

FINANCIAL
INCLUSION
TASKFORCE

Banking services and poorer households

December 2010

Introduction

1. The Financial Inclusion Taskforce is an independent body, which supports the Government's work to ensure that everyone can access the financial services they need. The Taskforce was established in 2005, and is chaired by Brian Pomeroy. Taskforce members act in a voluntary capacity and call on experience gained in industry, the third sector, consumer advocacy, local government and education.
2. Our terms of reference include commitments to track progress on access to banking services, to review evidence on the usage of basic bank accounts by poorer households and to monitor developments in the way banking services are delivered. In June 2010 the Coalition Government asked the Taskforce to undertake a formal review of banking services and poorer households, to inform the Government's policies on access to banking.
3. In late 2009 we commissioned complementary qualitative and quantitative research on low-income households¹. This research has investigated attitudes and behaviours towards banking and financial management among low-income households, including those who are unbanked and those who have recently opened an account. We have drawn on the findings from this research, as well as on analysis based on the Family Resources Survey, to inform our review.

Why is access to banking important?

4. In 1999 HM Treasury's Policy Action Team 14 made its report on access to financial services, taking a comprehensive look at the causes and consequences of financial exclusion. PAT 14 found that ensuring access to a bank account was an important foundation for putting help low-income households in a position to manage their money effectively, securely and confidently and to reduce some of the costs of managing in cash. PAT 14 also found that banking inclusion could serve as a gateway to other mainstream financial services, including saving, insurance and credit.
5. The Taskforce believes that ensuring access to basic banking facilities is just as important today as it was ten years ago. Indeed, many more

¹ *Realising banking inclusion: the achievements and challenges*, Policis 2010
Research on the motivations and barriers to becoming banked, GFK NOP Social Research

consumer services now rely on having the capability to make and receive direct payments. As a result, basic financial services have become increasingly essential to participation in modern society.

6. We would like to see every household in a position to access and to benefit from basic banking services — to be included in mainstream networks for deposits and payments. We believe that the key banking needs of poorer households remain:
 - An easy way to receive money, particularly non cash payments.
 - A way to keep money safely.
 - An easy way of making payments that is efficient for the receiver.

Summary

7. Our review has drawn the following conclusions about the current market for banking services and low income households.
 - The number of households without access to transactional banking services continues to decrease steadily.
 - The experience of banking services for poorer households has been mixed. While they have made savings on services and retail purchases, they have also lost money through bank fees.
 - The remaining unbanked are generally the poorest and the most deprived households.
8. We therefore have the following recommendations to put to the Government:
 - In the short term, banks can take steps to make basic bank account more accessible and easier to use for poorer households.
 - However, in the longer term, to address the main difficulties that poorer households experience with banking it will be necessary to explore new models and channels for the delivery of financial services.
 - The Government should therefore engage with banks, e-money service providers, bill payment organisations, retailers and Post Office to pursue new ways to tackle financial exclusion and to improve the opportunities for low income households to make the most of their money.

Increasing access to banking

9. Shortly after HM Treasury's Policy Action Team 14 (PAT 14) made its report, the major banks agreed that each of them would offer a basic bank account alongside their other retail current accounts. No formal standards were set for basic accounts and each bank was able to set the specific features of its account. However, the recommendations of PAT 14 for core features were incorporated into the design of each account including:
 - Income paid in by automated credit transfer
 - Cheques and cash paid in by the account holder
 - Cash out at convenient access points

- Bill payment by direct debit, credit transfer or budget account, linked to the account
 - No cost to the customer for everyday transactions
 - No risk of unauthorised overdraft
10. In 2001 the banks also agreed that each of their basic bank accounts should be made accessible at Post Office branches. The banks also contributed £180 million to the costs of developing and running the Post Office Card Account (POCA). The POCA provides consumers with the opportunity to receive welfare benefits and state pension payments directly without needing a full bank account. The POCA's functionality is extremely limited and holding a POCA does not amount to being financially included.

Reducing the 'unbanked': Progress to date

11. Since the Taskforce's inception we have used the Family Resources Survey to track how many households have access to banking services. Table 1 below provides the figures for adults without access to a transactional account, from 2002/03 to present.²
12. The data show that, since 2002/03, the number of adults living in households without a transactional bank account has decreased from 3.57m (in 2.57m households) to 1.54m (in 1.14m households) in 2008/09. The number of adults living in unbanked households has therefore decreased by 57% and now represents 3% of the population, compared to 8% in 2002/03.

Table 1 – Unbanked (without access to transactional account)

Year	Households without transactional account - Positively affirmed no account (000, % of total)	Adults without access to transactional account - Positively affirmed no account (000, % of total)
2008/09	1,140 (4%)	1,540 (3%)
2007/08	1,280 (5%)	1,750 (4%)
2006/07	1,410 (5%)	1,920 (4%)
2002/03	2,570 (10%)	3,570 (8%)

13. The latest figures, for 2008/09 show a continuing decline in the number of adults without access. This is an encouraging finding. It suggests that work by industry to make basic accounts available continues to drive reductions in adults without access. We also believe that the move to making direct payments for welfare benefits has also given a number of poorer households a good reason to open a bank account.

² The Government was unable to measure progress against the shared goal using FRS data for the two following years (2003/04 and 2004/05) because the data collection did not distinguish between basic bank account and Post Office Card Accounts (which do not count as a bank account for purposes of the shared goal).

The impact of extending access to banking to low income households

14. For more vulnerable and excluded groups, obtaining a bank account can be perceived to be life changing. A number of studies have found that becoming included in the banking system had psychological benefits, boosting self-esteem and building people's confidence as money managers³.
15. The newly banked (poorer households who have come into banking in the last five years) see security and convenience as the primary benefits of banking. The poorest households (in the bottom 25%) felt that greater independence was the most important benefit of being banked. Access to cash at ATMs was a driver for 23% of the newly banked to open their accounts. Having somewhere secure to keep money was important to 17%.
16. However, opening a bank account does not in itself amount to financial inclusion. True inclusion only comes when an account holder can use their account for day-to-day money management. Our research showed a spectrum of usage and attitudes among low-income, banked households. 45% of the newly banked continue to manage their money mainly in cash, citing lack of flexibility and transparency, as well as the threat of payment charges as reasons for doing so.
17. Very few newly banked respondents (4%) opened their accounts specifically to save money on their bills. However, over half of the newly banked went on to use their accounts to pay bills, primarily utility bills and phone and entertainment services. Some used multiple direct debits to support their budgeting. The ability to access entertainment services (particularly satellite television) was seen as a key benefit of an account.
18. Our research suggests that the newly banked have saved between £125 and £215 per annum on utility payments. However these savings are offset by an average loss of £140 per annum in penalty charges — a burden mainly borne by the poorest households. This in turn has driven a high rate of account failures where the newly banked have stopped using their accounts altogether (15%, including 19% of those on the lowest incomes).
19. These findings show that many poorer consumers are poorly served by the UK's 'free-in-credit' model for retail banking. If banking services could be delivered in a way that reduced or eliminated the risk of missed payment charges then poorer consumers could save money by paying a modest regular charge for a new service.

The remaining unbanked

20. Data extracted from the 2008/09 Family Resources Survey⁴ allows us to make the following observations about unbanked households without access to a transactional account:

³ *Low-income families and household spending*, Farrel and O'Connor, 2003

⁴ The 2008/09 Family Resources Survey (FRS) is a National Statistics dataset. More information on the FRS can be found at <http://research.dwp.gov.uk/asd/frs/>.

- Unbanked households were concentrated at the bottom of the income distribution, with 36 per cent of them being found in the lowest two deciles. 77 per cent were in the bottom half of the income distribution⁵.
 - Single households were over-represented among the unbanked, comprising 63 per cent of unbanked households compared with 44 per cent of households with access to a transactional bank account (banked).
 - Lone parent households were also represented among the unbanked, and made up 12 per cent of unbanked households compared with 6 per cent of banked households.
 - Households in which the household member with highest income was retired comprised 43 per cent of total number of unbanked households, compared with 24 per cent of banked households. Households where the household member with the highest income was not in work due to ill-health made up 20 per cent of unbanked households, but only 5 per cent of banked households. The majority of unbanked households were social renters, and 54 per cent of the unbanked lived in housing rented from a Local Authority or Housing Association (compared with 16 per cent of banked households).
 - The proportion of banked households headed by a male was greater (62 per cent of banked households) than the proportion of households headed by a female (38 per cent).
 - 58 per cent of unbanked households were headed by a person of working age, compared with 75 per cent of banked households
 - Households in which the household with the highest income was White made up 91 per cent of the 'unbanked', compared with 9 per cent from Black or Minority Ethnic Groups . These proportions were similar for the banked (92 per cent and 8 per cent respectively).
 - 89 per cent of unbanked households received at least one benefit, compared with 69 per cent of banked households.
21. Our commissioned quantitative research found that average monthly incomes for unbanked respondents were significantly lower (£635) than for the newly banked respondents (£955).
22. The research found further indicators of relative disadvantage among the unbanked. The findings complement our analysis of the Family Resources Survey data and show that: 8 out of 10 of the unbanked are in receipt of income-related benefits; more than a third (36%) have major health conditions; a quarter (26%) have numeracy or literacy problems; and 1 in 10 (11%) live in ethnic minority households.
23. As the number of unbanked adults reduces it is likely that they will become more concentrated within specific vulnerable groups. As a result it may be most fruitful to direct future efforts to extend access to banking towards the groups most represented among people who are unbanked.
24. One of the most important findings from the quantitative research is that a significant majority of unbanked individuals (six out of ten) have previously

⁵ A regression analysis on Family Resources Survey data for 2006/07 also showed that the likelihood of being unbanked was 12 times higher in households with the lowest incomes (less than £100 per week) than for those with the highest incomes (£500 or more per week). See here for the full analysis: http://www.hm-treasury.gov.uk/d/fitf_regression_analysis_unbanked

held a bank account. By contrast, six out of ten newly banked respondents said that they were opening a first account.

25. Many unbanked consumers express a preference for managing their finances in cash. Low-income households employ a number of strategies to ensure that money is available for essential living expenses including not withdrawing all their benefit payments at once, leaving a small amount of benefits as a buffer, cash (jam jar) saving towards quarterly bills and overpaying towards bills or on prepaid meters. The key feature of each of these strategies is having direct control over spending.

Reaching the remaining unbanked

26. Our research found that 52% of unbanked respondents would definitely or probably like a bank account, suggesting that there is still demand for banking services among those who do not currently have access. We believe that there are a number of ways in which accessing a bank account could be made easier for these individuals.

Mystery Shopping

27. In the last quarter of 2010, the Taskforce commissioned a nationwide mystery shopping exercise for basic bank accounts. Our purpose in doing so was to revisit the findings of the Banking Code Standards Board from a similar exercise in 2007⁶. We will publish a full report of this in early 2011.
28. The emerging indicative findings have been positive. Mystery shoppers found that bank staff recognised that a basic bank account was appropriate in roughly four fifths of cases. A similar proportion of customers were provided with a brochure or leaflet on the basic bank account, although only half of customers saw these brochures or leaflets displayed openly in the branch. Staff in the majority of branches provided information on the types of acceptable ID.

Identity verification

29. Advice and support agencies serving low income households continue to report anecdotal evidence of clients being unable to open bank accounts as they are unable to produce adequate ID.
30. The Money Laundering Regulations 2007, require banks (and other financial institutions) to carry out customer due diligence measures. The Joint Money Laundering Steering Group provides further guidance on customer identification for private individuals. Each bank has the discretion to interpret the guidance for itself and each bank takes a slightly different approach, with some more restrictive than others. This continues to lead to significant uncertainty for customers, and sometimes also for bank staff, as to what documents they need and which banks will accept them.

⁶ Found at http://www.bankingcode.org.uk/wpdocs/BBA_report_for_website_March_2008.doc and http://www.bankingcode.org.uk/wpdocs/REVIEW_OF_THE_PROVISION_OF_BASIC_BANK_ACCOUNTS.doc

31. This barrier to access can often be addressed by specialist intermediary organisations such as advice agencies and social landlords working with individuals to support them in finding appropriate forms of ID. Credit Unions and CDFIs can also play a useful role in helping their customers to access banking services, in many cases for the first time. Toynbee Hall has developed an ID guide, to support bank staff and consumers in obtaining and using a wide range of proofs of identity
32. There may also be scope to introduce greater transparency around bank policies. For example, banks could produce a full list of acceptable forms of ID. This would help customers or advice agencies to find out in advance what forms of ID they can produce to open an account at a specific bank. This could also help staff in different bank branches to know that they are applying their company policies consistently.

Trusted Intermediaries

33. We also believe there is scope for banks to seek opportunities for closer partnership working with 'trusted intermediaries'. For example, RBS have developed relationships with a number of community lending organisations. This allows the organisations to take their clients through the process to open a basic bank account with RBS.
34. This increases the opportunities for consumers to access bank accounts and allows those who are uncomfortable visiting a bank branch to go through the opening process in a different environment.

Undischarged bankrupts

35. Undischarged bankrupts continue to have a choice between only two basic bank account providers (Barclays and the Cooperative Bank). This is in spite of continuing calls by consumer groups and government ministers for more banks to make their accounts available⁷. As insolvency numbers continue to rise as a result of the recession, the impact could be to increase exclusion from banking services, unless there is greater provision for undischarged bankrupts in the future.

Financial Regulation

36. As the Government takes forward its plans to revise the current system of financial services regulation, we would encourage it to provide the new regulator for consumer protection (the CPMA) with a brief to monitor levels of financial inclusion. We would also like the new regulator to be able to ensure, through conduct of business rules, that banks continue to support their branch staff to welcome all potential customers, to support customers who are new to banking and to help them to meet ID requirements.

Post Office Card Account

37. 71% of those without access to a transactional account depend on the POCA to receive income. One straightforward way to bring a large number of people into banking would be to extend the POCA's functionality to align it with the features of a basic bank account.

⁷ A recent report from Citizens Advice is available here:
http://www.citizensadvice.org.uk/press_20100709

38. We have been longstanding advocates of getting value from the POCA and using it as far as possible to support improved financial behaviour by benefit recipients. We understand the regulatory and cost issues that have deterred ministers from taking this action so far. We realise that the layout of many Post Offices can compromise people's ability to deal with their finances confidentially. Extending the POCA could also make it less usable to those who do not wish to have access to full banking services. Nonetheless we would encourage the Government to keep under consideration ways in which the POCA could be reformed or improved.

New ways of delivering banking services to poorer households

39. It may be possible to make further reductions in the unbanked. Our recent quantitative research found that 52% of unbanked respondents would definitely or probably like a bank account, suggesting that approximately 750,000 more people could be ready to move into banking.

40. However, as set out above, the experience of taking up banking services has been mixed for poorer households. Many of the newly banked have incurred additional charges, putting extra pressure on already low incomes. Furthermore, the majority of unbanked adults have previously been banked, but have closed previous accounts or had them closed due to poor experience.

41. Given the diversity of the remaining unbanked, there is likely to be a substantial number of people for whom a bank account would not be suitable. This could include people who are terminally ill and those incapable of using an account because of severe learning difficulties, dementia and some other mental health conditions, severe physical disability or drug addiction.

42. We have therefore considered the scope either to improve basic bank accounts or to offer banking services in a new way that better fits the financial behaviour of poorer households.

Improving basic bank accounts

43. Bank charges for unpaid items have come under increasing scrutiny in recent years. As a result of this pressure a number of banks have reduced their charges⁸. Our research calculated average consumer charges using an average value of £25 per charge. Today most of the major banks have reduced their charges to below £10.

44. While a basic bank account will not allow an overdraft, a number of basic bank accounts feature a buffer zone of around £10. This was designed to ensure that customers could clear direct payments without incurring bank fees, if the total amount in their account was insufficient to cover the payment. However, a number of banks allow customers to access this buffer through cash withdrawals or debit card payments. We think it would be better to only allow access to the buffer to support direct payments.

New models for retail banking

⁸ See Table 2 of the OFT's recent Personal Current Account update report for bank charges in September 2010: www.of.gov.uk/shared_of/reports/financial_products/OFT1275.pdf

45. It remains likely that a significant number of the unbanked will be either unable or unwilling to use a conventional bank account. Those in this position will continue to incur additional costs and also to create additional costs for government and other service providers such as local authorities, social landlords, utility providers and others. It also remains likely that a number of poorer consumers with bank accounts will, in future, struggle to access their full functionality or will pay an extra cost, through missed payment fees, for doing so.
46. We have therefore considered whether the basic banking features could be provided through a non-retail-banking model. To successfully serve poorer households, any new model would have to mirror some of the features of cash budgeting, providing customers with greater certainty over the timing a level of charges they can incur and with an appropriate level of accessibility.
47. We have looked at developments in the e-money services market in the UK and internationally to understand whether technologies such as pre-paid cards and mobile banking platforms could provide transactional banking services.
48. E-money is monetary value (as represented by a claim on the issuer), which is:
- Stored on an electronic device (i.e. a card or a phone)
 - Issued on receipt of funds
 - Accepted as a means of payment by persons other than the issuer.
49. E-money has its own cost and revenue structures, depending on different business models compared to 'free-in-credit' banking services e.g. E-money issuers cannot pay interest or investment income to customers.
50. One target market for e-money that is developing significantly is the sector that is not served by traditional plastic cards. It includes consumers who do not have a bank account or a debit or credit card; or do not wish to give out their bank or card details on-line; and small businesses and start-ups. This market accounted for 7% of consumer internet payments in 2009⁹.
51. The most interesting features of e-money, from a Financial Inclusion perspective, are those that can substitute for conventional bank current account features. These enable a card account to make and receive payments through sort code and account numbers (IBAN and BIC). Bank account-like cards are a rapidly growing product in other countries, including several EU countries, but not, so far, in the UK.
52. Prepaid cards do not, at present, offer overdraft facilities. Lost or stolen cards can be cancelled and replaced (usually for a fee). There is scope for card providers to offer balance updates by text message, much as some banks do for current account customers. For example, O2's prepaid cards

⁹ Measured by transactions volume. UK Payments Markets. Payments Council. 2010

send a new balance update by text instantly, every time value is drawn from or added to a card.

53. Regulation can make it hard for providers to offer e-money services free of charge, and providers have to achieve significant scale before they can make worthwhile returns on balances. Providers typically rely on investment income and on sharing fees and discounts from merchants who take e-money payments. Some issuers rely on customers not reclaiming unused e-money to cross subsidise services.
54. Providers also generate income from customer fees. For many UK prepaid cards, the fees can seem excessive for low income households, particularly compared with 'free in credit' bank accounts.
55. Multiple use e-money products, are subject to the same customer due diligence regulations as transactional bank accounts, where the total amount transacted is over € 2,500 per annum¹⁰ (i.e. to offer an e-money product capable of accepting a full annual income an issuer would not be able to relax their customer due diligence procedures).
56. As stated above, any viable alternative product to bank account will need to deliver an appropriate and transparent fee structure and a wide range of access channels for payments into and out of the account. E-money accounts, by offering the scope to carry out some non-cash financial transactions are therefore a very interesting proposal, which could help poorer households move into online shopping or more secure forms of saving. However, prepaid cards are not yet able to offer transactional banking as cost-effectively as a basic bank account. . At present, we think that they could therefore act as a 'starter product' or a stepping stone to mainstream financial services.
57. In time it is possible that they may emerge as viable banking services in their own right. In particular, where they have scope to extend accessibility beyond traditional banking infrastructure, they may become more attractive than retail bank accounts. For example, allowing withdrawals or deposits through retail networks such as Paypoint or Payzone would be attractive to the many millions of customers who already make payments this way. Prepaid systems could be especially powerful where partnered with mobile technology, which could enable customers to make payments and keep track of their balance by SMS.

Access channels for banking and payment services

58. A range of retailers, including supermarkets and the Post Office, have sought to build their presence in the financial services market. While most primarily offer financial services by phone or online we believe there is scope for retailers to offer a physical environment that will seem more welcoming for customers who do not want to access services at bank branches. They could also offer highly convenient access to financial services, where customers already shop regularly at their outlets. Furthermore, existing customer relationships may enable retailers to deliver some financial services more profitably than bank branches. We

¹⁰ See the Money Laundering Regulations 2007, particularly regulations 5, 7 and 13.

think that the Government should encourage these businesses to consider the scope to serve poorer customers effectively as an element of their growth strategies for financial services.

59. We also recognise significant potential to extend financial inclusion through developing links from both retail banking services and retailers to bill payments services, based in retail outlets, which many poorer consumers currently rely on to pay for a range of services. For example, Amazon customers can now pay for goods ordered online by making cash deposits through Paypoint terminals. Other retailers could extend online discounts to the unbanked or underbanked by adopting this system.

New banking functions

60. We have noted the Coalition pledge to provide POCA customers with the opportunity to benefit from direct debit discounts. As set out above, poorer households often have significant difficulties using direct debit payments, incurring bank charges that outweigh the savings made through direct debit.
61. We are currently researching the scope to introduce budgeting functions into banking products. This could help consumers to pay for services such as rent and energy directly in a way that suits their pattern of income and avoids the risk of charges for missed payments. We believe there may be scope to offer such a service on a commercial basis. We would encourage banking and e-money services providers to engage with this research and explore the potential to offer this function in future.

Conclusions and recommendations

62. The Taskforce believes that strong progress by has been made by industry, government and others over the last ten years to bring poorer households into retail banking. We believe there are still opportunities to extend transactional banking facilities to people who currently do not benefit from them or who lose out.
63. In the short term we recommend further work between the Government and the banks to review the terms and conditions for the existing range of basic bank accounts. We would like the banks to consider the scope to widen access and improve features as suggested above.
64. In the longer term we believe that the Government should consider ways to improve personal financial management that do not rely on a conventional current account. The Government could consider ways to reduce the costs of cash budgeting such as holding down costs for prepaid energy and encouraging retailers to extend their range of payment systems.
65. However, there is considerable scope for the private sector to deliver an alternative to the 'free-in-credit' banking model. While there are some products currently available that come close to doing this, none yet include all the features that would make them a secure and attractive substitute for cash budgeting i.e.

- No or low fixed charges to operate;
- Security for funds;
- Easy access to cash and other services, potentially through both ATMs and retail networks; and
- An intuitive way to make and receive payments (including payments by cheque).

66. We therefore call on the Government to engage with banks, e-money service providers, bill payment organisations, retailers and Post Office to pursue new ways to tackle financial exclusion and to improve the opportunities for low income households to make the most of their money.