Written evidence submitted by the Financial Inclusion Commission

About the Financial Inclusion Commission

The Financial Inclusion Commission (FIC) is an independent body made up of parliamentarians (cross-party) and experts drawn from financial services, businesses, the charity sector and academia. https://www.financialinclusioncommission.org.uk/

Our mission is to champion financial inclusion as a public policy priority. We work with policy makers and a wide range of stakeholders, to come up with practical policy proposals for government, business and civil society.

Financial inclusion remains a significant challenge for 21st century Britain, a nation which prides itself on being a global leader in financial services. Yet 1.3 million people do not have a bank account, 16 million adults lack home insurance cover and 10.5 million UK adults would be unable to cover one month of living expenses if they lost their source of income.

The Financial Inclusion Commission wants to see a financially inclusive United Kingdom in which every citizen can enjoy decent financial well-being. We want financial services that are accessible, easy to use and meet people's needs over their lifetime. We want people to have the skills and motivation to use financial services, and to benefit meaningfully from them.

This means a United Kingdom in which:

- every adult is connected to the banking system, through having access to – and the ability to make full use of – a transactional account of his or her own;
- every adult has access to affordable credit from responsible lenders;
- every adult, young person and child is encouraged and enabled to save, even in small or irregular amounts, to share in the importance of a common savings culture. This is important to help build up resilience against financial shocks and as an additional resource for retirement;
- every adult has access to the right insurance cover for his or her needs, at a fair price;
- every adult has access to objective and understandable advice on credit, debt, savings and
- pensions, delivered via the channel most suited to that individual;
- every adult and child receives the financial education he or she needs, starting in primary school and carrying on throughout life and into retirement;

Executive Summary

The Financial Inclusion Commission believes there are several policy areas which the government could examine in order to create a more financially inclusive economy.

In the first instance, we are concerned at the credit-based approach of government support which, though the support is welcome, could lead to a mountain of debt as the country emerges from the crisis.

Related to that, we believe more must be done to support the provision of affordable credit to those who need it most. Currently, the most financially disadvantaged people often find it very difficult to access affordable credit.

We believe that better insurance products have a role to play. Many households and businesses have been disappointed by their insurance providers not covering the unfortunate circumstances arising from the lockdown. Nonetheless, better and more secure products could help protect households from income shocks in future.

The impact on pensions from this crisis should not be understated. It manifests itself directly in two ways. For the many people who have lost their job as a result of the economic shock, they, and their previous employer, will no longer be making pension contributions and therefore missing out on the compounding benefit. For those whose pensions are defined contributions, their pension pot will be adversely impacted by declines in the stock market.

A more inclusive design approach should be taken so that the most vulnerable are better provided by essential services. We believe this should include enforcing socio-economic duty as part of the public sector duty, and giving the Competition and Markets Authority a new consumer protection duty, in addition to competition protection.

The Commission has outlined these recommendations because we want to see a more financially inclusive society. We are concerned that without these protections, the aftershock of the crisis could be just as severe as the economic shock itself.

Response to call for evidence

Although much of the call for evidence focuses on macroeconomic issues, we have chosen to respond to some areas which we believe are relevant to the work of the Financial Inclusion Commission.

Financial Inclusion

There can be little doubt of the importance of financial inclusion at this time. There are now millions more people facing economic hardship as a result of the COVID-19 pandemic.

Yet, the environment was already difficult enough for many before the effects of the virus on our society took hold. The UK entered the crisis with half its population financially vulnerable - 12m categorised as 'financially struggling' (generally on low incomes), and 13m as 'financially squeezed' (better off but pretty highly leveraged).

The Financial Inclusion Commission believes that without rebuilding social and state safety nets, we would be trying to build financial inclusion, and better financial health, on sand.

What will be the economic impacts of the coronavirus outbreak and the social distancing measures in terms of sectors and regions and how temporary/permanent will they be?

It is already clear from evidence compiled by other organisations that the economic impact of coronavirus is severe, across sectors and the regions.

The Standard Life Financial Impact Tracker found that half of all UK households believe they will struggle to meet their financial commitments. The same tracker found that by the end of April, 7 million households had lost a significant part of their earnings.

The distribution of those impacted is not equal either. Of those identified as in serious financial difficulty, almost two thirds (64%) are renting, with 31% homeowners.

The tracker found that one in five of those surveyed had used a credit card to pay for food and other household expenses.

Clearly, this will have a long-term impact. The Financial Inclusion Commission is concerned at the level of debt being accrued during the crisis. It means that this over-hanging debt will have to be repaid for a long time after the immediate economic damage has subsided.

High levels of unmanageable debt can also create a vicious circle, leading often to mental health problems. The Money and Mental Health Policy Institute has carried out a survey of their research panel to explore the impact of the crisis on people's mental health. The charity reported:

"Unsurprisingly, many of the 568 respondents to our survey noted the toll the spread of coronavirus had already taken on their mental health. For some, this was through increased anxiety about their health or that of their friends and families. This made it harder to carry out essential tasks like buying food".

Support systems, whether they are family and friends or mental health services, can be invaluable in helping people to cope with such circumstances. But with social distancing measures in place, the two thirds (65%) of survey respondents who agreed or strongly agreed that they rely on face-to-face contact with friends and family may be missing that assistance. For those using health services, the help many depend on to manage their condition may be impossible to access, or delivered in a less effective way.

86% agreed or strongly agreed that as a result of coronavirus they were worried about struggling to access mental health services if they needed them. Phone and online-based contact will fill a gap for some. But for many others, including those without a clinical diagnosis of a mental health condition, the necessary restrictions in response to coronavirus will unavoidably be difficult to cope with. (MMHPI, Policy Note Number 18, April 2020)

The impact will not be distributed evenly on a geographical basis either. Those areas that come out of lockdown sooner, because of a lower transmission rate, are likely to benefit economically much quicker than those that take longer. This may already be happening with the delayed lifting of measures in Scotland, Wales and Northern Ireland as opposed to England.

Further, areas which have local businesses that previously relied on tourism will be much worse hit, than those areas where local business (which is embedded in the local community and understands the needs of local people) is supported by local people.

As a final point, we know hospital admissions for non-coronavirus related issues have fallen significantly, and from insurance companies that critical illness claims are drastically down. This is owing to individuals not seeking medical help, and therefore not receiving diagnosis they otherwise would. In the medium term, this will have a secondary financial impact on those individuals, who will have a medical condition they have been unable to address.

What will be the impact on inequalities within society and how should the Government address inequalities that may have been exacerbated by the crisis?

Many households will need access to credit to bridge the increasing gap between diminished incomes and living costs during the pandemic. Standard Life Foundation Tracker estimates 1 in 5 have used a credit card to pay for food and other expenses. Yet the sources of credit most used by poorer households are being reduced, as sub and near-prime lenders withdraw. Firms such as Brighthouse, the rent-to-own lender, have collapsed altogether. Some non-bank lenders (non-deposit takers) are finding their balance sheets squeezed between requests for greater forbearance to borrowers and lack of funding. Virgin Money at the beginning of May blocked 32,000 of their customer's credit cards as part of 'affordability checks'.

Citizens Advice estimates that more than 2 million people have already fallen behind on council tax bills as a result of Covid-19 and that as many as 11 million people could face problems paying bills when government support is phased out. The charity says people in the 'shielded' group are four times as likely to fall behind on a household bill compared to those not at increased risk from the virus.

Cambridge University Research has found that those under 30 and those on low incomes are more likely to have lost jobs or pay, and are less able to complete tasks from home. The intergenerational inequality that has seen younger people disadvantaged in employment, housing and pensions over many decades will be exacerbated by the current pandemic.

The same study found that workers earning under £20,000 can do 30% of the tasks in their main job from home compared to 55% for those earning more than £40,000; that 12% of low-income workers are now unemployed because of COVID-19 compared to 5% of higher earners; and that workers earning less than £20,000 expect to earn just 58% of their usual income between now and August with those earning more than £40,000 expect to make 69% of their usual income on average.

Another impact on inequality is through the intersection of digital and financial exclusion. Although 90 per cent of UK adults use the internet, this figure drops among many of the groups much more likely to be financially excluded. This is important in the current environment, where banking and financial transactions are almost exclusively taking place online.

ONS data shows that women and people aged over 65 are less likely to use the internet. There are high levels of online banking among younger generations (93 per cent for 25 to 34 year olds), but among 65-74 year olds and 75-79 year olds, it is 47 and 23 per cent respectively.

What are the lessons that society can learn for the future e.g. reducing carbon emissions, increased home working, business resilience?

The virus has exposed the lack of resilience of UK households, businesses, particularly small businesses, and therefore the economy itself.

Small business people and in particular those working as freelance contractors or in the gig economy are likely to earn less for the same work done by their employed counterparts. As a result they are less able to save, afford insurance such as income protection insurance, and plan for retirement. They are also more likely to run business and household finances from the same accounts and therefore if the business runs into financial difficulty household bills are likely to be affected too.

There is clearly a need to work towards greater financial resilience. The Commission supports greater income continuity insurance for individuals which can help protect households against substantial shocks. This crisis has revealed that the levels and nature of insurance products are not always suitable. Many businesses and freelancers have found their business continuity insurance has not provided them with the support they need. Long term affordable credit must also be more accessible, both for individuals and small businesses.

Part of building resilience in the long term is also financial education so that people who can afford to are able to build up their own resilience. It is too late for this to make a significant difference during the current crisis, but there is an urgent need to equip people with the capability to navigate future income shocks. The Commission has called for greater investment in financial education starting early in primary schools and in secondary schools and for improved access to financial capability initiatives through life. This is critical at key points of transition and change and to prepare for them (renting/buying flat/home, marriage/partnership, bereavement, children, redundancy, retirement) and also for better support and advice for small business people.

We should not forget that millions of people have been faced with the constant pressure of not having enough money to live on long before Covid-19 arrived. The virus is now shining a light on how unfit for purpose our system of welfare is.

For generations there has been a transfer of risk away from the state towards the individual who must now look to the market for their needs. But market imperfections mean that without adequate protections the most vulnerable are often charged more or are excluded altogether.

Covid-19 has lifted the veil on the gaps between government safety nets and what the market will provide. We need to make sure markets operate fairly. It should not cost more to be poor.

Insurance

The virus has shown how important it is for people to have protection from income shocks, whether this comes in the form of a virus, cancer, or a job/work loss. Income shocks are the biggest reason people get into debt. According to StepChange debt charity, 14 million people in Britain have experienced at least one income shock within a 12 month period; with 4.5 million people experiencing two or more. This was before COVID-19.

Without an adequate safety net, people can end up in a spiral of problem debt. But not everyone can afford to protect themselves privately, and the evidence suggests that the more you need insurance the costlier it is. And some people are actively locked out of getting it. Recent research carried out for Fair By Design by the University of Bristol (yet to be published) found that in 2019 area-based premia, particularly car insurance, were the largest contributor to the overall poverty premium faced by low-income consumers. Customers who live in a higher-risk area (20th percentile Indices of Multiple Deprivation (IMD) area) paid nearly £300 per year more on average, if they had insurance, than those who lived in a lower-risk area (50th percentile IMD). In 2016, this figure was only £74, which shows a striking increase.

Credit

We all need help sometimes to help smooth our finances. Covid-19 has demonstrated this starkly. However, all too often people who should have access to affordable credit, no interest loans or grants are instead pushed into using high cost credit, or in the case of small businesses and self-employed people, Government loans that have to be paid back at a later date. This makes a bad situation worse.

We must also make repaying debt much more manageable. The Breathing Space proposals are very welcome, and should be brought in quickly. Other options for debt consolidation and repayment include managing it via payroll.

Pensions

As people become unemployed, their long-term provisions are harmed, with both their own and their previous employer's pension contributions interrupted.

Even a year or two of missed contributions, especially early on in someone's life, when those contributions could get many years of compound growth, can mean significantly less someone's pot at retirement. Further, there are real difficulties for small businesses. One of the great successes of automatic enrolment has been that the employees of more than a million small employers have come into pensions saving for the first time.

The problems posed to the small business sector threaten this, and may push back the extension of automatic enrolment to people earning below the current threshold or to people below age 22, let alone any increase in the minimum rates of contribution to give pensions provision more in line with other developed countries (The UK State pension entitlement is less than half of the EU average and not much more than half of the OECD average.)

With the shift in recent years from 'final salary' DB pension schemes to Defined Contribution (DC) schemes, financial risk has been transferred from employers to employees, millions of whom will now find their incomes in retirement diminished by the impact of the crisis on stock-market values.

Energy

The energy market has been designed for people with the skills and time to constantly search for new deals. It has been designed for people with steady incomes and who are able to make use of direct debits. And, it has been designed to make it impossible for many of those who are eligible for discounts to claim them. Energy should not cost more if you are poor.

Inclusive design

The most vulnerable in society should be included in the design of essential services – so they don't cost more when you are poor and everyone should have access. The Competition and Markets Authority and regulators of essential services should adopt **inclusive design** strategies to:

- help set their priorities
- develop and implement interventions
- assess their effectiveness
- guide their expectations of business

Where inclusive design cannot solve issues the government and regulators should work together to bridge the policy divide – so markets work for everyone. The CMA should (as they have requested) be given a new consumer protection duty to sit alongside their competition duty to aid this.

Socio-economic Duty

Related to that, the Financial Inclusion Commission is supportive of including socio-economic status alongside other protected characteristics in Public Sector Duty under the Equality Act.

The Act itself does contain provisions for considering socio-economic duty, but these were not enforced by the then government when it came into force in April 2011.

We believe there is a strong argument to bring the socio-economic duty into force. This is an area in which devolved administrations have already made progress – in Scotland with the Fairer Scotland Duty, and in Wales with The Wellbeing of Future Generations (Wales) Act.

By properly considering those in a more difficult socio-economic position, we can help deliver a society which is more financially inclusive.

Conclusion

By offering only credit-based help, the UK will leave this crisis with a mountain of personal (as well as public, small business and self-employed) debt, which will take a significant period of time to be repaid, thereby saddling businesses and individuals with a large burden for long after the crisis.

Although the FCA has been clear its forbearance measures shouldn't impact credit scores, there's a risk firms will not follow this consistently. The Government should ensure there is a minimum standard, and make credit reference agencies responsible for ensuring lenders follow those standards – challenging any default reporting which doesn't factor in COVID-19.

The Commission is concerned that, without structural changes in systems of social and employment support and measures to increase the resilience of UK households in the form of insurance, savings, access to affordable credit and financial capability, the after-shock of this crisis could be worse than the earthquake itself.

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