Financial Services Consumer Panel

AN INDEPENDENT VOICE FOR CONSUMERS OF FINANCIAL SERVICES

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Clerk to the Select Committee on Financial Exclusion
Committee Office, House of Lords
London SW1A 0PW

14 September 2016

Dear Sir/Madam,

Call for evidence on Financial Exclusion

1. The Financial Services Consumer Panel welcomes the opportunity to respond to the call for evidence from the House of Lords Select Committee on Financial Exclusion.

2. The Financial Conduct Authority (FCA) is required to set up and maintain a panel to represent the consumer interest. The Panel represents the interests of all groups of financial services consumers and operates independently of the Financial Conduct Authority. The emphasis of its work is on activities that are regulated by the FCA, although the Panel may also look at the impact on consumers of activities that are not regulated but are related to the FCA's general duties.

Summary

3. Access to financial services has long been a Panel concern.

4. Financial exclusion is a consequence of financial services which are inaccessible, difficult to use, or which do not meet people's needs over time. It is generally accepted that financial exclusion particularly affects people on low incomes who may either be unable to access mainstream services or choose not to use them. However, as a recent FCA Occasional Paper[1] demonstrates, problems accessing financial services affect many different types of people, across the income range.

5. Access issues evolve over time so that people who have previously been financially included can find they become marginalised or excluded, because their personal circumstances change, because of a change in the way firms operate or because of wider trends, such as the digitalisation of financial services.

6. Financial products are often complex and financial decisions can have far reaching consequences. There is generally too much choice, rather than too little. Complex products, lengthy terms and conditions, and hidden fees and charges, often mean there are not appropriate products for those who are excluded.

7. Efforts to improve the UK's financial capability can only be effective if markets, including financial services, are properly regulated and provide adequate consumer protection. Individuals can be very financially capable but remain marginalised or excluded if they are unable to navigate financial firms' systems and processes, for example.

8. We have only answered the consultation questions where we have substantive comments to make.

[1] https://www.fca.org.uk/publication/occasional-papers/occasional-paper-17.pdf

Definitions and causes of financial exclusion

Q1: Is financial exclusion the inverse of financial inclusion and, if not, how do the two concepts differ? What are the causes of financial exclusion?

9. As the FCA's Occasional Paper describes[2], financial exclusion is the 'sharp end' of the problems that many people face accessing financial services. Access problems can result in financial exclusion where people either can't or don't engage with financial services and end up using poor-value or unregulated alternatives.

10. Financial exclusion is a consequence of financial services which are inaccessible, difficult to use, or which do not meet people's needs over time. The report of the Financial Inclusion Commission[3] explains financial exclusion in detail and provides statistics for the number of consumers affected.

11. Consumers can be excluded from financial products and services for a number of reasons. Lack of access can also affect different consumers at different stages of their lives. Some examples of the causes are outlined below:

- Market failure
    - There are no products available in the market that meet consumers' needs; or
    - Consumers cannot access financial products due to firms' withdrawal from particular geographical areas/market segments/distribution channels.
- Refusal
    - Firms refuse to offer products to certain consumers.
- Price/payment exclusion
    - Firms are only willing to offer products to consumers at prices that are unaffordable or represent poor value for money; or
    - Firms are only willing to offer products on payment terms e.g. direct debit, annual premium, which make them inaccessible or unaffordable.
- Condition exclusion
    - Firms are only willing to offer products with terms and conditions that significantly reduce their utility or value for money.
- Affordability exclusion
    - Consumers have insufficient disposable income to pay for financial products even when they are reasonably priced.
- Self-exclusion
    - Consumers choose not to access financial products due to
        - A lack of awareness of what is available;
        - A lack of financial capability or confidence;
        - The complexity of products;
        - Contingent bank charges, such as complex overdraft charges, which can deter people from having bank accounts;
        - Lack of trust in providers;
        - An inability to access products via the preferred channel;
        - Lack of perceived need for/value in having financial products; or
        - Psychological barriers.

12. From a regulatory perspective, appropriate access to financial products does not require that *all* consumers have access to *all* products. In some circumstances it will be more appropriate that consumers do *not* have access to a particular product. Appropriate access means that all consumers are able to make informed decisions about whether to use financial products and are able to access products that are necessary for everyday money management, medium-term saving, smoothing and protection and longer-term asset building.

[2] https://www.fca.org.uk/publication/occasional-papers/occasional-paper-17.pdf
[3] http://www.financialinclusioncommission.org.uk/pdfs/fic_report_2015.pdf

Q2: Who is affected by financial exclusion? Do different sectors of society experience financial exclusion in different ways? To what extent, and how, does financial exclusion affect those living in isolated or remote communities?

13. It is generally accepted that financial exclusion particularly affects people on low incomes who may either be unable to access mainstream services or choose not to use them. However, as the FCA's Occasional Paper demonstrates, problems accessing financial services affect many different types of people, across the income range.

14. For example, those living in rural or remote areas may have fewer bank branches as well as poorer internet access, making it harder for people to access and manage their finances.

15. Age is also a factor in exclusion from certain products and services. Older people are less likely to be digitally included[4], although that is changing rapidly, and they prefer accessing services face to face. This means they can struggle in a world where online services are becoming the norm, and banks are withdrawing their high street presence. Older people are likely to find themselves victims of age discrimination. This is not permitted in most service industries, but financial services are exempt[5]. Firms can use age as a risk factor in pricing financial products, or even refuse to provide products to certain age groups. So at an age when they have more leisure time to visit friends and family, or take a holiday, older consumers can find themselves unable to access travel or car insurance, or find that it is exorbitantly priced. At the other end of the spectrum, young drivers may be unable to get affordable car insurance, for example, which seems unfair if their individual risk profile is much lower than the average for their group.

16. Access issues evolve over time so that people who have previously been financially included can find they become marginalised or excluded, because their personal circumstances change, because of a change in the way firms operate or because of wider trends, such as the digitalisation of financial services.

17. Speaking generally, it is impossible for consumers to make properly informed decisions because information about the quality of a product or how a financial services firm may treat the consumer is not available in a consistent way, so comparison is often impossible. There are also conflicts of interest between brokers and consumers, and imperfect market conditions which mean that even very savvy consumers are excluded from making informed decisions.

18. Some products, like current accounts, have no price signals meaning that consumers cannot make decisions about value for money.

19. Many financial products are complex and bought infrequently so consumers cannot learn from past experience. Even apparently straightforward products require assessment of multiple variables and complex trade-offs. For instance, a packaged bank account requires the consumer to consider not just the annual cost of the account, but also to compare products that they may be able to get cheaper elsewhere on a standalone basis. The consumer also needs to check that they can use all elements of the account (eg there may be age or health restrictions on travel insurance, which is frequently part of the package).

20. Products like insurance, credit and investments all involve an element of risk, which few consumers are equipped to judge.

21. Exclusion from all financial products and services may affect a minority of the population but exclusion from informed decision making affects all consumers.

[4] An Age UK Digital Inclusion Policy Review document states only 29% of adults aged 75 years and over have used the internet: http://www.ageuk.org.uk/PageFiles/12810/Digital%20Inclusion%20Review.pdf?dtrk=true

[5] Section 3 of the Equality Act 2010 (Age Exceptions) Order 2012 – financial services include a service of banking, credit, insurance, personal pension, investment or payment nature.

Q3: What is the relationship between financial exclusion and other forms of exclusion, disadvantage or deprivation? What role does problem debt play in financial exclusion?

22. The evidence shows strong links between financial exclusion, social exclusion, disadvantage and deprivation.[6] As part of its recently-published anti-poverty strategy for the UK, the Joseph Rowntree Foundation calls for people in poverty to have access to good-value essential goods and services, including financial services, and to ensure that they are not subject to a 'poverty premium'.[7]

23. The poverty premium experienced by people without access to automated payments or mainstream credit is well documented. In 2014, Toynbee Hall calculated the premium was £1,014 per year[8]. Energy companies continue to discriminate against consumers based on the method of payment they use and cause significant harm.

24. Problem debt can quickly spiral out of control, with resultant fees and charges often preventing consumers breaking out of the cycle of debt. In its credit card market study[9], the FCA's analysis found that 'Low and Grow' card users were much more likely to have exceeded their credit limit than the generality of card users. While 'Low and Grow' cards may be useful products for consumers to build their credit rating and to smooth income and expenditure, this evidence indicates that such cards do not always work for consumers and may in fact risk damaging already fragile credit ratings. The market study also showed that over 20% of those who were in severe arrears in 2014 did not have an active credit card in 2012, suggesting a rapid descent into arrears. As the FCA report says, this raises questions about how firms assess creditworthiness for new borrowers.

Q4: Do individuals with disabilities, or those with mental health problems, face particular issues in regard to financial exclusion?

25. There are examples of mental illnesses that directly affect consumers' ability to manage money. The Money Advice Liaison Group issued a good practice guide for helping consumers with mental health conditions and debt in 2015[10]. There is also a best practice guide for the use of 'flags' to be placed on the accounts/case files of individuals in vulnerable circumstances who are unable to manage money[11].

Financial education and capability

Q5: Are there appropriate education and advisory services, including in schools, for young people and adults? If not, how might they be improved?

26. The previous government made financial education a compulsory subject in the secondary school curriculum in England. But for personal finance teaching to be effective requires sufficient time in the curriculum, and enough money to train teachers and support them with resources. We do not yet know whether this new education is working or making a difference. While it is important to equip young people with the skills to manage their personal finances, it is asking too much of financial education to fix the problems of an industry that wilfully ignores consumers' needs for simplicity and transparency. All financial education can do is help consumers become a bit more savvy, so they ask the right questions, know what they want, understand the risks, and can find impartial advice.

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[6] See, for example, Kempson, E., Whyley, C., Caskey, J. and Collard, S. (2000). In or out? Financial exclusion: a literature and research review. Consumer Research Report No. 3. London: Financial Services Authority.
[7] http://www.jrf.org.uk/sites/default/files/jrf/migrated/files/uk_without_poverty_summary.pdf
[8] https://www.theguardian.com/public-leaders-network/2015/nov/10/poverty-premium-costs-poor-energy-phone-tariffs-councils
[9] https://www.fca.org.uk/publication/market-studies/ms14-6-3-credit-card-market-study-final-findings-report.pdf
[10] http://www.malg.org.uk/wp-content/uploads/2015/04/Guidelines-2015.pdf
[11] http://www.malg.org.uk/wp-content/uploads/2016/04/Flags-Final-Mar16.pdf

Q6: How can financial literacy and capability be maintained and developed over the course of a person's lifetime?

27. Efforts to improve the UK's financial capability can only be effective if markets, including financial services, are properly regulated and provide adequate consumer protection. Individuals can be very financially capable but remain marginalised or excluded if they are unable to navigate financial firms' systems and processes, for example.

28. It is positive that, in its Public Financial Guidance Consultation[12], the government recognised the importance of improving financial capability. Evidence from around the world[13] indicates the importance of providing strong leadership to improve citizens' financial capability. Typically the finance ministry or central bank provides this leadership in other jurisdictions. It doesn't really matter, so long as it is an organisation with the clout to bring stakeholders together and drive the agenda forward. There also needs to be a 'centre of expertise' for financial capability, to keep up to date with what works.

29. In light of international experience, the government's proposal to abolish the consumer-facing Money Advice Service (MAS) brand appears to have been hasty and not founded on sound evidence. It is not clear where consumers will go for the type of guidance MAS provides. Most users of the MAS website come through Google search. These are not 'paid for' searches, but have been built from years of search engine optimisation. This will be lost when the MAS brand is switched off and we are concerned that consumers – who will still search for their answers in the same way – will be unable to find an independent source of guidance.

30. Excluding providers of debt and pensions advice and guidance, there are very few independent organisations providing impartial guidance on general money issues such as borrowing, mortgages, protection insurance and budgeting. Citizens' Advice, for example, is generally seen as an organisation that helps people on lower incomes when they are already in difficulty. For people wanting to get on top of their finances, the Citizens' Advice website links to the MAS financial health check. Other 'positive' impartial tools, for example, on annuity comparison, will also be lost when MAS goes, with poor outcomes for consumers' financial capability.

31. The Panel believes that the government should incorporate MAS's statutory objectives into the new pensions advisory body (itself an amalgamation of the Pensions Advisory Service and Pension Wise). This would follow the example of New Zealand's independent Commission for Financial Capability (formerly Retirement Commission), which recognises the importance of building financial capability throughout individuals' lives, and encouraging them to think about retirement options early, not at some arbitrary point when it may be too late.

32. New technology like Open APIs and the introduction of the Payment Services Directive (PSD2) and Account Information Service Providers (AISP) will provide fertile ground for innovators to provide new services that help people manage their money, like Mint in the US or MoneyDashboard on the UK. Services like these could go a long way to improving financial capability, allowing virtual 'jam-jarring', providing prompts to save or helping people switch to better providers.

33. However, there is currently nothing in place to stop commission-based business models, which create conflicts of interest. Pro-active and thoughtful regulation in this market may ensure that consumers are not in future struggling to compare opaque AISP services as well as opaque products.

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[12] https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/467105/public_financial_guidance_consultation.pdf

[13] Advancing National Strategies for Financial Education, A Joint Publication by Russia's G20 Presidency and the OECD, 2013, page 212: https://www.oecd.org/finance/financialeducation/G20_OECD_NSFinancialEducation.pdf

34. In the new digital age, digital capability is likely to be as important as financial capability. Both Lloyds and Barclays are developing new indices to measure digital capability and financial capability.

Addressing financial exclusion

Q7: What role should the concept of 'personal responsibility' play in addressing financial exclusion? Is appropriate support available for the most excluded and, if not, how should support be strengthened? What role should Government, the charitable sector and business play in tackling financial exclusion?

35. The 'consumer responsibility' principle fails to take into account the imbalance in power between firms and their customers and information asymmetries. Firms make more money from products that are complex and opaque, it is difficult to know what 'consumer responsibility' means in these conditions.

36. Research[14] carried out on behalf of the FCA's Practitioner Panel in 2013 concluded that retail consumers are willing to take on responsibility when buying financial products or services. However, the research also clearly underlined the barriers consumers face in making informed choices. These included inappropriate remuneration structures that incentivise mis-selling; increased product complexity and excessive disclosure of information, for example, through 'one-sided and impenetrable' terms and conditions. It is therefore clear that a significant shift in firms' behaviour, by acting in the consumer's best interest, needs to occur before individuals can be expected to exercise full responsibility.

37. The legislative framework does not help. The FCA must secure an appropriate degree of protection for consumers of regulated activities[15]. However, section 1C(2)(d) of FSMA specifies that the FCA must have regard to 'the general principle that consumers should take responsibility for their decisions'.

38. The Panel has long argued that consumers can only reasonably be expected to take responsibility for their decisions where firms have exercised a duty of care[16]. A duty of care would avoid the current legislative uncertainty, and ensure a consistent approach to consumer protection.

39. Given the interest government has in transferring benefits directly into bank accounts and the reduced costs associated with doing so, it has a responsibility to ensure that suitable accounts are available and that the benefits of automated payments are also available to people who have the least and could benefit the most. This ensures that benefits are not eaten away by the 'poverty premium'.

40. The voluntary sector is vital in helping people who are excluded or who have experienced problems with financial services. But the primary responsibility should be with banks to improve their services and take steps to stop their customers getting into debt or going into unauthorised overdraft. Unauthorised overdrafts could, for instance, be banned or simply refused.

41. Support for people who are marginalised and excluded is fragmented and varies from area to area. It is difficult to assess, therefore, whether this support is adequate. We believe this is something the inquiry should explore in depth. We are aware of locally-based programmes to provide support, such as the Big Lottery Fund's Improving Financial Confidence programme and its Help Through Crisis programme, but these are time-limited and only apply to England. Public funding cuts are likely to significantly limit the chances of such programmes rolling out to larger populations over the longer-term.

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[14] http://www.fs-pp.org.uk/documents/fca_practitioner_panel_consumer_responsibility_report_september_2013.pdf#page=10n
[15] https://fshandbook.info/FS/glossary-html/handbook/Glossary/R?definition=G974
[16] https://www.fs-cp.org.uk/sites/default/files/fscp_position_paper_on_duty_of_care_2015.pdf

42. Support for people in financial difficulty has been significantly curtailed, particularly because of cuts to legal aid funding. Citizens Advice reported in 2014 that 87% of bureaux that had previously held legal aid contracts for specialist debt advice had reduced their capacity; most also had difficulty referring clients to specialist legal advice across all areas.[17]

Q8: Are appropriate financial services and products available for those who are experiencing financial exclusion? What might be done to address any deficit? What role should banks play in increasing access for those most at risk of exclusion? What is the role of the Post Office in providing access to financial services for such customers, and how might that role develop?

43. The Financial Inclusion Commission has considered this question[18].

44. Financial products are often complex and financial decisions can have far reaching consequences. There is generally too much choice, rather than too little. Complex products, lengthy terms and conditions, and hidden fees and charges, often mean there are not appropriate products for those who are excluded.

45. Consumers need access to a range of services that provide, within clearly defined parameters, information, guidance or specific recommendations. Product information and promotional materials should be written in clear language with transparent information on interest rates, fees and charges.

46. Many of the problems associated with financial products are due to a lack of real time information about account balance and payments as well as a lack of 'in-the-moment' control over payments. Continuous payment authorities are a good example of a payment facility that allows the payer no control over when the payee takes money from the account or how much they will take. These sorts of facilities undermine trust and exacerbate debt.

47. We supported the introduction of the voluntary agreement between the banks on the provision of "free-of-charge" basic bank accounts, although we have raised issues about the lack of cost transparency. We are pleased that implementation of the Payment Accounts Directive (PAD) gives consumers a clear legal right of access to a basic bank account, and a route to challenge firms' decisions before a court if they do not grant access.

48. As we have said above, we believe that banks owe a duty of care to their customers. This would ensure that they developed to products and services to benefit their customers and help those that are otherwise excluded.

<u>Accessing affordable credit</u>

Q9: What has been the impact of recent changes to the consumer credit market – such as the capping of payday loans - on those facing financial exclusion? How can it be ensured that those in need of affordable credit can access appropriate products or services?

49. Access to credit is complex because while some consumers are unable to access the credit products they need, there is clear evidence that others have been granted credit when they should not have been.

50. The Panel welcomed the FCA's scrutiny of the high cost short-term credit (HCSTC) market and supported the cap on the total cost of credit and the eradication of widespread poor practice in the market. However, we have argued strongly that unarranged overdrafts also in many cases breach HCSTC rules and should be regulated in the same way. It is not clear why different consumer credit products are subject to

[17] https://www.citizensadvice.org.uk/global/migrated_documents/corporate/citizens-advice-submission-to-jsc-on-impact-of-laspo-april-2014.pdf
[18] http://www.financialinclusioncommission.org.uk/pdfs/fic_report_2015.pdf

different regulatory treatment and rules, particularly when 'mainstream' credit products are the major cause of over-indebtedness.

51. The HCSTC rules have led to the creation of new products that don't fit the FCA's strict definition of HCSTC, and so which can circumvent the FCA's rules. Gaming the system is inevitable when such a small part of the lending market is subject to strict rules.

52. It is also likely (though we have seen no current evidence) that tightening up the HCSTC market will lead people to use other expensive sources of credit, such as pawnbrokers or 'rent to buy', or even resort to illegal money lenders. People cannot easily tell the difference between legitimate home credit providers and loan sharks, especially if the latter are 'friends of friends'.

53. StepChange recently reported[19] that the number of people borrowing money from family and friends is increasing and that the amount now averages £4,000 which can put significant strain on relationships.

54. Credit scoring can also have a perverse impact on consumers' creditworthiness. A credit score is a blunt instrument that does not confirm a consumer can afford the amount of credit being offered. Indeed, it is often the case that those consumers with access to the most credit are those with the highest credit score, and therefore the most able to access even more credit.

55. We believe the FCA should consider whether people should have access to credit they cannot afford to repay at the market price they are offered, and whether that market price is a fair one in relation to risk.

<u>Government policy and regulation</u>

10. How effective has Government policy been in reducing and preventing financial exclusion? Does the Government have a leadership role to play in addressing exclusion?

56. The Financial Inclusion Commission has addressed this question[20] and we agree with its conclusions.

11. What has been the impact of recent welfare reforms on financial exclusion?

57. The FCA's occasional paper 17, on Access to Financial Services in the UK, considers this issue[21]

12. How effectively are policies on financial exclusion coordinated across central Government? Is there an appropriate balance and interaction between the work of central Government and the work of local and regional authorities, and the devolved administrations?

58. There is very limited co-ordination or consideration of how central and local authorities work. Indeed local authorities can exacerbate debt and housing problems by overly-aggressively pursuing council tax debts in a way that creates more cost elsewhere for the local authority.

59. The report of the Financial Inclusion Commission[22] concluded that all government departments, devolved administrations, local authorities, voluntary organisations and industry are all working in different ways to address financial exclusion, with no leadership or coordination.

[19] https://www.stepchange.org/Mediacentre/Pressreleases/Averagedebttofriendsandfamily.aspx
[20] http://www.financialinclusioncommission.org.uk/
[21] https://www.fca.org.uk/publication/occasional-papers/occasional-paper-17.pdf
[22] http://www.financialinclusioncommission.org.uk/pdfs/fic_report_2015.pdf

13. To what extent is the regulation of financial products and services in the UK tackling financial exclusion? Are alternative or additional regulatory interventions required to address financial exclusion? What balance should be struck between regulations and incentives for financial institutions?

60. Financial exclusion can be exacerbated by regulations. Financial institutions' interpretations of their responsibilities to prevent money laundering can lead to exclusion (establishing identity is often a problem for foreign nationals, or people who move house frequently). We have also seen many examples of people having their bank accounts closed for no apparent reason. In these cases the bank may suspect fraud or other criminal activity, but cannot discuss the reasons with the customer for fear of breaching the law. This leaves people unable to open an account with any bank. We have long argued there should be an appeal route for people whose accounts are forcibly closed.

61. The FCA must secure an appropriate degree of protection for consumers of regulated activities[23]. However, those that are excluded from financial services, who therefore aren't 'consumers', can fall through the regulatory gap altogether.

Financial technology (Fintech)

Q14: Does the Government have a role to play in ensuring that the development of financial technologies (FinTech) and data capture helps to address financial exclusion? If so, what should this role be?

62. The Government set out plans for open Application Programming Interfaces (APIs) in banking during 2015. The Competition and Markets Authority's (CMA) final report from its retail banking market investigation requires the largest banks to establish APIs for current accounts. The scope of the Payment Services Directive (PSD II) is broader, covering all transactions originating in the EU and requiring that banks open up access to payment accounts, allowing firms to be able to 'plug-in', draw down data and provide value added services.

63. We support the introduction of open APIs, which will allow consumers to access their information simply. There are security and privacy issues to overcome, a task made more difficult as there is not one regulator responsible for addressing the data concerns.

64. However, we believe that APIs and other forms of data capture will lead to different types of exclusion. The benefits of 'open banking' will not reach those who are digitally excluded, and the government should develop policies to address this.

65. Once consumers have allowed access to their data by a third party, they will no longer be in control of how it is used. Consumers may be unaware that firms are using personal data such as that gained from social media activity to make decisions about the price and availability of financial products, and even selling it to third parties. This could lead to firms 'red lining' consumers on the basis of factors unrelated to risk.

66. Big Data offers insurers opportunities for increasingly individualised risk assessments, which could have a significant impact on risk pooling and individual premiums. This potential demutualisation of risk will affect different segments of the market in different ways. The use of individualised micro risk assessments means that some people are likely not to be served at all. Others will pay much higher premiums. Conversely of course, some consumers should pay lower premiums because their individual risk, or the average risk in their pool, is lower.

67. The same logic applies to credit products. While the use of personal data may help some people with 'thin' credit files get access to credit, others will be excluded, or offered credit only at exorbitant prices.

68. This demutualisation of risk is a policy issue. The government recognised this in setting up Flood Re and there may be other products, over time, where a degree of

[23] https://fshandbook.info/FS/glossary-html/handbook/Glossary/R?definition=G974

mutualisation may be socially desirable in order to enable affordable access to essential financial services.

69. In future the risk may be that if you are unwilling to share your data you no longer have the right to access certain products and services. The right to withhold your data without discrimination is one worthy of more public debate.

Yours sincerely

Sue Lewis
Chair, Financial Services Consumer Panel