The Financial Inclusion Centre
Promoting fair, affordable financial services

A FINANCIAL INCLUSION 'MANIFESTO'

MAKING FINANCIAL MARKETS WORK FOR ALL IN A POST FINANCIAL CRISIS WORLD

SUMMARY

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About The Financial Inclusion Centre

The Financial Inclusion Centre (The Centre) is an independent research and policy innovation think-tank dedicated to promoting financial inclusion and fair, efficient, competitive, and accountable financial markets. The Centre supports its aims through a number of core activities.

Research and analysis

We aim to be a leading centre for research into financial exclusion and consumer behaviour in financial services focusing on: analysing the impact of exclusion on consumers; analysing the root causes of exclusion so that solutions are effective; providing insights into consumer behaviour so financial capability initiatives have greatest impact and products are better designed to meet consumers needs; and assessing the impact of government and regulatory policy, and 'environmental' factors such as changing socio-economic and demographic trends on consumers.

Innovation and partnership

We don't just research and analyse issues, we believe in promoting inclusion through innovation and partnerships, developing practical policy measures and innovative solutions that provide access to fair and affordable financial products and services. We actively promote fair and efficient financial markets and an effective regulatory system to promote consumer confidence and greater take-up of financial products by consumers. As consumer advocates we continue to campaign against poor practices but make a point of working in partnership with industry to ensure consumers' financial needs are met. We help firms develop fair and transparent products that consumers trust and understand, and provide independent consumer audits for firms. We believe consumer advocates can help markets evolve by working with providers rather than just campaign against practices. We are developing innovative solutions based on partnerships between the financial services industry and the third sector to meet the needs of consumers who are not economically viable for mainstream financial services providers.

Planning and advisory services

With our expertise and experience, we also work with social partner organisations to develop and implement strategies for combating financial exclusion. This includes: helping partners develop focused, targeted financial inclusion and capability strategies; providing practical help in setting up organisations to combat exclusion such as credit unions; and building capacity in the third-sector to help it play a more effective role in meeting the needs of excluded and marginalised consumers.

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INTRODUCTION

The unprecedented crisis in the financial system has triggered equally unprecedented interventions by policymakers and regulators[1]. The direct costs involved are estimated at @3.5% of UK GDP (a total of £50bn[2]). So far, the authorities[3] have understandably prioritised stabilising the financial system to make sure the banking system continued to function and savings were protected, and slashing interest rates to significantly reduce borrowing costs. Indeed, the crisis reminds us of just how important the banking and financial system is to the functioning of society, and why a different approach to regulating and running the system is needed.

We are not out of the woods yet and complacency must be avoided due to the risk of a secondary crisis, but these interventions appear to have been successful (in the short term at least) in stabilising the system. But, we must not forget how the financial crisis affects the most vulnerable consumers in society. Even if the economy stages a strong recovery, and despite welcome support measures[4], vulnerable citizens will continue to be penalised in the form of higher risk of unemployment and repossessions[5], and becoming victims of unfair financial practices.

Moreover, on top of short term effects, we should not underestimate how the crisis is fundamentally reshaping financial markets. Forcing banks and insurance companies to behave more prudently and responsibly is absolutely necessary but there are serious consequences to be recognised. The retail financial industry[6] will understandably increasingly focus on medium-higher income/ lower risk consumers. Vulnerable consumers will pay a higher price for access to financial services, be pushed into the sub-prime markets, or be denied access altogether. Concerted positive action is needed to prevent the chronic financial exclusion crisis in the UK being exacerbated.

Therefore, The Financial Inclusion Centre (The Centre) has developed i) a range of consumer protection measures designed to protect vulnerable consumers from the immediate and ongoing effects of the financial crisis and ii) proposals for longer term regulatory and structural reforms we think are needed to promote a fair and inclusive financial system that is aligned with the needs and interests of all in society. There are 30 measures in total packaged together in the form of a Financial Inclusion 'Manifesto'. Each of the individual policy measures would warrant a separate report. So, we have summarised the key elements of the measures in this report.

We hope to stimulate a debate and generate innovative ideas for those in the financial inclusion field. Comments are very welcome. If anyone is interested in finding out more details about specific proposals, or how these would be implemented, we would be very happy to elaborate.

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[1] this has included improving deposit protection schemes to protect consumers' savings, the de facto nationalisation of some of the UK's major banks, massive injections of public funds into the banking system, dramatic cuts in benchmark interest rates, a programme of quantitative easing by the Bank of England, and the establishment of an Asset Protection Scheme (APS) to offer banks insurance against future risks and losses.

[2] however, this figure excludes the other crisis related spending such as quantitative easing which are of a magnitude greater, and are estimated to run to hundreds of billions of pounds.

[3] Government, Bank of England and Financial Services Authority

[4] for example, The Homeowners Mortgage Support Scheme, and improved Court Protocols on repossessions

[5] especially in the regions

[6] banking, lending, insurance and savings sectors

WHY DO WE NEED A FINANCIAL INCLUSION MANIFESTO?

The Government has introduced a range of measures to protect vulnerable households including: the Mortgage Rescue Scheme, Homeowner's Mortgage Support Scheme, new Court Protocols on repossessions, and persuading major lenders to be sympathetic to borrowers in difficulty. These measures, combined with concerted intervention by the Bank of England to reduce interest rates, have protected thousands of households from the worst effects of the financial crisis. But, welcome as these measures are, more needs to be done to protect the most vulnerable households in the UK from the immediate effects of the crisis.

Some real progress has been made towards the longer term challenge of promoting financial inclusion. But the financial crisis changes everything. We argue that existing financial inclusion strategies are not 'fit for purpose' to deal with the long term effects of the crisis, and that we need a concerted programme of robust structural reforms to promote sustainable financial inclusion, and much needed corporate accountability in the banking and financial system.

For example, we think the case for a UK Financial Inclusion Act (FIAct) similar to the US Community Reinvestment Act (CRA), and charge caps on expensive sub-prime loans is compelling. We recognise that some measures would take some time to introduce. However, action must be taken now to protect consumers and we must take advantage of any opportunities to make a start on a long term reform programme. Introducing a set of Financial Inclusion Disclosure (FIDs) measures to require banks to disclose data on access to banking and lending is a priority.

There is no escaping the fact that additional funding is needed to tackle exclusion. We are reluctant to simply argue for more funds on the grounds that society has spent £billions rescuing the banks. However, it does seem only fair to point out that spending less than one half of one per cent (1/2%) of the direct costs spent on rescuing the banks would release £250m for financial inclusion initiatives. Every measure outlined in this action plan could be fully funded by a reasonable financial inclusion levy on banks and other significant financial institutions.

However, we emphasise that regulation and funding are not the only answers. Everyone with a stake in promoting inclusion (government, the financial services industry, civil society groups, and consumers themselves) must share the responsibility and play a greater, more active role in making things work.

Innovation and partnership between the financial services industry and civil society groups will be critical. The financial authorities have used considerable ingenuity to devise innovative structural interventions to underwrite banks potential losses and support the banking system – for example, the asset protection scheme and the quantitative easing programme. This is in stark contrast to what we think is a comparative poverty of ambition and imagination shown by stakeholders in developing structural, practical solutions that would promote sustainable, long term financial inclusion. We urge the 'City' to work with civil society groups and put its unrivalled financial skills to creating social useful financial instruments to tackle one of the greatest public policy challenges facing the UK.

SUMMARY OF MEASURES

The measures which comprise the Financial Inclusion Manifesto are described in more detail in the main report. These are summarised below with the page numbers of location in main report for ease of reference. The measures are split into two groups according to the purpose of the measures:

- priority consumer protection measures; and
- regulatory and structural reforms.

Some of the measures we are proposing are radical. However, the Centre argues that, given the scale of the financial exclusion crisis, we must fundamentally change the way we think about financial inclusion. In our view, financial inclusion is not just about 'opportunities' or 'access' *per se,* or the number of products consumers hold. We must adopt an outcomes-based or 'equity' approach to defining financial inclusion and be guided by a vision of fairness and social justice - closer to the way access to healthcare, education and utilities are thought about in the UK.

Adopting a financial inclusion vision based on fairness and social justice means policymakers and campaigners would recognise that it is not enough to provide vulnerable consumers with opportunities. We must ensure ***core financial needs*** are met[7], ensure consumers have equal rights of access, and refuse to accept the poor are second class citizens who should pay more or deserve second class products and services. And we must be objective about how best to meet those needs: sometimes the market is the best solution; for others not-for-profit organisations are best suited; in other cases, the state or regulatory interventions provide the only realistic option.

PRIORITY CONSUMER PROTECTION MEASURES

The proposals outlined below are intended to protect vulnerable consumers from the immediate and ongoing consumer detriment caused or exacerbated by the financial crisis. The types of consumer detriment include: restricted access to properly functioning basic bank accounts, and further bank branch closures; sustained high levels of arrears and repossessions (disguised to some degree by the emergence of sale and rent back schemes); potentially unfair pricing practices by lenders exploiting vulnerable consumers unable to switch to better deals; aggressive and unfair behaviour and practices by legal and illegal sub-prime lenders; distressed loans being sold onto unregulated companies; the behaviour of commercial debt management providers; and pressures on the NFP debt advice sector to cope with the increase in demand for objective money advice.

1. Statutory Financial Inclusion Disclosure measures (FIDs) and financial inclusion audits (p19): to promote corporate accountability and allow financial inclusion policies to be monitored properly, banks and other significant financial institutions should be required to disclose data on basic bank accounts and lending to disadvantaged consumers and communities.

2. Financial Inclusion Protected zones (p20): government should create 'protected zones' – areas most affected by the crisis and recession. These zones would attract special protection measures and 'blitzed' with targeted policy interventions.

[7] See Vision for financial inclusion for definition of core financial needs

3. **Transparency on mortgage arrears and repossessions (p21)**: a priority is for individual lenders to be required to disclose data on arrears, repossessions, numbers of borrowers participating in various support schemes, policies on treating borrowers in arrears, and details of penalty fees for borrowers in arrears.

4. **Protecting vulnerable consumers in the mortgage market (p22)**: the FSA is committed to introducing tougher regulation on mortgages. This is welcome. But this should be supported by other measures including tough, transparent enforcement action against lenders who breach regulation, and production of clear, mortgage compliance statements to make it clear what FSA expects of lenders and to help consumers/ advisers know their rights. Sub-prime lenders are a priority.

5. **A Be Fair! Checklist for lenders (p24)**: introducing tougher mortgage regulation will take time. Therefore, we have developed an interim Be Fair! Checklist for lenders – a set of measures to ensure borrowers are treated fairly. We urge fair minded lenders to adopt this.

6. **A National Mortgage Rescue Scheme (p27)**: the existing mortgage rescue scheme (MRS) is welcome. However, take up of the scheme is low. We argue for improvements including an increase in the funding available to £400m to create a truly nationally coordinated, locally delivered scheme, plus reforms to the way the MRS is administered including greater transparency to ensure that all lenders are behaving responsibly.

7. **Investigation into irresponsible lending (p28)**: to accompany ongoing reform of mortgage regulation, the FSA, OFT and Financial Ombudsman Service (FOS) should undertake a joint investigation into the extent and causes of irresponsible lending including remedies available to borrowers affected by reckless lending practices.

8. **Investigation into unfair contracts, pricing, and practices in lending markets (p28)**: a thorough investigation is needed into unfair contract terms and practices (including pricing models) in the secured and unsecured lending markets. This should assess whether vulnerable 'sub-prime' consumers who have little real choice in the market are being trapped and exploited by contracts, and what remedies are available to protect consumers,

9. **Sale and Rent Back (SRB) Schemes (p30)**: the growth of SRBs has disguised the true scale of repossessions in the official, published data. Tougher regulation is being introduced which is welcome. However, regulators need to establish what can be done to 'rescue' those consumers who may already be victims of SRB schemes. Moreover, additional structural funding mechanisms should be developed to allow social landlords to purchase properties on sale and rent back basis – for example, through local authority bonds, or social investment bonds.

10. **Regulating commercial debt management plan providers (p31)**: commercial DMPs have been a real source of concern for many campaigners and the potential for future detriment is huge in the aftermath of the financial crisis. Current regulation of DMPs is ineffective. New regulation is urgently needed including capping charges, with tougher controls on the marketing and promotion

of DMPs. All lenders should commit to ‘hot-key’ borrowers to debt advice charities, not to commercial DMP providers.

11. **Regulating distressed debt sales (p33)**: similarly, vulnerable borrowers may be at risk from lenders selling distressed debt to unregulated firms whose behaviour is unconstrained by reputational risk. Distressed debt sellers and buyers should be regulated by FSA, and subject to robust conduct of business rules to ensure borrowers are treated fairly. Lenders wishing to sell distressed debt books should be required to obtain express consent from regulators.

12. **Capping charges on expensive loans (p34**): financially excluded consumers can face exorbitant charges on legal loans. There are arguments for and against capping charges. However, on balance we recommend that charges should be capped. Unfettered charges contributed to the current level of overindebtedness in the UK allowing legal sub-prime lenders to aggressively ‘sell’ unsustainable volumes of debt. Legal sub-prime lenders also appear to act as a channel for borrowers into the hands of illegal loan sharks, not act as a bulwark. Charges should be capped at 3% per month. To address the risk of displacement into the hands of illegal lenders, this should be phased in over 3 years and accompanied by a major programme of capacity building in the alternative lending sector (community based lenders, social fund and growth fund), and creating a Community Money Advice Service to work in vulnerable communities (see below).

13. **Expanding and improving the Growth Fund and Social Fund (p36)**: these initiatives have had some success. However, given the expected reduction in access to affordable credit and limited capacity of NFP community lenders, we recommend the Growth and Social Fund (GSF) should be increased both by an additional £100m. However, the delivery should be enhanced. The GSF should be used in combination with our proposed Community Money Advice Service (CMAS), and focused on priority zones to proactively target households trapped in a cycle of unfair debt. To encourage a move towards sustainable savings, the GSF should be used as a feeder fund for community lenders, borrowers should be encouraged to participate in money management plans operated by the CMAS or money advice charities and/ or join a credit union.

14. **A Loan Shark Rescue Fund (p37)**: £50m of the enhanced GSF should be ring fenced to create a loan shark rescue fund for the most vulnerable communities.

15. **A Community Money Adviser Service (p37)**: we propose that a new Community Money Adviser Service (CMAS) be set up consisting of 300 Community Money Advisers based in the 100 protected zones. These new community advisers could be based in local authorities, social landlords, and community based charities and would in effect be the financial equivalent of community health visitors,acting as ‘change agents’ to: proactively promote financial inclusion and capability in the heart of communities; provide financial healthchecks; improve awareness of choices available to consumers; raise awareness of community lenders, and help consumers avoid legal and illegal sub-prime lenders. We estimate that this CMAS would cost just £13m per annum to run.

REGULATORY AND STRUCTURAL REFORMS

The financial crisis will fundamentally reshape financial markets – exacerbating financial exclusion trends that were already in train. Forcing banks and insurance companies to behave more prudently and responsibly is absolutely necessary but there are serious consequences which must be recognised.

The retail financial services industry[8] will understandably increasingly focus on more profitable, medium-higher income/ lower risk consumers. We expect to see a significant increase in the numbers of consumers who will find it harder to get access to fair, affordable, products and services that meet their core financial needs.

Furthermore, the financial crisis has led to a major consolidation in the banking and mortgage markets which increases the risk of anti-competitive practices.

At a more general level, there are real concerns that the financial crisis will undermine efforts to ensure consumers make sufficient financial provision for the future – whether building up enough savings for a rainy day, insuring against risks and shocks that life throws at them, or building up a decent pension.

Improving financial capability standards and access to objective advice will be a priority to ensure consumers are able to make the right decisions in very trying financial circumstances, and have the confidence to plan for the future.

Concerted positive action is needed to promote sustainable financial inclusion. So, this second set of measures set out below are intended to address longer term exclusion effects and promote a fair and inclusive financial system that is aligned with the needs and interests of all in society.

16. **New statutory objectives for financial regulators (p41)**: we argue that existing statutory financial regulation objectives are not fit for purpose to deal with the post financial crisis challenges. Regulators should have four consumer protection objectives[9]: consumer protection; promoting fair, efficient, competitive markets; promoting financial capability; and promoting financial inclusion and provision.

17. **A Financial Inclusion Agency (p41)**: a new Financial Inclusion Agency (FIA) should be established to promote financial inclusion and oversee relevant financial inclusion measures eg. monitor financial inclusion disclosure measures (FIDs). The FIA should be situated within established regulatory framework rather than create another regulator[10].

18. **A UK Financial Inclusion Act (p43)**: we argue that the case for a UK version of the USA Community Reinvestment Act (CRA) is compelling. This UK Financial Inclusion Act (UK FIAct) should be built around and enshrine the financial inclusion measures described in this manifesto.

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[8] Banking, lending, insurance and savings sectors

[9] Separate to the important financial stability objectives

[10] This could be the FSA, the Equality and Human Rights Authority, or the Consumer Protection Agency as proposed by the Conservative Party.

19. A financial inclusion levy (p44): it is only fair that banks and other significant financial institutions (BOFIs) should be subject to an annual financial inclusion levy in return for the financial support provided by society. Further modelling is required but we propose that this levy should be set at just 0.5% of annualised BOFI profits. We estimate this would raise £250m which should be used to meet costs of measures to promote financial inclusion.

20. Access to banking – universal service obligation (USO) (p44): we view access to a fully functional bank account as a necessary precondition for citizens to participate in society. Therefore, banking should be classified as a universal service obligation (USO) enforced by a legal right of access and regulatory monitoring by an independent agency.

21. A new approach to regulating consumer lending (p45): access to fair, affordable credit is hugely valuable for consumers but managed improperly consumer debt is one of the biggest sources of detriment for vulnerable consumers. The current approach to regulating consumer lending is not robust enough and has been too permissive. Detrimental practices continue to emerge as non-mainstream lenders introduce market 'innovations'. The default approach to consumer credit regulation followed by regulators fostered aggressive/ reckless lending and seems to allow practices to continue until and unless overwhelming evidence of major detriment can be found. Any regulatory response that follows closed the stable door after the horse has bolted. Furthermore, we think this permissive approach has discouraged responsible behaviour by consumers undermining capacity to save/ insure for the future. A new approach is warranted. The FSA should become the single regulator for consumer credit; consumer credit providers should be subject to authorisation and conduct of business regulations relating to marketing and selling of consumer credit. A new risk-based approach to consumer credit is needed with new products and services subject to a pre-approval process (or disapproval process) before being launched on market.

22. Best practice compliance checklists (p47): FSA, OFT, FOS, industry trade bodies and consumer groups should work together to develop best practice compliance statements covering marketing and selling, relationships with consumers, and treating customers fairly. These compliance statements would make it clear the behaviours and practices considered acceptable in retail financial services. These would help consumers and their representatives understand their rights. We believe the market would work better and firms have more confidence if they were able to identify practices which are likely to breach regulations and legislation. Firms should display on their websites: policies and practices; compliance with best practice compliance statements; and remedial actions where breaches have been identified.

23. Financial capability funding (p48): sustained financial capability interventions are needed to promote self-determination and self-sufficiency amongst consumers. Moreover, financial capability is a pre-emptive intervention ie. if effective, it reduces the risk of consumer detriment occurring in the first place thereby requiring less intrusive regulation. We urge Government to make a further £20m available to financial capability over the next two years.

24. Promoting savings and asset building (p48): it is critical to rebalance regulation to discourage unsustainable lending and promote savings and asset building. The proposals outlined above should lead to more responsible lending, and we argue that regulators should be given a statutory objective to promote financial inclusion and provision. In addition to this, we recommend that Government convene a working party consisting of Government departments, consumer groups, and regulators (with industry trade bodies as advisers) to examine whether genuine regulatory barriers to saving can be safely removed. Furthermore, we encourage Government to investigate the creation of a lifetime savings account with incentives or matched funding for lower income households. This could be funded by limiting tax relief on pension contributions to basic rate tax for everyone. However, further evaluation needs to be undertaken to understand the impact on existing pension savings.

25. A Financial Inclusion Innovation Fund (p49): we recommend the establishment of a £20m financial inclusion innovation fund to research and develop alternative solutions for excluded consumers. Priorities for R&D could include: benchmark core insurance and protection products; benchmark home equity scheme developed with local authorities, social landlords, and charities to allow homeowners to release small amounts of equity to pay for long term care and other needs; new forms of securitisation schemes based on rental incomes to allow social housing providers to expand affordable housing provision; or new versions of local authority bonds to increase infrastructure funds for local government.

26. Social Investment Bonds (SIBs) (p50): public sector funding for community organisations is likely to come under pressure due to the need to reduce the public sector deficit. Alternative sources of capital for social investment projects and community based lenders will be critical. We urge the government and the City to develop Social Investment Bonds (SIBs) as a new asset class to channel sustainable investment and loan capital from long term investors such as pension funds, local authorities, corporate and philanthropic investors. If just 1/100th of one per cent of assets managed in the UK was invested in SIBs this would provide around £50m of capital for social investment purposes.

27. The Social Investment Bank (p50): we fully support the establishment of the Social Investment Bank to provide wholesale capital for social businesses.

28. Promoting competition in the banking sector (p50): real fears have emerged that the consolidation in the banking sector that has taken place since the crisis has undermined effective competition in the market[11]. Measures are needed to protect against anti-competitive practices. Nothing should be ruled out including capping margins and market share. However, the plurality and diversity that was lost as a result of the demutualisation of building societies in 1990s needs to be reintroduced into the market. Therefore, we urge the Government to actively pursue the remutualisation of Northern Rock.

29. The role of UKFI (p51): the overarching objective of UKFI is to protect and create value for taxpayers, with regard to financial stability and competition. But the taxpayer is not the only stakeholder with an interest in how the banks within UKFI's remit are run. We argue that UKFI

[11] For example, the top four lenders took 64% of gross mortgage lending in 2008, while net interest margins have risen to highest in over a decade. See, Are banks and building societies playing fair? The Financial Inclusion Centre, 2009, www.inclusioncentre.org.uk

should be given new public objectives with regards to lending to industry, consumers, treatment of borrowers, and financial inclusion. The governance of UKFI needs to be reformed. There are no representatives on the board of UKFI with a public/ consumer interest background. All but one of the UKFI board members has a banking or investment industry background (the exception is one senior civil servant from HMT). The Government should appoint two board members with a recognised public interest background. Moreover, UKFI needs to be more transparent and accountable. The individual banks within UKFI's remit should be required to publish information on lending to communities and SMEs and treatment of borrowers in financial difficulty.

30. Forging a new banking landscape (p52): a sounder, more prudently managed financial system should emerge if the prudential regulatory reforms underway are carried through. But it would be a shame if post-crisis the banks were allowed to behave the in the same way they did pre-crisis despite having been bailed out by £billions of taxpayers' funds and leaving society with a massive debt legacy. The crisis provides a once-in-a-generation opportunity to reform the financial system so it is better aligned to meet the needs of all in society and is: better governed and more accountable to society; pluralistic and diverse; truly competitive and efficient; fair and inclusive; and produces socially useful products and services. Our proposals for new statutory objectives for financial regulators would contribute to the creation of such a system. However, we argue that a new banking landscape is needed. We support the separation of major banks into consumer/ utility banks and investment banks operating under differentiated regulatory systems. In terms of diversity, we propose the creation of a National Mortgage Bank (NMB), remutualisation of Northern Rock, and establishment of a People's Bank built around the Post Office infrastructure.

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