders.

Credit unions and community finance organisations have demonstrated their potential to offer a viable alternative to commercial credit for people on low incomes, if they were able to increase the scale of their lending. The discretionary Social Fund helps people on very low incomes to meet periodic needs, but proposed changes may reduce access to grants and loans in the future.

Savings and insurance are potential alternatives to borrowing to meet periodic needs. But many people on low incomes do not have savings and the UK generally does not have a strong savings culture. Low coverage of home contents insurance among social housing tenants persists, with low awareness among tenants of affordable schemes and a lack of effective promotion by landlords.

It is important that achieving financial inclusion is not seen as a substitute for ensuring that people have an adequate income. Our vision for meeting periodic needs therefore includes a crucial role for government in providing a safety net for financially excluded people, both in terms of financial support (in the form of adequate welfare benefits and state pensions) and free health and dental care at the point of use. It was not within the scope of this research to consider what might constitute adequate support, nor do we describe in any detail the Government's proposals for welfare reform and their implications for income adequacy.

Instead, we focus on the periodic needs that are regarded in the vision as primarily the responsibility of the individual, namely meeting predictable expenditures, covering major unpredictable financial outlays and meeting the costs of goods and services that are considered necessary for social inclusion (such as family holidays, children's outings). In the following sections we describe the current situation in relation to credit use, saving and insurance.

Credit use

Credit use is a complex area of financial inclusion, not least because it is unclear how the extent of inclusion should be judged. We know that more than half of the UK population does not make significant use of credit (Daffin 2009; Office of Fair Trading 2010b). As levels of credit use do not vary a great deal by income, this will broadly

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be the case among people on low incomes as well, and will include those who do not want to borrow as well as those who are unable to. Moreover, the Office of Fair Trading report found that a large body of research showed that the most appropriate source of credit for people on low incomes is small, short- and fixed-term loans; not revolving credit (i.e. credit without fixed repayments), such as credit cards or overdrafts (OFT 2010b).

On the supply side, the Office of Fair Trading has highlighted the limited sources of additional credit supply to provide the types of small-sum cash loans that people on low incomes require. The likelihood of banks or other mainstream lenders lending small sums directly to financially excluded individuals is extremely low (except through sub-prime subsidiaries lending to people with impaired credit histories, where these still exist). And, while a number of banks support credit union and CDFI development indirectly (for example through grants and professional support), to date very few UK banks have invested financially in the sector. Similarly, it is very uncommon for UK banks to provide credit unions and CDFIs with loan capital; where it is available the conditions are often prohibitive (Financial Inclusion Taskforce 2010b). The Financial Inclusion Taskforce expressed disappointment in the level of engagement of the UK banking sector in supporting credit unions and CDFIs.² On the demand side, there seems to be little appetite among credit unions and CDFIs to borrow commercially (Collard et al. 2010).

Looking to the sub-prime credit market, concerns about a lack of competition in the high-cost credit market resulted in a Competition Commission inquiry into home credit (2004–06) and the Office of Fair Trading review of high-cost credit (2009–10). Both highlighted the lack of new entrants into this part of the credit market, particularly those that specialise in lending to people on low incomes. It seems unlikely, therefore, that lower-cost loans will become available as a result of greater competition at this end of the market. There has been no review to date of the effectiveness of the mainly information-based remedies proposed by the Competition Commission to improve competition in the home credit market.

In assessing the current situation regarding the use of credit to meet periodic needs, we identified the following key issues:

- a heavy reliance among financially excluded people on high-cost credit for all needs (day-to-day and periodic);
- the use of illegal lenders by a significant minority of financially excluded people;
- the emergence of potentially sustainable credit unions and CDFIs;
- the importance of the discretionary Social Fund in helping people meet periodic needs;
- consumer credit regulation; and
- how best to help financially excluded people who are refused credit.

We explore each of these issues below.

² www.fabians.org.uk/events/transcripts/brian-pomeroy-lecture

Reliance on high-cost credit to meet all needs

Regardless of income, families with children tend to be among the heaviest users of credit (Daffin 2009; Finney et al. 2007). The options open to people on low incomes who are credit-constrained are generally limited to higher-cost providers, with home credit and mail order being among the most common (Collard and Kempson 2005). Payday loans, while an increasingly prominent feature of the UK sub-prime credit market, tend to be used by young single adults who are in work (Dominy and Kempson 2003; Burton 2010). It is estimated that at least three million households use high-cost credit to borrow at least £3 billion in low-value loans per annum (Financial Inclusion Taskforce 2010b).

There is a significant body of research in the UK that looks in detail at the high-cost commercial credit options available to people in the UK who are financially excluded. This includes research conducted as part of an inquiry into the home credit market (Whyley and Brooker 2004; Competition Commission 2006), a major review of high-cost credit carried out by the Office of Fair Trading (Office of Fair Trading 2010c), and an assessment of the costs of credit exclusion carried out for the Financial Inclusion Taskforce (Whyley 2010). As well as the high charges that people pay for credit, other costs related to the use of high-cost lenders can include punitive or unclear terms and conditions and the risk of financially excluded households finding themselves in a cycle of borrowing and debt (see Whyley 2010 for a summary of the literature). At the same time, there are features of high-cost commercial credit products that are attractive to people on lower incomes, primarily the ability to borrow small sums of money quickly and easily, fixed term loans with affordable weekly repayments and no penalties for late payments or the occasional missed payment (Collard and Kempson 2005).

Also of concern in developing a vision for financial inclusion is the fact that financially excluded people may rely on high-cost credit to meet *all* their needs: day-to-day as well as periodic, essential and discretionary. Research dating back 20 years highlighted that people on low incomes borrowed more often for necessities than those who were better off (Berthoud and Kempson 1992; Kempson et al. 1994). Little seems to have changed since then, with around a third of lower-income credit users borrowing to cover an outstanding bill or to help with day-to-day household spending (Office of Fair Trading 2010c).³

The same Office of Fair Trading research found that around 2 in 10 people (23 per cent) borrowed to purchase a particular item, and 3 in 10 (26 per cent) wanted the money for a special occasion such as Christmas or a birthday (Office of Fair Trading 2010c). Again this is consistent with earlier research which highlighted borrowing from high-cost lenders for material and social inclusion purposes (Whyley and Brooker 2004; Collard and Kempson 2005; Jones 2005; NOP 2005).

A challenge for realising our vision for financial inclusion, therefore, is whether it is possible to reduce people's reliance on credit to meet many types of needs, to using a mix of credit, saving and (where appropriate) insurance. It also raises the

³ This is based on use of the types of credit commonly associated with people on lower incomes, including payday loans, logbook loans, mobile phone loans by text, pawnbroker loan, home credit loans and credit union loans.

fundamental question of whether it is reasonable to expect people on low incomes to have to borrow for everyday essentials because of persistent income inadequacy.

The use of illegal lenders

There has long been anecdotal evidence of illegal lending among poor communities in the UK. The nature and scale of illegal lending has only recently been the subject of empirical research, with an estimated 310,000 people borrowing from an illegal lender in 2010 (Policis 2010), up from an estimated 165,000 in 2006 (Policis 2006). Illegal lending is concentrated in areas of high deprivation, with users having few or no alternatives for borrowing money. The people who use illegal lenders tend to be women, mostly in their thirties and forties, often lone parents bringing up families, and on low-incomes.

Loans from illegal lenders may be used for a variety of purposes, spanning day-to-day and periodic needs. Common elements of illegal lending include extremely high charges, which are often applied and increased arbitrarily, no paperwork or formal agreement, and the use of intimidation, threats and violence to ensure prompt payment (Policis 2006, 2008). Since the mid 2000s, specialist teams to tackle illegal lending have operated across Britain, and in the first three years of operation arrested 280 alleged illegal lenders (Policis 2008).

The emergence of potentially sustainable credit unions and CDFIs

Credit unions and CDFIs have long been seen as a major plank of financial inclusion policy to provide financially excluded people with lower-cost alternatives to commercial high-cost credit. But not all credit unions and CDFIs are necessarily interested in lending to large numbers of people. And not all credit unions operate the risk assessment and risk management processes necessary to offer instant access loans without the need for borrowers to save money into a credit union account beforehand – a major barrier to accessing credit union loans for people on low incomes (Collard and Kempson 2005; Policis 2008; Whyley 2010). Even so, both the number of credit unions able to offer instant loans and the number of people able to access credit union services has increased greatly in recent years.

The DWP Growth Fund, which operated from 2006 to March 2011, represented a major investment in credit unions and CDFIs, to increase access to lower-cost credit in communities where demand exceeded supply. It aimed to build the capacity of credit unions and CDFIs to make small-sum instant access loans to financially excluded households, and in doing so displace the use of high-cost credit. A key element of the Growth Fund was its model of 'intensive relationship-based contract management' (Whyley 2010).

The Growth Fund was delivered by around 150 lenders across England, Scotland and Wales, of which around 130 were credit unions. At the time the Growth Fund was evaluated, over 330,000 loans had been made, with a total value of £137 million.⁴ The total interest savings per Growth Fund borrower was estimated at between £377 and £425 over the lifetime of their current credit obligations (Collard et

⁴ Statistics published after the evaluation was completed indicated that over 400,000 loans had been made to the end of March 2011, with a total value of £175 million.

al. 2010). To put lending on a more stable commercial footing, however, would require either higher interest rates than the 26.8 per cent APR charged by most Growth Fund lenders or a significant reduction in operating costs (Collard et al. 2010).

As well as providing benefits to borrowers, the Growth Fund has provided further evidence that there are potentially sustainable credit unions and CDFIs (that are not reliant on grant funding) in the sector. This is a significant development: with the possibility of sustainability in sight, the idea of some Growth Fund credit unions and CDFIs significantly expanding their lending becomes more feasible. To give some idea of the scale of lending required, it is estimated that credit unions and CDFIs would need to provide one million affordable loans worth £400 million per annum, covering at least 200 local authority areas that have above-average demand for credit (Financial Inclusion Taskforce 2010b).

Building on the Growth Fund, support for credit unions may continue for up to four years, through a fund of up to £73 million, conditional on the report of a feasibility study. This study was established by the Department for Work and Pensions to 'examine the scope and options for the modernisation and expansion of credit union'. Its report was delivered to the Minister for Welfare Reform in December 2011 and, at the time of writing, the outcome is not known.

In addition, a new Legislative Reform Order, amending the Credit Unions Act, came into force in January 2012. The changes it introduces aim to stimulate the development of the credit union movement by removing barriers to membership.

The importance of these developments is underlined by research showing that the sector faces significant operational and management challenges in order to realise its full potential. Credit unions vary considerably in the extent to which they are equipped to grow, with a significant number not yet generating sufficient income to sustain and capitalise their business (Jones and Ellison 2011). It also seems unlikely that credit unions and CDFIs will ever be able to replicate the home credit model on a not-for-profit basis (Kempson et al. 2009), which may limit their appeal among some financially excluded borrowers.

The importance of the discretionary Social Fund

The discretionary Social Fund is currently made up of Community Care Grants (for specific purposes such as leaving residential care or to ease exceptional pressure on families), interest-free Crisis Loans (for living expenses in an emergency, or as a consequence of a disaster) and interest-free Budgeting Loans (to help people with the cost of bigger essential items like furniture and household equipment). Eligibility for Community Care Grants and Budgeting Loans is restricted to people on qualifying benefits and in the case of Budgeting Loans only to those in receipt of qualifying benefits for 26 weeks. The scale of assistance from the discretionary Social Fund is far greater than that currently available through credit unions and CDFIs. In 2010/11 over 1.1 million Budgeting Loans, more than 2.6 million Crisis Loans and just over a quarter of a million Community Care Grants were awarded, totalling over £815 million (Department for Work and Pensions 2011a). In April 2011,

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however, significant cuts were made to the budget for Crisis Loans, with eligibility being restricted and the level of individual payments reduced.

Despite its important role, the Social Fund has largely been excluded from financial inclusion policy. It was not, for example, within the remit of the Financial Inclusion Taskforce. Research indicates, however, that it is more widely used than commercial sources of credit by people who qualify to borrow in this way (Collard and Kempson 2005; Collard et al. 2010). In particular, Budgeting Loans are an important means for people on Income Support or income-based Jobseeker's Allowance to meet the sorts of periodic needs described in Chapter 2, especially for meeting unexpected expenditure such as replacing white goods that had broken down. Very few of them had savings they could call on in such an emergency (Whyley et al. 2000). This same research showed that home credit was the only other source that met the same range of needs as Budgeting Loans. That said, use of Social Fund Budgeting Loans by older people who qualify is far lower than might otherwise be expected. This has been attributed to lack of knowledge and the stigma of applying (Kempson et al. 2002).

Social Fund Community Care Grants are only available to people on income-replacement benefits who need assistance to live independently in the community. By definition, therefore, they include some of the most vulnerable people in the population. Because the budget is cash-limited the level of refused applications of Community Care Grants is far higher than for either Budgeting Loans or Crisis Loans. Moreover, many of those who are successful receive only a partial award, of less than half the amount they apply for. The consequences of failing to receive the money needed were often of real concern – with vulnerable people going without essential items for extended periods of time or, in a sizeable minority of cases, using commercial credit and getting into financial difficulties as a consequence (Kempson et al. 2004).

The discretionary Social Fund has long been criticised because of its inability to adequately meet people's needs within its cash-limited budget. This applies particularly to the Community Care Grant budget, which has been frozen at £141 million since 2006/07 (see, for example, House of Commons, Committee of Public Accounts 2010). In April 2011, mounting concerns about the increasing use of Crisis Loans led the Government to announce cuts to the scheme. Crisis Loans are no longer available to replace cookers and beds (unless the need has arisen as a consequence of a disaster); the rate paid for Crisis Loans for living expenses was reduced from 75% to 60% of benefit rate; and a cap was introduced of three awards for general living expenses in a rolling twelve-month period. The Welfare Reform Bill 2011 contains provision for the abolition of Community Care Grants and Crisis Loans, to be replaced by locally administered assistance from April 2013.

In England, at least, there will be no new statutory duty on local authorities to deliver this form of assistance, and funding transferred from the Department for Work and Pensions to local authorities will not be ring-fenced. There are, as yet, few details of how replacement services would work in practice, although early discussions between the Department for Work and Pensions and English local authorities indicate that none would expect to offer loans, only assistance in kind (including

supermarket vouchers) (Communities and Local Government Committee 2011). The Government has also ruled out a replacement for the Independent Review Service that currently considers appeals against Social Fund decision-making. This is on the grounds that it would be impracticable because they expect local services to vary widely.

The devolved administrations in Wales and Scotland are currently considering how best to provide a replacement safety net. The Welsh Government seems to have ruled out the possibility of running a national scheme. Neither has yet ruled out either ring-fencing the money or the provision of an Independent Review Service. In 2012, the Welsh Government produced a consultation document on the nature of a replacement service (Welsh Government 2012), which explicitly draws the link between Social Fund provision and financial inclusion.

There are serious and widespread concerns about the impact of the proposed changes both on poor and vulnerable families and on grant-making voluntary and community organisations that will have to try and breach the gap. Fifteen leading charities wrote an open letter to the Secretary of State for Work and Pensions; concerns have been voiced in both Houses of Parliament and a report of discussions between the Department of Work and Pensions and local authorities shows that many have real concerns about their ability to provide a suitable replacement for Crisis Loans and to make adequate provision in rural areas (Department for Work and Pensions 2011b). The Communities and Local Government Committee concluded that the proposed localisation will result in a 'postcode lottery' of support and may be a 'poisoned chalice' to local authorities (Communities and Local Government Committee 2011).

The Welfare Reform Bill also proposes to replace Budgeting Loans with a 'modernised and simplified national system of payments on account accessed through the benefit system'.⁵ This is much less controversial.

Consumer credit regulation

In a market where low-income consumers have limited choice, the need for robust regulation of the credit sources they can access is very important indeed (Office of Fair Trading 2011). Although much of the debate focuses on the cost of credit at this end of the market, terms and conditions are every bit as important – as recognised in the Consumer Credit Act 2006. The Act gave greater powers to the Office of Fair Trading to intervene in the credit market, which has resulted in more enforcement action. There are still serious concerns about the effectiveness of consumer credit regulation in the UK, however. Government consultations in this area include a review of consumer credit and personal insolvency and options for the future regulation of the market. There have also been repeated calls for a cap on the cost of credit.

In developing a vision for financial inclusion we focused on two elements of consumer credit regulation. The first is recent efforts to tighten up responsible lending. The transposition of the Consumer Credit Directive into UK law in 2010

⁵ Steve Webb, Minister of State (Pensions), Work and Pensions, Hansard Written Answers and Statements. HC Deb 10 May 2011, c1168w.

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introduced a new obligation on lenders to assess the creditworthiness of borrowers. In addition, in 2010 the Office of Fair Trading published its guidance on irresponsible lending, which aims 'to provide greater clarity for businesses and consumer representatives as to the business practices that the Office of Fair Trading considers constitute irresponsible lending practices'.

The second relates to the ongoing scrutiny of lenders, in the form of the Office of Fair Trading's review of high-cost credit, which included an investigation of the costs to the borrower of high-cost credit and the options that they have (Office of Fair Trading 2010d). The Office of Fair Trading made a number of recommendations which it recognised were likely to have a limited impact on the deep-seated issues it identified, namely consumer financial capability, cultural attitudes to credit, and increasing the supply of credit to low-income borrowers through the mainstream market and/or the Social Fund. It also concluded (like the Competition Commission's 2006 home credit inquiry) that the introduction of price controls for high-cost credit would be inappropriate. The Financial Inclusion Taskforce has also cautioned against the introduction of price controls until there is a sufficient supply of alternative lower-cost loans. A study for the Friends Provident Foundation argued that regulation needs to be both sensitive and flexible in order to address the risks attached to products across the credit market, without damaging individuals' access to credit or market innovation (Ellison et al. 2011).

There is, nevertheless, a growing lobby for the introduction of a cap on credit charges. This is reflected in a private members Bill that would, among other things, introduce a cap on the total cost of credit.

How best to help financially excluded people who are refused credit

In promoting access to lower-cost for financially excluded people, it is important to strike a balance between achieving inclusion while still ensuring responsible lending and borrowing. This gives rise to the question of how best to help people who are refused credit, have no other options for borrowing (short of an illegal lender) and whose circumstances, anyway, may be such that further lending would be irresponsible.

The experiences of Growth Fund applicants and lenders help to shed some light on this difficult issue, although they do not suggest any easy solutions. Some of the most common reasons for Growth Fund lenders to refuse loan applications were insufficient disposable income to repay a loan, poor credit history, arrears and difficulties in providing appropriate identification. Survey data indicates that half (51 per cent) of unsuccessful applicants did not know the reason they had been turned down; and the majority said they had not been referred for money advice when they were turned down (Collard et al. 2010). Qualitative interviews with unsuccessful Growth Fund applicants indicate that take-up of money advice may be low in any case (Collard et al. 2010; Policis 2008). While a small proportion of unsuccessful Growth Fund applicants in the survey went on to borrow from a commercial lender (typically a home credit company or finance house), the majority did without the money and the goods or services they had planned to buy. One in 10 unsuccessful applicants had either taken out a loan from the Social Fund or borrowed from a

friend or family member – although many of those turned down would not have been eligible to apply to the Social Fund (Collard et al. 2010).

Qualitative interviews indicate that Growth Fund lenders struggled to know where to direct unsuccessful applicants, short of the Social Fund (which has strict eligibility criteria and a limited budget), grant-giving charitable organisations, or money advice if an applicant was in financial difficulty (Collard et al. 2010).

Saving

From a government perspective, encouraging people to save is a means of promoting independence, opportunity and self-reliance. This in turn, it is hoped, will help reduce reliance on the state and ease financial pressure on the public purse.

Whether or not it is appropriate or realistic for financially excluded people on low incomes to save has been a matter of debate in the UK. It is argued, for example, that people on low incomes would be better using any spare money to pay down debts rather than saving (Peacey 2010). Another concern is that low-income families may save at the expense of maintaining a basic standard of living, although research has shown this not to be the case (Kempson et al. 2005). Overall, however, the evidence indicates that the material and psychological benefits of saving for people on low incomes outweigh these concerns (Kempson 2007; House of Commons Treasury Committee 2006; Collard and Smith 2006; Kempson et al. 2005; Finney and Davies 2011).

In considering the current situation in relation to non-pension saving, we focused on the following issues: regular saving; informal, short-term saving; incentives to save; and regulation of informal savings accounts.

Regular saving

In the twenty-first century, regular saving is not part of UK culture. At a national level, the household saving ratio in 2008 was the lowest recorded since 1970, although household saving subsequently increased in reaction to the economic recession (Carrera and Beaumont 2010).⁶ The Wealth and Assets Survey found that most people in 2006/08 did not have a strong orientation towards spending and many reported having money left over at the end of the week or month at least sometimes. Despite this, only a half of people had actively saved any of their income in the last 12 months (Daffin 2009).

A survey of lower-income families found that one in four (25 per cent) were not saving in any way at all. Lack of money is the most common self-reported reason why people on low incomes do not save (Kempson and Finney 2009), although recent studies have emphasised the importance of looking beyond this, to distinguish between genuinely having no spare money to save and having other priorities for any spare cash (Dolphin 2009; Kempson and Finney 2009). Indeed, multivariate analysis has shown that, among people on lower incomes, attitudes to saving are by far the most important determinant of regular saving (Kempson and Finney 2009).

⁶ The saving ratio is defined as the proportion of total resources that households do not spend on goods and services but instead put aside every year as savings.

This is strongly borne out in a study of people with lower household incomes (below 70 per cent of the median). Like previous research, it found that economic factors did not offer a sufficient explanation of why some saved and others did not. Quantitative analysis showed that while only one in five were 'active savers', twice as many were 'saving inclined' (Finney and Davies 2011). Qualitative research highlighted that internal motivations (such as not wasting or owing money and avoiding going without) clearly distinguished savers from those who were saving inclined and non-savers. At the same time, those not actively saving often expressed negative views of savers as 'stingy' or 'tight' and described those who did not save as 'normal'. They were quite unable to name either a real-life or fictional champion of saving.

Informal, short-term saving

Lower-income families are much less likely than those who are better off to have a savings account; to have any money saved in an account; and to be actively saving money into an account. Many people on low incomes do, however, save small amounts of money using informal methods such as saving cash at home or buying saving stamps, generally for short-term needs. Survey data analysis indicates that more than 6 in 10 (63 per cent) of lower-income families save informally, and 4 in 10 (38 per cent) *only* save that way (Kempson and Finney 2009). Informal saving is also popular among black and minority ethnic groups, who tend to be unfamiliar with and to mistrust financial institutions (Khan 2009).

Incentives to save

The demand-side issues outlined above highlight the challenge of encouraging people on lower incomes to develop a regular saving habit, and preferably to save into regulated savings accounts.

A review of research on saving among lower-income households concluded that there are no major structural failures in the supply of saving accounts in the UK, but rather a mismatch between the things that people on lower incomes want or need and the products and services that are available (Kempson and Finney 2009). This applies particularly to incentives to save.

In the prevailing economic climate it would be difficult for a low-income saver (or indeed any saver) to find an ordinary, easy access savings account that offered an interest rate sufficient to protect savings from inflation. In February 2012, the interest rate offered on 'best buy' easy access savings accounts was in the region of 3 per cent AER.⁷ The rate of inflation (as measured by the Consumer Price Index) was higher than this, at 3.6 per cent in January 2012, down from 4.2 per cent in December 2011. Tax relief and interest rates have little relevance to people on lower incomes with only small sums of money to save. Consequently, these traditional forms of incentive are not sufficient to encourage them to start saving in a formal account (Dolphin 2009; Kempson et al. 2005; Finney and Davies 2011).

Evidence from the UK and elsewhere indicates that clear and simple incentives such as matched saving schemes and bonus payments effectively targeted at people on

⁷ www.moneysavingexpert.com, accessed on 17 February 2012.

lower incomes are far more effective (Kempson and Finney 2009). And the evaluation of the Saving Gateway identified a number of its features that encouraged the accumulation of savings. The setting of a realisable maximum amount that could be saved each month (£25) became a target for regular saving. The fact that the matching was based on the maximum amount in the account over its lifetime (18 months) also acted as a goal to aim for and discouraged withdrawals (Kempson et al. 2005).

There is also a real need to tackle the lack of motivation to save (Finney and Davies 2011). In doing so, it is important to start where people are: acknowledging that people live for today but emphasising that it is just as important to live for tomorrow; and stressing that even small sums of savings mount up over time. Saving champions – people from humble origins who have succeeded but continue to have a modest lifestyle – could help convey these messages. Specific goals can also motivate people to save. At the same time, a failure to save can be due to disorganised money management, in which case the design of accounts can make it possible for people to save (as opposed to making it attractive to do so). This includes automatic deductions into a savings account and accounts that limit access but where funds can be withdrawn if really needed, for example 48-hour notice accounts or accounts where withdrawals can only be made in person at a branch.

Regulation of informal savings accounts

The risk of saving in commercially provided unregulated accounts or products and the need for robust consumer protection was highlighted in 2006 by the collapse of the Farepak Christmas Club, in which 150,000 families lost £40 million savings (Pomeroy 2007). In the wake of this, safeguards were introduced to protect the predominantly low-income savers who use these schemes and clubs to spread the cost of paying for Christmas. Customers' pre-payments now have to be held in ring-fenced trust accounts where they are protected if savings clubs or their parent companies go bust. The scheme is monitored by a new trade association. A number of companies entered the Christmas savings market following the Farepak collapse including PayPoint, the Post Office and Argos. The Office of Fair Trading's Save Xmas Campaign was introduced to promote the various options to save for Christmas and to heighten public awareness of consumer protection in relation to saving products (Ipsos MORI 2008, 2010).

Insurance

Our vision for financial inclusion includes a crucial role for government in providing free dental and health care at the point of use, and state financial support in the case of job loss or where individuals are unable to work due to disability or ill health. In the absence of these state safety nets, the alternative would be for individuals to meet these expenses themselves through insurance (or possibly savings), or to have no cover for these events. Discussion of the adequacy of state safety nets was outside the scope of this project. Instead we have focused on the issue of home contents insurance, which remains a key area of financial exclusion for many low-income households. In describing the current situation in relation to home contents insurance, we looked at: low coverage of home contents insurance among low-

income households; the availability and take-up of tenant contents insurance; insurance exclusion among particular low-income groups.

Low coverage of home contents insurance among low-income households

In 2008, 52 per cent of households in the bottom fifth of the income distribution lacked home contents insurance, compared with 18 per cent of middle-income and 9 per cent of high-income households. Three-quarters of households not covered by home contents insurance were in rented accommodation, with most being social housing tenants who rented their home from a housing association or local authority (Parekh et al. 2010). As the authors note, this picture has changed very little over the last ten years.

The case for lower-income households to take out home contents insurance is strong, with social housing tenants more likely to be burgled than owner-occupiers; a higher incidence of arson attacks in low-income communities; and the higher likelihood of low-income families living in high flood-risk areas (Wheeler 2011). In the absence of home contents insurance, people on low incomes may struggle to recover from a burglary, fire or other insurable event. There is a range of reasons, beyond the cost of taking it out, why people on low incomes do not take out home contents insurance. These include: placing a low priority on insurance in the household budget; the perceived low likelihood of experiencing insurable events; lack of knowledge about level of cover and exclusions; a lack of payment options; and mistrust of insurance companies (Dayson et al. 2009; Ipsos MORI 2007; Toynbee Hall, 2005). The development of tenant contents insurance aimed to address some of these issues.

The availability and take-up of tenant contents insurance

Tenant contents insurance refers to home contents insurance offered by housing associations and local authorities to their tenants. It includes insurance-with-rent schemes, where tenants pay insurance premiums with their rent, as well as insurance promoted by housing providers where tenants pay premiums direct to the insurer (referred to as arm's length schemes).

Tenant contents insurance (and insurance with rent in particular) was identified more than a decade ago as an effective means of increasing home contents insurance coverage among social housing tenants (Kempson 1999; Whyley et al. 1998). A partnership approach between housing providers and insurance companies meant that home contents insurance with terms and conditions appropriate to the needs of social housing tenants could be provided at relatively low cost. The facility for tenants to pay insurance premiums with their rent or to have payment options other than direct debits was also important.

Tenant contents insurance is widely available – it is estimated that it is available in 85 per cent of the social housing stock in England and Wales (Experian 2009). Take-up by tenants has generally been low, however, estimated at between 10 and 16 per cent in England and Wales depending on the type of scheme (Experian 2009). This has largely been attributed to low awareness among tenants and a lack of effective promotion by social housing landlords (Wheeler 2011).

Insurance exclusion among particular low-income groups

Efforts to improve home contents insurance coverage among low-income households have focused on social housing tenants, who are much more likely than people in other tenures to be financially excluded (Kempson and Whyley 1999).

The challenge of promoting home contents insurance among lower-income tenants in the private rented sector remains an issue, as does the provision of appropriate protection for low-income homeowners (Stephens et al. 2008). At the present time, there are also no Shariah-compliant home contents insurance products on the market to meet the needs of Muslim tenants and homeowners (Wheeler 2011).

The lack of low-cost insurance for tenants and homeowners with unspent convictions (along with members of their households) has been highlighted by UNLOCK, a charity for reformed offenders. UNLOCK has campaigned to improve this situation and provides information on insurers that offer cover in these circumstances (www.unlock.org.uk).

Promoting and coordinating financial inclusion

At a national level the Financial Inclusion Taskforce and its sub-committees have played a pivotal role in promoting financial inclusion. This was complemented locally by the DWP Financial Inclusion Champions, who undoubtedly played an important strategic role in developing and coordinating financial inclusion policy and practice on the ground. An evaluation of the initiative found that the Champions had a key role in developing and strengthening networks and provided valuable advice to a wide range of providers. The services delivered by organisations on the ground and supported by the Champions were reaching people at risk of financial exclusion and often made a significant, constructive difference to their lives (Signoretta et al. 2011).

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SUMMARY

In terms of the needs that people have to meet themselves, the foundations for realising our vision already exist. New product developments such as mobile wallets have potential to meet people's day-to-day needs provided they are free or very low cost to the end user. Scope to build on existing provision includes greater standardisation of basic bank accounts to allow low-income people to compare accounts and choose the most appropriate one.

Credit union current accounts, loans and savings can help people on low incomes to meet day-to-day and periodic needs. The credit union movement requires support to deliver these services on a bigger scale, as do community finance organisations that specialise in lending to people on low incomes. Partnerships, for example with the Post Office or PayPoint, may help not-for-profit organisations extend their reach into low-income communities.

Further work is needed to promote savings and home contents insurance to people on low incomes as alternatives to credit. Understanding people's motivations is crucial to designing effective promotions and incentives.

To be realised, our vision for financial inclusion requires ongoing work in the areas of consumer protection and financial capability. Above all, measures to promote inclusion must be championed and coordinated at a national level if they are to be effective, a role that HM Treasury and the new Financial Conduct Authority are well placed to play.

The starting point for our vision is that the State, through general taxation, ensures that everyone has an adequate income, whatever their circumstances, and that health care is free at the point of use. Realising our vision for financial inclusion therefore requires continued state support in these areas. In the event that any of these safety nets are reduced, greater responsibility will be placed on the individual to save, insure or borrow. Efforts to realise our vision would be seriously undermined by a reduction in the adequacy of the state safety net (including working-age income-replacement benefits, assistance with housing costs and the reform of the Social Fund), or if essential health services ceased to be financed by general taxation.

In our vision for financial inclusion, the individual would, therefore, be responsible for meeting their day-to-day financial transaction needs and also periodic needs such as: predictable lumpy expenditure and financial outlays; acquiring goods and services to ensure social inclusion; smaller unpredictable financial outlays; and covering major unpredictable financial outlays.

The foundations for delivering this vision seem largely to be in place. The challenge is how to consolidate and build on these foundations to the benefit of financially excluded individuals and families across the UK. And, while the aim of having a vision is to help guide policy and practice over the next ten years or so, this is only

the beginning of the process. The vision has to be communicated effectively to policy makers and practitioners. Progress towards greater inclusion must be monitored. Monitoring needs to take place to identify barriers to inclusion and the risk of new forms of exclusion and marginalisation. And the vision itself has to be revisited and refreshed periodically.

In setting out the actions and efforts that are likely to be required in order to realise our vision for financial inclusion we have focused on the potential to achieve scale and reach into financially excluded communities through a range of particular organisations, and partnerships between them. At the same time, it is important to recognise that a wide range of other organisations can also deliver and promote services to financially excluded people and that these, too, have a role to play.

Meeting day-to-day needs

Appropriate money transmission services are the key to accessing other financial services such as credit, saving and insurance. The cost of credit falls if the creditor can reliably collect payments electronically and saving can be encouraged as part of budgeting for bills or paying for goods. So, ensuring access to ways of managing day-to-day money is an important component of achieving full financial inclusion.

Development of appropriate accounts

Although only about 1 in 20 households now lacks access to a transaction bank account, we are in danger of having created a revolving door, where people close their accounts because they have incurred default charges as a result of using them for bill payment. Many of the building blocks to achieving our vision with regard to day-to-day money management are, however, already in place. Appropriate accounts and services to enable people on low incomes to manage their money day-to-day are becoming available through a diverse range of providers who want to operate in this market. This includes a minority of (committed) high-street banks and building societies, credit unions and a range of new entrants (some with banking licences). In addition, the Post Office and PayPoint are likely to develop their payment facilities further, although neither seems likely to offer a basic bank account or 'jam jar' account in the near future. Nevertheless some important steps need to be taken to realise our vision, building on the services currently offered by this diverse group of committed providers.

Basic bank accounts

All banks should continue to be required to make available a basic bank account, but there needs to be greater standardisation of the key features of these accounts, as proposed by the European Commission (2010). To date, attempts to achieve this have tended to involve drawing up a blueprint of the features these accounts should have. This approach has led to a wide variation in the features offered, with some basic bank accounts not offering important features such as a debit card or widespread access to free ATMs. It also runs the risk that basic bank accounts are not redesigned when services offered with other current accounts are developed. Instead we propose that a basic bank account is defined as one that offers all the features of a mainstream current account, but cannot be overdrawn, except for a buffer zone equivalent to the smallest amount that can be withdrawn at an ATM.

But it is important to go beyond this baseline provision of basic bank accounts. The minority of banks who are committed to achieving full banking inclusion should be actively encouraged to go further and develop basic bank accounts that are tailored to the needs of people on low incomes, for example by harnessing the opportunities offered by developments in information technology. It might also include the development of a generally available 'jam jar' account for bill-payment (as described below). Banks that accept this challenge should be given recognition for doing so by the industry and government.

Credit union current accounts

The introduction of a credit union current account is a major development for the sector. Credit unions need help to enter the bank account market at greater scale, however. This requires initial investment to develop the back-office functions that would enable a larger group of credit unions to begin to offer transactional banking services (as well as increasing access to low-cost loans and other financial services). The recent government announcement of further financial support following the end of the Financial Inclusion Fund, and covering a modernisation and expansion programme, may prove sufficient to achieve this (see below). If not, there seems to be a strong case for further government funding. In addition, it will be important to create access to credit union banking for areas that do not have a credit union. This could be achieved by the establishment of a national credit union; or by a small number of very large credit unions providing universal coverage, possibly relying on access to the account at a local Post Office. Recent changes to the law that allow credit unions to expand the communities and areas they serve would facilitate this, as will the link-up with the Post Office.

In developing its transactional banking services, there are opportunities for ABCUL to build on developments outside the traditional banking sector both to improve the appropriateness of its account for people on low and low-to-middle incomes and to reduce the costs to the customer. This includes exploring the feasibility of developing a two-tier account (with a 'jam jar' bill-payment facility and a stored value payment card), such as is being developed by other new entrants to banking (see below). At the same time, it should explore the possibility of covering some of the costs of this account by levying charges on suppliers of key services for whom payments are processed.

New product developments

There are opportunities to harness new product developments in the form of de facto accounts with bill-payment facilities, which can better meet the needs of people on modest incomes. These should build on business models that aim to offer services that are free (or very low cost) to the end user. Such accounts are currently offered or planned by new entrant banks and at least one mobile phone company. The interest of Department of Work and Pensions Ministers in promoting the availability of bill-payment accounts is therefore welcome.

As trusted organisations that are used by large numbers of people who are unbanked or marginally banked, it is to be hoped that the Post Office and PayPoint continue to develop their payment facilities and perhaps in the longer term look to develop accounts of their own.

These new product developments could also offer a model for enhancing the POCA, which would very likely require Government encouragement and promotion.

Dialogue with bill originators

The current situation in relation to day-to-day money management highlights an urgent need for a dialogue with the main originators of bills – such as utility companies, telephone companies, subscription service providers (including both cable and satellite companies) and local authorities – to deal with some of the difficulties that people who are unbanked and marginally banked face. Some of the key issues we have identified include: restricted access to services if people do not want or are not able to pay by direct debit; and additional charges if payment is not made by direct debit.

The availability and promotion of flexible payment dates, weekly payments and, in the case of originators where variable direct debits are set up (including those where subscriptions can be varied), greater customer control over increases to direct debit amounts need to be discussed in relation to people on low incomes who choose to pay by direct debit. We envisage that the coordinating body described above, together with the relevant regulators, would initiate these discussions. For energy companies, this should form part of the ongoing discussions about fuel poverty.

Encouraging and facilitating account opening

If people on low incomes choose to ‘mix and match’ banking services from a range of providers in the way we envisage, they will require readily available information and guidance. This includes comparison information to help people shop around and choose between different types of provider and account. As noted earlier, there is low awareness even of basic bank accounts and certainly of the new ‘jam jar’ accounts, indicating that these and other appropriate services should be promoted in a targeted way to people on low incomes. The information about basic bank accounts currently provided by the Money Advice service on its website should, therefore, be extended to cover key new entrants to basic banking.

At the same time, the existing wariness of using facilities provided by new entrants to the sector needs to be overcome and people currently in the revolving door of banking need to be assisted to regain confidence in using banking services. These roles are most appropriately played by the Money Advice Service and by local intermediaries.

Information and help are also needed at the time of account opening, to ensure that low-income customers get the most out of the account or service they choose to use and to recognise and avoid any potential pitfalls. Providers could be supported to do this by the Money Advice Service and we therefore note with some concern that their focus has shifted away from ‘vulnerable consumers’. There is also an important role for local intermediaries to play here.

Meeting periodic needs

Our vision for financial inclusion in relation to periodic needs requires a combination of credit, savings and insurance. Part of realising this vision must also involve efforts

to change the way in which people on lower incomes meet periodic needs, away from a reliance on high-cost credit towards a balance of credit, savings and insurance. It also depends on the provision of adequate state safety nets in the form of dental and health care that is free at the point of use and in cases of job loss, ill health or disability.

Credit

In its review of high-cost credit, the Office of Fair Trading drew attention to the lack of new entrants at this end of the market. It is possible that the development and use of 'jam jar' bill-payment accounts, offering greater certainty of payment, will encourage lower-cost sub-prime lenders to extend their customer base (Collard and Kempson 2005).

Credit unions and CDFIs

In the absence of commercial alternatives, there is strong support for a continued and expanded role for credit unions and CDFIs to deliver loans to financially excluded people at sub-commercial rates of interest. The challenge is to significantly increase the number of loans that are made and to extend the reach of lenders into a greater number of communities. Following the cessation of the Growth Fund in March 2011, the Department for Work and Pensions committed a further £73 million to explore the feasibility of modernising and expanding credit unions and CDFIs that are ready to expand, to the point where they are able to become financially sustainable within four or five years. For credit unions, this included the potential to develop banking services.

The effective use of technology will be an important element in any modernisation programme as a means of extending services while also reducing operating costs. Examples include the development of a central back office for credit unions (as already discussed in relation to banking) and the potential use of mobile phone and web applications to deliver services to financially excluded people. Here there may be scope to learn from the payday lending industry, such as the development of simple online tools for borrowers and real-time loan processing.

Partnership working is another crucial aspect in expansion. The proposed formal link-up between the credit union sector and the Post Office network described earlier has the potential to deliver not only banking, but also credit and other financial services to financially excluded communities. Partnerships between credit unions or CDFIs and housing associations provide another model of delivering credit at sub-commercial rates to financially excluded people. My Home Finance, for example, is a social enterprise set up by the National Housing Federation in 2010, supported by the Government, Royal Bank of Scotland, Wates Giving and housing associations in the West Midlands. Moneyline (a CDFI) provides back-office functions, while the housing associations deliver front-office services.

But how are essential developments to be funded? At present, the credit union and CDFI sectors are heavily reliant on central government investment to modernise and expand. Development of this sector would be greatly assisted if the Government decides, following its feasibility study, to fund a programme of modernisation and expansion of the sector. In the absence of this financial support, the likely options

are to increase the cost paid by the borrower (i.e. higher APRs), to reduce operating costs further, or to borrow commercially. Other opportunities to fund growth are the extension of the Community Investment Tax Relief scheme for personal lending CDFIs, and finance from the Big Society Bank (effectively a wholesale bank for social investment), which cites financial exclusion as one of the social issues within its proposed remit (Iona et al. 2011).

Social Fund

The future of the Social Fund is of great importance, given its central role as a safety net in meeting the periodic needs of people on the margins of financial services. While the proposals for reform of Budgeting Loans have the potential to ensure their continued availability to people who need them, proposals for the reform of Community Care Grants and Crisis Loans are of greater concern.

The proposal to devolve them to local authorities from April 2013 is of concern because the lack of ring-fencing of local budgets or a duty on local authorities to provide a service of some kind will undoubtedly lead to even greater variation in provision across the country than currently exists. Together with the loss of an independent review service, which currently overturns a high proportion of appeals against decisions, this will almost inevitably lead to a postcode lottery and to vulnerable people being left without the assistance they require. If the proposals go ahead as planned, there will be an urgent need to monitor and evaluate the impact of the changes, across the UK, with a full report published after the first year of operation of the new arrangements.

Assisting those who are refused credit

There has long been a need to address the issue of problem borrowing. The creation of a new body (the Money Advice Service) with responsibilities covering both financial capability and debt advice offers a real opportunity to fill this gap. Government and other major creditors should jointly provide financial support for budgeting and debt advice services.

It has proved difficult to identify appropriate ways in which to help financially excluded people who are refused credit. Some people may be responsive to offers of debt advice, but it will not be the solution for all. Depending on circumstances, alternatives might include credit repair, budgeting advice or referral to a grant-giving charity. At the very least, in the short term people who are refused credit (from for-profit or not-for-profit lenders) should be told the reason why they were turned down. In the longer term this is an issue that should be investigated further by the Money Advice Service.

Saving

Saving levels are low across the population, but especially so among those on the margins of financial services. There seems, therefore, to be a compelling case to encourage people to start saving in order to generate at least a small financial safety-net and possibly avoid the need to borrow (or borrow as much) in the future. Overall, the greatest potential to do this seems to lie with non-mainstream providers and intermediaries such as credit unions and CDFIs, the Post Office, PayPoint and

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social housing providers (and partnerships between these). For the present, however, the loss of the saving Gateway leaves a large hole in suitable provision.

Actively promote and facilitate saving

Far greater promotion of regular saving is required among people on lower incomes. Targeted social marketing (i.e. marketing with a social purpose) through popular media such as television, radio and social media is one means to achieve this, with appropriate champions of saving to overcome the negative image many non-savers hold of those who save. Encouraging children and young people to start saving and develop a saving habit, for example through national school-based schemes working with partners such as credit unions and other providers, is another important aspect.

The Growth Fund evaluation highlighted the possibility of linking saving to loan repayment, which was most successful where credit unions used 'soft compulsion' to encourage people to include an amount for saving when they first took out a loan. Although CDFIs are not deposit-takers, some of them work in partnership with banks to offer savings and bank accounts, which would enable them to similarly encourage saving. The CAP Account offered by Christians Against Poverty to people in debt also has a savings facility built into it. Lloyds TSB 'Save the Change' is an example of harnessing inertia to help people build up savings. Every time a customer uses their debit card, the amount spent is rounded up to the nearest pound and the difference transferred to a savings account.

Start where people are

To get people on lower incomes saving, it is important to 'start from where they are' by acknowledging that many people feel it is important to live for today, but also stressing the importance of living for tomorrow too and that even small amounts soon mount up into a worthwhile sum of money. It will also be important to link saving to goals or events such as Christmas, a family holiday, a new baby, or to buy a new car. Partnerships to promote this idea might include providers or intermediaries (such as PayPoint) working with travel agents to promote saving for holidays. Credit unions and other providers could offer things like 'car accounts' that encourage people to save up for a car by offering a year's free breakdown cover. The Money Advice Service, other advice providers and local intermediaries could play a role in helping people to set savings goals and to budget in order to reach their goals.

Widen access to savings products

A range of opportunities exists to extend access to saving facilities among people on lower incomes to fill the gap left by the demise of the Saving Gateway. There is the possibility that PayPoint will develop its own-brand saving products for distribution through other organisations. PayPoint is also extending counter services for credit union members, so that members can pay in money to save or to repay loans (minimum payments may be required by some credit unions). The proposed link-up between the credit union sector and the Post Office would allow Post Office branch staff to accept and pay out savings. There is also scope for credit unions to work more closely with employers to encourage low-income earners to start to save, for example through payroll deduction.

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Offer the right incentives

Getting the incentive to save right is key to the success of any saving scheme targeted at people on low incomes. Examples of possible incentives include prize-based savings accounts, financial incentives to open accounts or to save regularly, and product tie-ins such as free breakdown cover or retail discounts.

While we understand the Government's decision not to roll out the Saving Gateway at a time when cuts to public spending are being made, we should not lose sight of the features of the account that made it so successful in encouraging regular and longer-term saving. Even if it is not rolled out as originally designed, when the economy picks up serious consideration should be given to an account that incentivises regular deposits over a fixed period of one to two years.

Insurance

There is now a range of low-cost home contents insurance products with terms and conditions appropriate to people on low incomes. But despite this, more than half of low-income households still lack a policy. The key challenge in realising our vision is their promotion and take-up. Based on DWP research, in 2011 the Chartered Institute of Housing published practical guidance for social housing landlords about promoting and encouraging insurance take-up. The Association of British Insurers has convened workshops with social housing landlords and produced a training tool for housing officers on the topic of tenant contents insurance.

These efforts may not result in a significant increase in take-up, however. Other options include using an opt-out model, where all new tenants are automatically signed up for contents insurance unless they decide to opt out; and block policies where a landlord purchases a policy that would cover all tenants. North Glasgow Housing Association, for example, block-purchased contents insurance for all its tenants aged over 60 in a pilot scheme. In addition, Moneyline (a CDFI) is exploring the possibility of becoming an agent for an insurer, with the aim of cross-selling low-cost contents insurance to its borrowers.

In the past the Financial Inclusion Champions have played an important role in promoting both the provision and take-up of insurance with rent schemes. We therefore welcome the continuation of funding for this function, at least for the next few years.

Consumer protection

Consumer protection is of great importance for new users of financial services and particularly so where they have limited choice or where products sit outside mainstream regulatory control. Generally speaking, regulators will require a greater familiarity with the types of informal products that tend to be targeted at people with low incomes and are not covered by their existing regulatory regime. With the steady increase of providers of banking services using e-licences (rather than full banking licences) it will be important that consumers have the same level of protection regardless of how their provider is licensed and that any charges for new banking products aimed at people on low incomes are proportionate and fair.

Assertive enforcement of responsible lending, arrears management and debt recovery legislation and guidance in the high-cost sub-prime credit market are essential. And this needs to be accompanied by constant vigilance to ensure that any additional costs paid by users of this sector are proportionate and fair. There should also be proactive searching for new forms of potentially exploitative lending, as recommended by the Office of Fair Trading in its high-cost credit review. In addition, there needs to be a continued clampdown on illegal lending by the specialist illegal money lending teams.

Similarly, any savings schemes that are developed and targeted at people on low incomes must be covered by regulation to ensure the security of people's savings. Again this means identifying new informal savings products and any potential risks associated with them, to avoid another situation like the failure of Farepak, which was a major provider of (unregulated) Christmas savings accounts. Making savers aware of the protection that is offered goes hand-in-hand with this.

There should also be a system of redress for people who are unreasonably denied access to banking, savings or insurance facilities or are subject to unfair charges. This role seems most appropriately filled by the Financial Ombudsman Service working with regulators. Local advice agencies also have an important role to play.

Oversight and coordination

Finally, our vision requires a coordinating body to monitor and encourage the development and promotion of appropriate financial services for those on the margins. Its activities should include searching for and investigating new developments with a potential to promote greater inclusion and, just as important, threats to inclusion. It would, for example, need to be alert to any groups of people who were at risk of being left behind by developments in financial services or the impact of charging for transactional banking services should this be introduced generally in the UK. At the same time it needs to be alert to developments (such as cuts to social welfare provision) that might increase financial exclusion. It should also be responsible for periodically reviewing and refreshing any vision for financial inclusion.

This coordinating role, formerly undertaken by the Financial Inclusion Taskforce reporting to HM Treasury is almost certainly most appropriately undertaken by HM Treasury and the Financial Conduct Authority working together. It is, however, likely to need inputs from a range of experts, from industry, the voluntary and community sector and consumer organisations.

Conclusion

While most of the potential building blocks to achieve our vision for financial inclusion are either currently available or in development, it would be wrong to be complacent. They require promotion and coordination, and new developments that can enhance financial inclusion will need to be harnessed. These are roles that would be most appropriately played by HM Treasury working with the Financial Conduct Authority and (at present) the Office of Fair Trading. In addition, there is likely to be a continuing need for the regional and sector-based work that has been undertaken by

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the Financial Inclusion Champions and also for local intermediaries, who have played an important role in promoting financial inclusion.

There is also a real need for targeted work on various aspects of financial capability, including: information on choosing and using appropriate products; guidance on using transaction banking services and maintaining control over one's finances; helping people who cannot gain access to credit; and promoting both a saving culture and a shift from borrowing to saving and insuring where it is appropriate to do so. This is a clear role for the Money Advice Service as well as local advice agencies and other organisations working with people who are on the margins of financial services.

But there is also a need for vigilance. Just as there will be new developments that have the potential to enhance financial inclusion, there will be others that could undermine it. There will, therefore, be a need to watch out for such threats, including developments that have the potential to leave certain groups of people behind and any reduction in the State provision that is the bedrock for meeting many periodic needs.

Appendix: Research methods

Evidence assessment

An evidence assessment was carried out to provide a robust foundation for developing a vision and to assess the progress towards financial inclusion that has already been achieved in relation to banking and bill payment, saving, insurance and credit. The evidence review was restricted to UK publications and to those published since 2000, when the last major review was carried out (Kempson et al. 2001). Key studies published prior to 2000 were included, however. The main output of the evidence assessment was a 'straw man' for financial inclusion, which was developed and refined in the subsequent stages of the research.

Initial round-table meetings

Three expert round-table meetings with stakeholders were held in July 2010, on banking and bill payment; credit; and savings and insurance. Their main purpose was to get feedback on the 'straw man' for financial inclusion that we had developed in the first stage of the research. The following participated in these initial meetings:

Banking and bill payment

Chris Bath	UNLOCK
Sharon Collard	Personal Finance Research Centre (facilitator)
Ross Hume	DWP Financial Inclusion Strategic Champion
Elaine Kempson	Personal Finance Research Centre (facilitator)
Karl Meekings	Accenture Research
Brian Pomeroy	Financial Inclusion Taskforce
Susan Rice	Lloyds TSB
Michelle Smith	Barclays Bank
Danielle Walker Palmour	Friends Provident Foundation

Credit

Sharon Collard	Personal Finance Research Centre (facilitator)
John Cray	DWP Financial Inclusion Team
Katija Dew	DWP Financial Inclusion Strategic Champion
Chris Hobson	TRANSACT
Peter Kelly	Consultant
Elaine Kempson	Personal Finance Research Centre (facilitator)
Sue Maddin	Friends Provident Foundation
Stephen Sklaroff	Finance and Leasing Association

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Richard Walton	Northern Rock Foundation
Claire Whyley	Financial Inclusion Taskforce

Saving and insurance

Chris Bath	Unlock
James Berry	Bristol Credit Union
Kate Carr	ABI
Sharon Collard	Personal Finance Research Centre (facilitator)
Sara Davies	Personal Finance Research Centre
Tony Dolphin	IPPR
Stuart Glassborow	HM Treasury
Elaine Kempson	Personal Finance Research Centre (facilitator)
Catriona McKay	Scottish Executive
Ashley Taylor	Friends Provident Foundation
Sharon Wheeler	DWP Financial Inclusion Strategic Champion

Telephone interviews

Telephone depth interviews were conducted in September–October 2010 with stakeholders, in order to follow-up particular issues arising from the initial round-table meetings and to help refine the vision for financial inclusion, particularly how it might be realised. A total of 16 interviews were conducted, with representatives from the following organisations:

ABCUL
Barclays
CDFA
Department for Work and Pensions
Finance and Leasing Association
Financial Inclusion Taskforce
HM Treasury
HSBC
Lloyds TSB
Office of Fair Trading
O2
PayPoint
Post Office
Social Finance
Which?

The interview data was analysed using thematic grids designed specifically for use with qualitative data.

Community select committees

The community select committee is a research technique that we devised for consulting intended beneficiaries about practical solutions for their needs (Collard et al. 2003). It is an effective technique for consulting people on the margins of financial services about the types of products and service they would like to be able to access.

For this project, two community select committees were held in Bristol in March 2011. The focus of the community select committees was banking and bill payment, as it was clear from the research that getting these services right was the cornerstone to greater financial inclusion. The sessions each lasted around five hours, with a break for refreshments.

One community select committee comprised 11 people in their twenties and thirties, the other was made up of 13 people in their fifties and sixties. The committees were structured by age in this way to ensure that we adequately captured the views of younger and older people. Participants were recruited on the street from low-income areas of Bristol, on the basis that they were unbanked or marginally banked.

Each committee started with a short warm-up session in which participants discussed their perspectives and experiences in relation to banking and bill payment. This was followed by short presentations from four providers of banking and bill payment, who were selected to provide a range of different options for people to meet their day-to-day money management needs. After each presentation, participants had the opportunity to 'cross examine' these 'witnesses'. The committees ended with a general discussion of the various products and services (without providers present) to gain a view of the extent to which they were likely to meet people's needs and to hear what participants particularly liked and disliked about the products and services that had been presented to them.

Final round-table meeting

A final round-table meeting was held in April 2011 to discuss the vision for financial inclusion that we had developed and to explore how it might be taken forward. The following people participated:

Karen Arthur	AVIVA
Peter Brooker	PayPoint
Sharon Collard	Personal Finance Research Centre (facilitator)
Phil Edwards	O2
Harry Glavan	CDFA
Jon Graham	Secure Trust Bank
Matt Harris	HM Treasury
Chris Hobson	TRANSACT
Elaine Kempson	Personal Finance Research Centre (facilitator)

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Mark Lyonette	ABCUL
Lucy Malenczuk	Age UK
Alan McPhail	AVIVA
Craig Oldroyd	O2
Brian Pomeroy	
Danielle Walker Palmour	Friends Provident Foundation
Richard Walton	Northern Rock Foundation
Stuart Williams	Secure Trust Bank

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