
TARGETED, TIMELY AND RELIABLE ACCESS TO CREDIT

Roundtable Report

March 2017

Attendees

- Neil Couling
- Steve Coulson
- Dean Duke
- Jerry During
- Patrick Fitzgerald
- Helena Forsythe
- Malcolm Gardner
- Chris Hewitt
- Frank Hobson
- David Jenkins
- James Langsford
- Polly Mackenzie
- John McClean
- Clare Payne
- Phil Reed
- Ben Sanders
- Peter Schofield
- Rebecca Simpson
- David Spencer
- Baroness Philippa Stroud of Fulham (chair)
- Martin Syms

The roundtable took place on Wednesday 22nd September, 2016. Please note that, while the points made in our report draw upon some of the major themes discussed at this roundtable, each point should not be construed as representative of all the parties outlined in this list.



Introduction

This is the third in a series of three roundtable reports broadly related to the financial inclusion of the bottom 20%. The first entitled '*The Use of Digital Technologies to Tackle Financial Exclusion*'¹ explored how technological innovation and digital skills can be utilised to solve the issue of financial exclusion. The second, '*Next Steps for Universal Support in Universal Credit*'² concluded that Universal Support Programme is an essential provision with Universal Credit (UC). This roundtable considered the possibility of attaching a 'back-banking system' into the UC infrastructure that would allow UC recipients to access reliable and low-cost credit.

Too many people on low incomes lack access to short term credit to cover unforeseen costs, such as new school uniform or a broken washing machine. A lack of access to mainstream sources of finance pushes many towards expensive payday lenders and unregulated loan sharks. Ensuring that people on low incomes have access to affordable credit is therefore key for both economic opportunity and social justice. A back-banking system would allow mainstream financial institutions to lend to UC recipients against future UC payments. It would be low risk, low cost, and prevent many low-income individuals and families from getting stuck in risky problem debt.

On 22 September, the Centre for Social Justice (CSJ) held a roundtable to discuss this proposal of a back-banking system being available to

1 The Centre for Social Justice (CSJ), *The Use of Digital Technologies to Tackle Financial Exclusion*, London: CSJ, 2016

2 The Centre for Social Justice (CSJ), *Next Steps for Universal Support in Universal Credit*, London: CSJ, 2016

UC claimants as an alternative to predatory lending companies. Our roundtable drew an impressive group of experts from the financial sector, third sector organisations and the DWP, providing invaluable insights on the opportunity to create an alternative model, which is sustainable for banks and meets this social justice need. In the discussions, we discussed a possible model that would align the needs of UC claimants with back banking and the role of banks in the process. We also considered the challenges that banks and claimants could face and put forward general recommendations to help find a solution. This paper brings together some of the main themes and proposals that arose from our discussion.

Background

Many low-income families that have insecure sources of income and are unable to plan their finances over a medium to long term period are subjected to what is known as the poverty premium. Examples of the poverty premium include a 10% premium for families who pay for electricity via direct debit as opposed to the cheaper pre-payment option or financial penalties associated with late payment. In 2016 the poverty premium was estimated at £490.³ Individuals and families at risk of incurring the poverty premium will often rely on short term loans to make up weekly or monthly cash shortages. These high interest loans are often used to pay off overdue electricity or credit card bills.

Exclusion from mainstream finance can push individuals and families towards expensive payday lenders and unregulated loan sharks. Both these sources of credit place borrowers under huge financial pressure and hardship. We estimated that in 2012 more than two million people took out a high-cost loan as they were unable to access any other forms of credit. More than three million users of high-cost

3 University of Bristol, *The Poverty Premium: When low-income households pay more for essential goods and services*, Bristol: University of Bristol, p1 [accessed via: www.bristol.ac.uk/media-library/sites/geography/pfrc/pfrc1614-poverty-premium-key-findings.pdf]

credit are in serious financial difficulties.⁴ It is also estimated that between four and seven million people regularly incur bank penalty charges that negate the financial benefits of banking, with around one million people incurring financially crippling levels of penalty charges.⁵ More than 1.8 million social housing tenants are unable to access basic financial services online because they are unable to complete automated checks.⁶ An estimated 310,000 people borrow from illegal moneylenders.⁷

As millions of low-income households struggle to access traditional high-street banking and mainstream credit or pay disproportionate amounts to do so because of high penalty charges and fees that can drive them into a debt spiral,⁸ ensuring that people on low incomes have access to affordable credit is a key social justice issue.

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- 4 Note: CSJ estimate based on applying the percentage of households who responded, “Only kind of credit I can get”, to the YouGov Debttrack survey question: “Why did you take out your last loan?” to the number of customers estimated to use one of three high-cost loan products included in the survey (pawnbroker, payday loan, home credit). The number of pawnbroker customers was estimated from the minimum total of loans per year (2 million) and the average number of loans taken per customer per year (2.5); The Department for Business, Innovation and Skills (BIS), *Credit, debt and financial difficulty in Britain*, London: BIS, 2013; National Pawnbrokers Association (NPA), *Pawnbroking: A successful and established profession*, London: NPA, 2013; The Department for Business, Innovation and Skills (BIS), *The impact on business and consumers of a cap on the total cost of credit*, London: BIS, 2013; Financial Conduct Authority (FCA), *Consultation paper CP 14/10: Proposals for a price cap on high-cost short-term credit*, London: FCA, 2014
- 5 Social Finance, *A New Approach to Banking, Extending the use of Jam Jar Accounts in the UK*, London: Social Finance, 2011; Department of Work and Pensions (DWP), *DWP credit union Expansion Project, Project Steering Committee, Feasibility Study Report*, London: DWP, 2012
- 6 As written on Experian’s website, *Credit Scoring Boost for 93% of Social Housing Tenants* [accessed via: www.experian.co.uk/blogs/latest-thinking/2013/11/credit-scoring-boost-for-93-of-social-housing-tenants/] Note: 35% of 5.2m social tenants that cannot access services online.
- 7 Department for Business Innovation and Skills (BIS), *Interim evaluation of the national illegal money lending projects – summary*, London: BIS, 2010
- 8 The Centre for Social Justice (CSJ), *Restoring the Balance, Tackling problem debt*, London: CSJ, 2014

A 'basic bank account' is a product designed for people with poor credit scores and on low-incomes. The basic bank account is a current account which allows small cash withdrawals, payments to be made by direct debit, but crucially without overdraft facilities. Whilst the CSJ welcomes the starting point of basic bank accounts, they do not answer the question of low cost credit. The most effective way of meeting this social justice need is to design a system that would provide low cost credit, which is sustainable for banks. At present, just over a million people use a credit union, and yet up to eight million people who currently use high-cost credit would benefit from access to more affordable forms of credit.

In phase two of the UC build it should be possible to build a back-banking system. This would provide new opportunities for more targeted, timely and reliable access to credit – a back banking system could support the roll out of UC, which for the first time would enable short-term, interest-free lending provision within the welfare system and negate the need for high interest loan providers who currently dominate the market. By fostering a new generation of socially responsible Alternative Financial Institutions which offer financial products specifically tailored to the needs of low-income families, government could help people avoid high-interest payday loans.

Back-banking: What would it look like

Using the Universal Credit Infrastructure

The basic infrastructure for a back-banking system exists. The system on which UC operates is linked to individual's accounts and allows third parties to make deductions from a UC claimants account. Banks can gauge quickly how much money is going in and coming out of a UC claimant's account. UC is also a relatively secure source of income for claimants (conditional on claimants not incurring sanctions). The reduced insecurity of income reduces the risk associated with this demographic. With a lower risk profile, banks are more eager to lend to UC claimants.

Once a bank has loaned a claimant credit, it will be able to make small deductions to recover the loan. A simple deduction mechanism reduces the anxieties of the clients and reduces the risk of non-payment to the bank. This is an exceptionally rare case of a policy where everyone benefits.

The Department for Work and Pensions would also be able to leverage the work completed as part of the Credit Union Expansion Project, ensuring credit unions and their low risk banking services are available via a UC based back banking system. One roundtable attendee stated, *"The capital investment that would have been required, if an entirely new system was being introduced, could be reinvested so that the banking platform was available at an affordable price"*.

Alternative providers

A back-banking system underpinned by the UC system would allow for multiple providers, each offering a heterogenous array of financial products. The DWP cannot use UC to build its own low cost lender, and retail banks are better placed to offer competitive offers to claimants. One roundtable attendee said, *“The important underlying principle here must be that the parties participating in this back-banking system must have a shared goal of solving the financial services problems encountered by low income consumers in the UK”*. The DWP must ensure that alternative providers, such as building societies and credit unions, can offer their services via the UC back-banking system. This would have the dual aim of maximising consumer welfare by broadening the array of products available to them, and increasing competition in the financial services industry.

Throughout the discussions, attendees agreed that the credit unions could offer invaluable services. The credit unions could be the first to pilot the new system once the migration of platforms is finalised. Credit unions would be invaluable in providing financial support to claimants, ensuring the necessary friction to enable good decision-making.

Case study: SourceCard^{9,10}

The SourceCard model combines public support (for example: government agencies, charities and local authorities) with targeted private philanthropy to enable the most vulnerable to become financially independent. A low-cost bank account is linked to two Visa cards (Essentials and Flexi). The account is divided into five specific wallets (food, rent, utilities, travel and other necessities) and public sponsors load funds into these wallets. The financial support that SourceCard offers is targeted and personalised. Clients are encouraged to continue to pay for the essentials such as rent payments, utilities and the necessary costs associated with finding work. This framework promotes a social wider partnership that places the client at the centre.

Management and regulation

The roundtable brought up that the developments around UC must be consistent with supporting the recommendations on banking and payments put forward by the Financial Inclusion Commission in March 2015.¹¹ Those referred to were:

9 As written on SourceCards' website, *SourceCards*, [accessed via: <https://sourcecards.org/>]

10 <https://vimeo.com/168343607/3a4700e343>

11 Financial Inclusion Commission, *Improving the Financial Health of the Nation*, London: Financial Inclusion Commission, 2016

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- The new Payment Systems Regulator to ensure direct debits and faster payments are accessible to small organisations and new entrants;¹²
 - Regulators to ensure payment mechanisms are responsive to the needs of all consumers;
 - The Department for Work and Pensions to promote inclusive alternatives to the Post Office Card Account to support the introduction of Universal Credit, which meet the new basic bank account industry standard agreed by HM Treasury, including electronic payment facilities;¹³
 - The Financial Conduct Authority (FCA) to promote greater consistency and accessibility in identifying requirements for opening a bank account;
 - The Cabinet Office to continue to work with industry to deliver a world-leading digital identity that supports financial inclusion.

The recommendations also state that close liaison with Payment Systems Regulator, DWP and FCA would provide an opportunity to potentially support the effectiveness of existing measures introduced to support the report's recommendations.

12 The Payment Systems Regulator is a new economic regulator for the retail banking sector. Created through the Financial Services Act 2013, it aims to encourage competition and reduce the number of barriers to entry faced by smaller fledgling banks. As written on Gov.uk, *Designation of payment systems for regulation by the Payment Systems Regulator*, [accessed via: www.gov.uk/government/consultations/designation-of-payment-systems-for-regulation-by-the-payment-systems-regulator/designation-of-payment-systems-for-regulation-by-the-payment-systems-regulator]

13 The Post Office Card Account is aimed at those without a traditional bank current account and designed to receive state pensions, benefits, tax credits and war pensions. This protects the most vulnerable pensioners. An estimated 2.5 million people use a Post Office Card Account. Department for work and pensions, Press Release, *Post Office service for pensioners and benefit claimants to be safeguarded with new government contract*, 16 December 2014, [accessed via :www.gov.uk/government/news/post-office-service-for-pensioners-and-benefit-claimants-to-be-safeguarded-with-new-government-contract]

The benefits and risks for banks

The main lenders are an integral part of our financial system, ensuring competition and providing the best rates and services to their clients.

What benefits are there to the banks?

Through a back-banking framework, there is an opportunity for the banks to ultimately replace predatory lenders in the market. A back-banking system reduces the risk of lending to UC claimants and provides banks with a customer base that is underserved and financially profitable. By involving themselves in this scheme, the banks would demonstrate that they are committed to providing access to lending and a multitude of account types, to reflect the needs of their clients, rather than regarding their clients as simply 'cash cows' to improve shareholder profits.

What risks are there to the banks?

A major risk to the bank is the non-payment and defaulting on loans. This may occur when there is an unexpected loss of employment or a claimant has their UC payments sanctioned. However, with JSA sanctions as low as 2% each month, it is unlikely to pose a serious risk to 'banks' profitability.

There is a potential risk in prioritising consumer credit over other outstanding loans. The safety of claimants may be jeopardised if consumer credit is given primacy in the debt management hierarchy.

Currently, non-priority loans, such as credit, can be repaid at a rate that you can afford through a Debt Management Plan (DMP).¹⁴ Prioritising consumer credit the same way as secured loans could diminish the ability to write off debt.¹⁵

Moreover, back-banking can be provided by multiple providers, including social enterprises or the banking industry. The focus of the providers is on providing low-cost credit to low-income families and all parties involved should be committed to solving the financial problems that low-income customers encounter in the UK.

How can these risks be mitigated?

However, there are several ways in which these risks could be mitigated:

- Guarantee that banks would be a priority in debt management hierarchy;
- Introduce a lending criteria so that most customers meet certain standards (perhaps related to abstinence from drug abuse, or committing to certain weekly working hours);
- Negotiate government guarantees;
- Use insurers as a way of covering risks;

14 As written on the money Advice Service's website, *Writing off your debts*, [accessed via: www.moneyadvice.org.uk/en/articles/options-for-clearing-your-debts-england-and-wales#writing-off-your-debts]

15 As written on Citizens Advice's website, *Your rights when borrowing money*, [accessed via: www.citizensadvice.org.uk/debt-and-money/borrowing-money/your-rights-when-you-borrow-money/]

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- Develop a reserve fund to cover potential losses;¹⁶
 - Place stipulations upon how the credit can be spent.

Some of potential solutions do run the risk of alienating UC claimants from engaging with the scheme.

¹⁶ RateSetter protects lenders through its Provision Fund that manages risk. Some borrowers are also required to guarantee a security against their loan, and if a default occurred then Ratesetter could recover the debt through the security. As written on RateSetter's Website, *The Provision Fund*, [accessed via: www.ratesetter.com/invest/everyday-account/protection]

The benefits and risks for UC claimants

The benefits of a back-banking system

The benefits to the UC claimants if the right system is implemented are immediate and far-reaching. The first benefit will be the ability to rely upon the UC system to help access credit. By accessing short term loans quickly and easily, UC claimants will not have to risk leaving their children hungry or their house cold before incurring an expensive penalty.

A UC claimant who accesses credit via the back-banking system will also be able to manage their finances more easily, paying off loans over time at low rates of interest, not in the manner of a payday lender at high rates of interest, or a loan shark in one lump sum payment.

Lastly, UC claimants will be able to build up a credit score while accessing credit through the back-banking system. Credit scores are important determinants of an individual's long term financial health. Low credit scores prevent individuals being able to access credit cards, home loans or even mortgages. This can be the case when a low credit score was the result of poor choices at a young age. UC claimants who graduate from welfare with high credit scores and low debt, will be in a much better position to thrive financially and personally.

How will the back-banking system be perceived by UC claimants?

Several attendees raised concerns that gaining the trust of claimants should not be underestimated. Guidance is paramount but the advice being given should not be patronising or condescending. For the system to be of maximum success, it should be a completely voluntary system.

With regards to the system itself, there was concern that if there are many restrictions, it would fail to positively change lives. There is a general distrust of the government system because some of the most vulnerable have been subjected to government sanctions and other punitive punishments in the past. The more attached the DWP, and by extension the government, is to the system, the more likely claimants will view the help offered negatively. The reason high interest loans are successful is that, through the process, many people believe they are making choices that they are in control of.

What risks are there to customers?

The biggest risk to any UC claimant is the effect of access to one more form of credit. If a claimant falls behind on repayments through the back-banking system, there is little to prevent them from accessing unregulated loan sharks or illegal money lenders. Roundtable participants all commented on the risk that customers receiving Universal Credit will fail to budget effectively.

Another risk identified to UC claimants was the perception that incoming UC payments could inhibit switching current accounts.

The Competition and Markets Authority (CMA) identified that for low income customers, greater measures needed to be introduced to increase confidence in current account switching services.¹⁷

How could these risks to customers be mitigated?

There are several measures that were suggested by the roundtable participants and internally at the CSJ that could mitigate the risks of unsustainable debt for UC claimants accessing credit via a back-banking system:

- To risk mitigation for banks, any back-banking system could have lending criteria introduced for anyone looking to borrow funds. This would greatly reduce the risk of unaffordability for customers of the back-banking system.
- Financial education has been a core policy advocated by the CSJ that tackles the problem of unsustainable debt.
- Universal Support delivered locally (USdl) is a trial programme at the Department of Work and Pensions which pairs UC claimants at risk of problem debt with debt advisors operating out of Job Centre Pluses. By getting access to debt advisors, claimants can develop personalised debt management plans and work with a personal advisor on issues of financial management.

¹⁷ Competition and Markets Authority (CMA), *Retail banking market investigation: Provisional decision on remedies*, London: Crown, 2016

Conclusion, recommendations and next steps

Although the focus of the roundtable was upon back-banking as a possible solution, there was recognition it was necessary to pursue both preventative and retrospective measures to stop low-income households accumulating high and catastrophic levels of debt.

In summary, our roundtable discussion highlighted the following ways in which the banking sector could potentially help UC claimants and the reservations that must be considered when attempting to successfully tackle this issue:

- Build a back-banking system that connects retail banks and UC claimants;
- Consider how to engage the banks in creating and issuing these loans to UC claimants;
- Consider how other third party enterprises, outside of the banking sector, can be used to create, fund and implement this scheme. These companies may be crucial in providing a premium product that will entice people;
- Implement a scheme where choice is paramount in accessing services, as self-identification is the first step to ensure maximum success. Trust and perception of the scheme will be crucial in involving the most vulnerable;
- Improvements to current regulation such as overdraft fees to limit damage to current clients;
- Introduce both preventative and retrospective measures to stop spirals into unmanageable debt. The former is required to stop the descent and the latter in helping those currently affected by this;

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- Introduce good financial education to stop future generations from repeating these mistakes and accumulating high levels of debt;
 - Support the roll out of Universal Support delivered locally, helping claimants get access to debt advice via Job Centre Plus;
 - Consider the scope of UC claimants and how this may evolve as the gig economy grows considerably in the short-medium term.



Putting social justice at the heart of British politics

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