



# **Realising banking inclusion: the achievements and challenges**

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## Introduction

Realising banking inclusion has been a central social policy goal for more than a decade with banking seen not only as the gateway to wider financial inclusion but also as bringing significant social justice and poverty mitigation benefits in its own right. Foremost among these have been the effort to address the “poverty premium” whereby the poor pay more for essentials such as utilities and credit, primarily because of the payment channels and products that are available to those without banking facilities. The cash-based channels used by the poor to pay bills – such as payment meters and fuel keys – are significantly more expensive per unit than direct debits. Similarly policy makers have seen banking as providing the means for users of high cost credit, most notably of home credit, to move towards low APR credit products paid through low-cost electronic payment channels.

Significant progress has been made on banking inclusion. The Financial Inclusion Taskforce announced in 2009 that the Shared Goal for Banking, of halving the number of unbanked adults, agreed in 2004 between the banks and the Government, has been met. Against the background of this success, and to shape the direction of the future financial inclusion agenda, the Taskforce has sought answers to some policy-critical key questions:

### **What financial inclusion benefits and cost savings has the move into banking delivered to the newly banked?**

- What is the scale of cost savings for the newly banked arising from the move into banking?
- Are the newly banked moving on to wider financial inclusion and is banking delivering access to more affordable credit, increased savings and other benefits?
- What is the extent of bank account dormancy or failure among the newly banked?

### **How should banking inclusion most effectively be extended to the 1.6m individuals that still remain unbanked?**

- What are the remaining barriers to the move into banking and how can these be overcome?
- Is any further adaptation required on the supply side to facilitate the move into banking and ensure that more of both the unbanked and newly banked realise the benefits of banking as a gateway to cheaper services and financial inclusion?

To answer these questions, the Taskforce commissioned a survey with a nationally representative sample of 1500 low-income households<sup>1</sup>, with boosted samples of 250 unbanked<sup>2</sup> and 350 newly-banked<sup>3</sup> individuals.

## Key Findings

### **There appears to have been significant variation between groups in the extent to which the newly banked have benefitted from the move into banking**

- Banking inclusion has been successful in reaching many of the poorest people in society, with the majority of the newly banked being new to banking.
- The major benefits of the move into banking are seen to be enhanced security, increased convenience, and enhanced ability to avoid financial difficulty and greater independence and a sense of social inclusion rather than savings on bills or the cost of credit.
- Some of the newly banked have clearly benefitted from banking, are achieving savings through use of direct debits and are both saving and taking advantage of overdraft facilities, and to a lesser extent, other financial products such as insurances. These are a minority however, being circa 1 in 4.
- A significant minority, also around 1 in 4, have moved into banking but have not realised the benefits of banking primarily because they continue to manage their money largely in cash.
- Others, however, around 4 in 10 of the total and mainly those in the bottom 20% of household incomes, appear to have been disadvantaged by the move into banking. They have suffered a net loss and some damage to their financial security as well as an increase in indebtedness. This damage arises primarily as a result of penalty charges associated with unmet direct debits and unauthorised overdraft charges.
- A small, and more affluent group, roughly 1 in 10 of the newly banked, appear also to have sustained some damage to their financial well-being through the move into banking. These are among those who have been most engaged with banking, most likely to manage their money through their account and most active in moving into the wider financial mainstream. Their budgets remain tight and cash flows and payment patterns irregular however, so that their very activity has exposed them to a high incidence of penalty charges for unmet direct debits.
- Both these latter groups have a high propensity to banking failure, with around a third of both groups falling out of banking.

### **Credit use would appear to be a significant factor in determining whether financial stability is enhanced or damaged**

- Credit use would appear to be an important factor in whether savings have been made and financial stability enhanced or damaged by the move into banking. For

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<sup>1</sup> The survey was conducted face-to-face, in-home, during December 2009, the sample is representative of households in the lowest 50% of household incomes.

<sup>2</sup> Unbanked is defined as: having no bank account, or no bank account that can be used, or having only a POCA.

<sup>3</sup> Newly-banked is defined as: using a bank account, opened in the last 5 years, and excludes people switching from another account; students; people who had opened an account when they turned 18, started their first job or left home for the first time.

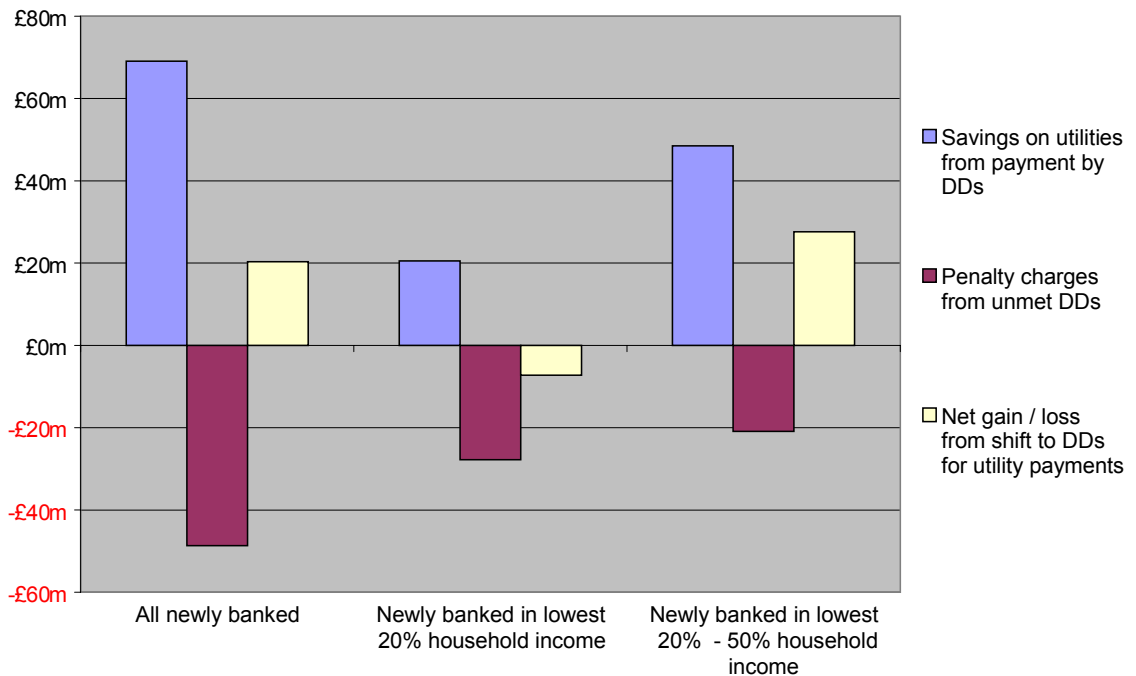
the better off, much of the negative impact appears to be associated with the move into mainstream credit, which has increased indebtedness and outgoings on debt service, while undermining financial stability and security.

- The lowest income credit users have been disproportionately exposed to delinquency charges on overdrafts, which significantly outweigh any savings from cheaper credit. However these individuals have not seen debt service payments escalate in the same way as more affluent newly bank credit users. Nor have they acquired additional debt to the same extent. This is largely because they have continued to use high APR credit products and have not moved into revolving credit as have their more affluent newly banked counterparts.

**The savings anticipated from the move into banking have not been fully realised primarily because of penalty charges**

- Much of the savings gains from access to cheaper utilities have been nullified by exposure to penalty charges on associated unmet direct debits. Those moving into banking have realised savings on utility bills of £69m p.a. from payment by direct debit. However these savings need to be set against insufficient fund penalty fees on associated direct debits of some £49m, reducing the net gain to £20m. The lion’s share of the gain in utility savings in fact accrues to the better off among the newly banked. For those in the lowest 20% of household incomes, penalty charges on direct debits outweigh gains from cheaper services, resulting in a small net financial loss, of around £12 p.a., or circa £7m in total.

**Savings on utilities are largely outweighed by insufficient fund fees on failed direct debits**

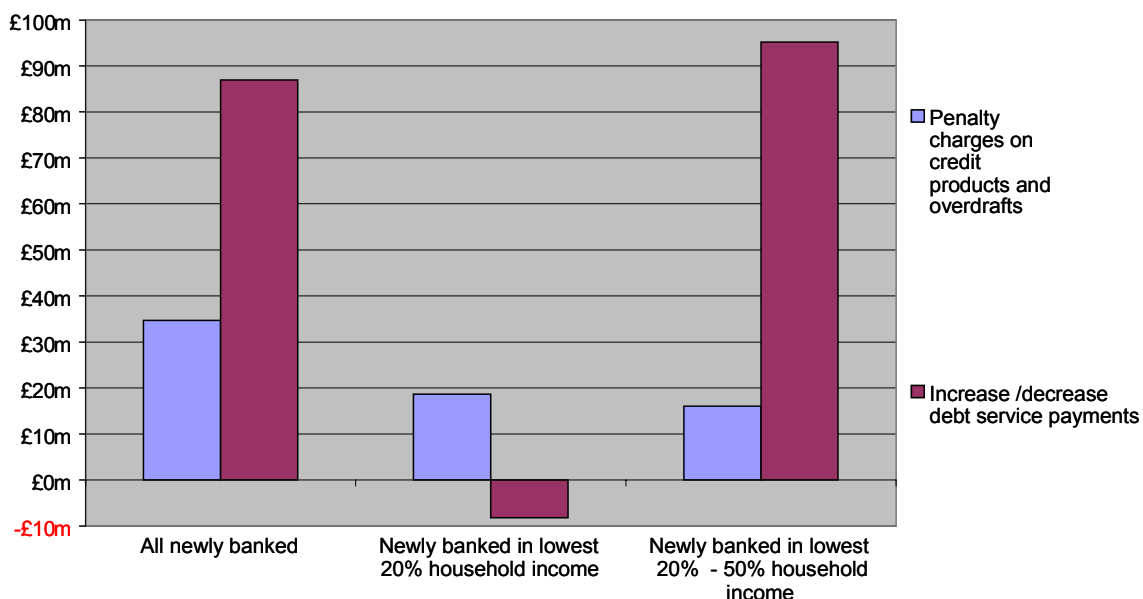


- A similar effect is evident in relation to savings from access to cheaper credit but the dynamics are more complex and differ also between more or less affluent consumers. For those on the lowest incomes, the gains in access to cheaper overdraft credit are outweighed by unauthorised overdraft fees, often disproportionate to borrowings. The better off working poor who have moved into

mainstream loans and credit cards have also experienced significant penalty charges where they have been unable to maintain an even payment record, but these are less significant in relation to the sums borrowed.

- Payments on debt service by the newly banked have increased as a result of the move into banking. This is primarily because of a significant increase in indebtedness as the newly banked have moved to take on a range of mainstream credit products, primarily overdrafts and revolving credit. Overall, controlling for incomes and household type, spend by the newly banked on debt service has increased by some £87 million p.a. relative to their unbanked credit user counterparts. This is driven almost entirely by the better off whose increased spend results primarily from significantly increased debt on newly acquired revolving credit. Penalty charges on credit cards and loans add a further £35 m p.a. to debt service costs, bringing the increase in overall spend on debt service arising from the move into banking to £122m p.a. for the newly banked as a whole.
- Of this, £111m relates to increased spend by those in the 20 – 50% of household incomes, of which £16m is penalty charges. Indebtedness has increased much faster than spend on debt service, however, primarily among the better off “working poor”, reflecting the high incidence of partial and minimum payments on revolving credit among this group. Controlling for income and household type, indebtedness among the newly banked is higher than for the unbanked- by £1,465 for those in the lowest 20% of household incomes and by £3, 645 for those in the lowest 20 – 50% of household incomes, reflecting higher credit card debt among the latter.
- Those in the bottom 20% of household incomes have seen a small gain – of a little over £8m p.a. – as a result of access to cheaper overdraft credit. This small gain has been more than outweighed, however, by a £19m p.a. loss on penalty charges, primarily on overdrafts. There is thus a marginal increase in overall spend on debt service, including both spend on mainstream and sub prime credit.
- Outside overdraft use, there would appear to have been minimal movement from high cost credit to low APR credit products such as credit cards and personal loans. Only 14% of home credit users among the newly banked, some 26,000 individuals, have taken on mainstream loans or cards.
- Overall, taking both the utilities and credit effects together, net gains for the newly banked from the move into banking have been marginal. Savings average £18 per head per annum for the newly banked or a total of £20m across the 1.12m newly banked individuals overall. Most of this gain accrues to the more affluent newly banked, with those in the lowest 20% household incomes suffering a net loss of £12 per head per annum, or £7m overall.

**The better off have seen significant increases in spend on debt service with poorest seeing savings on cheaper credit outweighed by penalty charges**



- Against this background, there is a relatively high rate of failure among the newly banked, 15% overall rising to 1 in 5 of those in the bottom 20% of household incomes. This is concentrated however primarily among credit users and those using direct debits for a wide range of bills, including credit commitments, among whom around a third of accounts fail, primarily as a result of account delinquency and penalty charges.

**There would appear to be considerable risk attached to the effort to move the remaining unbanked into banking**

It is not clear that those who now remain unbanked will make effective use of banking functionality or that they will gain from cost savings from any move into banking. There would appear to be considerable potential for risk to financial well-being from a move into banking, many having already fallen out of banking.

The remaining unbanked are significantly more disadvantaged than those who have moved into banking.

The majority of the unbanked (6 in 10) have previously had a bank account, having fallen out of banking, largely as a result of penalty charges and escalating debt on their account.

Most of the unbanked (7 in 10) have a POCA, with around half of these feeling that they have no need of a bank account and further banking functionality. However, where those with POCAs do want a bank account, the primary driver is for the convenience of payment cards.

The lack of motivation for a move into banking is reinforced by affinity with cash based payment channels and resistance to direct debits. Fewer than 1 in 10 of the unbanked cite direct debits as a preferred payment channel, with just 3% of POCA owners citing direct debits as a channel they would prefer to use in preference to cash-based channels.

For those who have been banked, almost 3 in 10 cite a fear of penalty charges as a reason for not having an account.

There is considerable ambivalence on the benefits of banking. One in three (32%) of three of the unbanked would definitely like to move into banking, rising to 6 in 10 of those with dormant accounts. A little over a quarter (27%) definitely don't want an account, however, rising to 44% for POCA owners with no banking history.

### **Key conclusions**

There are clear benefits to account ownership for some of the newly banked. Around one in four realise cash savings. A further one in four benefit from enhanced security and convenience but still maintain a cash budget and continue to be exposed to the poverty premium.

For the remaining half of the newly banked the anticipated savings from reduced utility costs and a move to lower cost credit have not materialised. The gains from any savings they make from paying bills by direct debit have been all but entirely outweighed by the costs associated with penalty charges, resulting in a net loss for the lowest income households.

The most disadvantaged of the newly banked have not only suffered financial losses but have also experienced risks to their financial security and well-being.

The structure and pricing of banking products which functions on the presumption of regular fixed payments is a poor fit with the needs of those on low incomes and very tight budgets. This is the primary reason for both the failure to realise the anticipated savings from the move into banking and for the high failure rate of accounts.

As 6 out of 10 of the remaining unbanked have fallen out of banking due to difficulties with an account and that poor previous banking experience is a key barrier to banking inclusion, it seems imperative to re-think the structure and pricing of bank accounts for those on low incomes.

Any further move towards banking inclusion which does not address this fundamental structural flaw risks simply setting the remaining unbanked up to fail and risk further more deeply entrenched financial exclusion.

# The Newly Banked – a segmented perspective on the experience of moving into banking

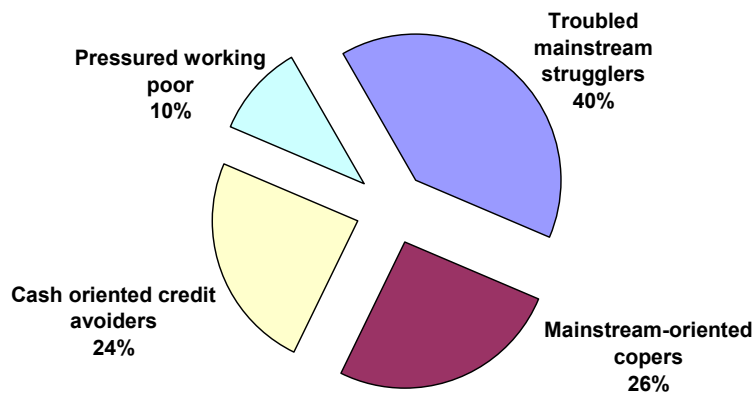
We identify four segments within the newly banked:

## Pressured working poor

10% and 110,000 individuals  
 Highest average incomes  
 Most likely to be in employment  
 Account based money management  
 Direct debits for both bills and credit  
 Heavy credit users  
 Use overdraft facilities  
 New mainstream credit, especially credit cards  
 Payday users  
 Heavy exposure to penalty charges  
 High incidence of bank failure

## Troubled mainstream strugglers

40% and 450,000 individuals  
 Most disadvantaged  
 Closest in profile to remaining unbanked  
 Many previously banked  
 Cash oriented  
 Heavy sub prime and home credit users  
 Struggling with bills and credit payments  
 Use overdrafts and direct debits for some bills  
 High exposure to penalty charges  
 High incidence of account failure



## Cash oriented credit avoiders

24% and 270,000 individuals  
 Higher and more stable incomes  
 Three quarters new to banking  
 Cash managers  
 Little use of banking functionality  
 Little use of mainstream credit  
 No history of sub prime credit use  
 Very low incidence of penalty charges  
 Minimal account failure

## Mainstream-oriented copers

26% and 290,000 individuals  
 Majority new to banking  
 Coping well financially  
 Half using account to pay bills  
 Progression to savings, to lesser extent insurances  
 Little use of payment cards  
 Use overdraft but little use of other credit types  
 Low incidence of penalty charges  
 Minimal account failure

The various newly banked segments have experienced very different outcomes from the move into banking.

The “**Mainstream-Oriented Copers**” represent 1 in 4 of the newly banked, and some 290,000 individuals. They appear to be realising the benefits of banking to a greater extent than other segments.

Two thirds are new to banking. 7 in 10 use direct debits and almost half use their account to pay bills. This segment are more likely to have opened savings accounts but, although they use overdraft facilities, make little use of other credit products. This segment largely avoids exposure to penalty charges and has a low rate of banking failure. This segment are net gainers, having reduced their external credit commitments and saving and are gaining an average of £31 on their credit spend and £60 per annum on their utility bills.

The “**Cash-Oriented Credit Avoiders**”, 1 in 4 of the newly banked and 270,000 individuals, are realising some of the benefits of banking, mainly in terms of enhanced security and convenience but nonetheless use little banking functionality, choosing to manage primarily in cash. They thus realise little in the way of savings. As this group use very little credit and pay few bills by direct debit they are also little exposed to penalty charges. Overall the segment gain £30 per annum on their utility bills and the

move into banking has not caused any significant change what is in any case very low credit related expenditure.

The largest single segment, and the most disadvantaged, is the “**Troubled Mainstream Strugglers**”, representing 4 in 10 of the newly banked and 450,000 individuals. This segment has suffered the greatest net financial losses, being the segment in which exposure to penalty charges is most heavily concentrated. This is also the segment whose profile is closest to that of the remaining unbanked, with the highest proportion of benefit dependent households and disadvantage families, including single parents.

This segment is the one in which home credit use is highest. They appear to have made little move away from high cost credit however. Although relatively heavy credit users, there is very low take up of low APR revolving credit and personal loan products, of which these consumers remain wary, reflecting the estimated £19m in credit and overdraft related penalty charges associated with this segment.

A little over a third (35%) of the segment have fallen out of banking, with almost a quarter stopping using their account on account of the penalty charges they have experienced.

A smaller, and better off segment, representing 1 in 10 of the newly banked and 110,000 people, “**The Pressured Working Poor**” have also encountered problems in the transition to banking, albeit that the dynamic differs from that of the larger more disadvantaged segment just described. For this group, also relatively heavy credit users compared to other segments, the major problems have arisen from a move into a range of low APR credit products, notably bank overdraft and revolving credit cards. The uneven payment patterns and propensity to have insufficient funds to meet direct debits and thus to miss payments on credit agreements and exceed overdraft limits have resulted in penalty charges of £12m.

For this group debt service payments and overall indebtedness appear to have increased as a result of the move into banking. Debt servicing levels have increased by £84 per month and overall debt by £3,740. This group also have a high banking failure rate, with some 3 in 10 falling out of banking. Despite being significantly better off than the larger, more down-scale segment earlier described, this group is just as likely to be in arrears on household bills and are more likely to be struggling with loan and credit repayments, perhaps reflecting their increased levels of debt and credit repayments.

## The unbanked – a segmented perspective on the barriers and challenges in moving into banking:

As with the newly banked, there are clear segments within the unbanked population:

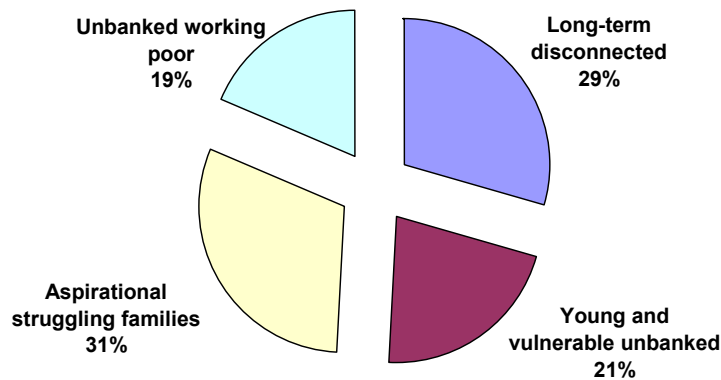
### The unbanked segments each represent a series of challenges for banking inclusion

#### Unbanked working poor

20% and 290,000  
 Highest but irregular incomes  
 Older without dependent children  
 High POCA ownership  
 Half never banked  
 Careful and effective money management  
 Tight budgets with credit essential to make ends meet  
 Social Fund and Home Credit users  
 Strong attachment to cash budgeting  
 Little perceived need for account

#### Long-term disconnected

31% and 480,000 individuals  
 Older and lowest incomes  
 Significant minority have no POCA  
 3 in 10 from BME groups  
 Profoundly digitally excluded  
 Strong affinity cash based channels  
 Deeply risk averse  
 Resistant to banking



#### Aspirational struggling families

20% and 340,000  
 Benefit dependent  
 9 in 10 previously banked  
 Constantly juggling finances  
 Majority in arrears on commitments  
 Motivated to enter banking  
 Want payment card technology and access to services  
 Deep rooted fear of banking costs and risks

#### Young and vulnerable unbanked

29% and 460,000 individuals  
 Benefit dependent  
 Struggling with commitments  
 Majority have fallen out of banking  
 History of penalty charges and bank-closed accounts  
 Like payment card technology  
 Otherwise resistant to banking  
 Strong affinity with cash payment channels

The experienced of the unbanked highlights the risks of the move into banking and the reasons both for the deeply felt affinity with cash based management and the sometimes deeply felt resistance to banking in some segments.

The “**Long Term Disconnected**, 3 in 10 of the unbanked and 480,000 individuals, are particularly resistant to becoming banked, with 70% saying that they definitely or probably don’t want an account. This group have a strong affinity with cash based channels and are diligent and successful money managers who are highly credit averse.

The “**Young and Vulnerable Unbanked**”, also represent 3 in 10 of the unbanked and some 460,000 individuals. Some 6 in 10 have previously been banked but have fallen out of banking due to difficulties in managing their account. Half have stopped using their account due to penalty charges and 3 in 10 have had their account closed by the bank, with 4 in 10 having a hangover of mainstream credit card debt. This group struggles to make end meet on a week in week out basis Although they are attracted to the convenience of payment cards, most are wary of banking and the inflexibility of electronic payment channels. 9 in 10 cite fuel keys and prepayment meters as their preferred payment method for bill payment.

**“Aspirational struggling young families”**, comprise 1 in 5 of the unbanked and 340,000 individuals. More than 9 in 10 of this group have previously been banked, with 6 in 10 having stopped using their account because of penalty charges. A third had had their account closed by the bank. This was the group most likely to have borrowed from home credit companies and the Social Fund. However 6 in 10 were still servicing outstanding credit card debt.

The **“Unbanked working poor”** also represent 1 in 5 of the unbanked and 290,000 individuals. They are largely older and without dependent children, and broadly more affluent than the other unbanked segments. Incomes were however irregular and unpredictable. Almost half (46%) had never been banked and more than half felt no need for an account. A quarter had however been refused an account, primarily because they were unable to produce the required paperwork. This group were entirely wedded to cash based management, cited by 98% as their preferred money management option. 6 in 10 say that they definitely do not want a bank account.