



House of Commons  
Treasury Committee

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**Financial inclusion:  
Government and other  
Responses to the  
Committee's Twelfth and  
Thirteenth Reports of  
Session 2005–06 and the  
Committee's First Report  
of Session 2006–07**

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**Fourth Special Report of Session  
2006–07**

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## The Treasury Committee

The Treasury Committee is appointed by the House of Commons to examine the expenditure, administration, and policy of HM Treasury and its associated public bodies.

### Current membership

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### Powers

The Committee is one of the departmental select committees, the powers of which are set out in House of Commons Standing Orders, principally in SO No 152. These are available on the Internet via [www.parliament.uk](http://www.parliament.uk). The Committee has power to appoint a Sub-Committee, which has similar powers to the main Committee, except that it reports to the main Committee, which then reports to the House. All members of the Committee are members of the Sub-Committee, and its Chairman is Mr Michael Fallon.

### Publications

The Reports and evidence of the Committee are published by The Stationery Office by Order of the House. All publications of the Committee (including press notices) from Session 1997–98 onwards are available on the Internet at [www.parliament.uk/parliamentary\\_committees/treasury\\_committee](http://www.parliament.uk/parliamentary_committees/treasury_committee). A list of Reports of the Committee in the present Parliament is at the back of this volume.

### Committee staff

The current staff of the Committee are Colin Lee (Clerk), Fiona McLean (Second Clerk and Clerk of the Sub-Committee), Adam Wales, Jon Young (Committee Specialists), Lis McCracken (Committee Assistant), Michelle Edney (Secretary), Tes Stranger (Senior Office Clerk) and Laura Humble (Media Officer).

### Contacts

All correspondence should be addressed to the Clerk of the Treasury Committee, House of Commons, 7 Millbank, London SW1P 3JA. The telephone number for general enquiries is 020 7219 5769; the Committee's email address is [treascom@parliament.uk](mailto:treascom@parliament.uk). Media inquiries should be addressed to Laura Humble on 020 7219 2003.

# Fourth Special Report

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In November 2006 we published three Reports on the theme of Financial inclusion, as follows:

- Twelfth Report of Session 2005–06, *Financial inclusion: credit, savings, advice and insurance* (published on 16 November 2006, as House of Commons Paper No. 848-I);
- Thirteenth Report of Session 2005–06, *“Banking the unbanked”: banking services, the Post Office Card Account and financial inclusion* (published on 19 November 2006, as House of Commons Paper No. 1717); and
- First Report of Session 2006–07, *Financial inclusion: the roles of the Government and the FSA, and financial capability* (published on 28 November 2006, as House of Commons Paper No. 53).

On 28 March 2007 we received a combined Government response to these three Reports. This response is published as Appendix 1 to this Special Report. On 22 February 2007 we received a response by the Financial Services Authority to the same Reports, which is published as Appendix 2 to this Special Report. We are also publishing in Appendix 3 to this Special Report a letter from the Chairman of the Banking Code Standards Board which we received on 17 January.

## Appendix 1: Government response

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### Introduction

This is the Government’s response to the three Reports published by the Treasury Committee following its inquiry into financial inclusion in the 2005–06 Parliamentary session. The Government welcomes the reports and recognises the valuable contribution which the work of the Committee has made to promoting financial inclusion. The Government’s own strategy, published in 2004, identified three priority areas for action:

- access to banking services;
- access to affordable credit; and
- access to free face-to-face money advice

The strategy also set out a framework for delivery, including a dedicated fund of £120 million to support initiatives, a goal, shared with the banks, to halve the number of adults without access to a bank account, and an independent Taskforce to monitor progress.

The Government has now published *Financial inclusion: the way forward*, setting out general principles for its ongoing financial inclusion strategy. The document outlines the Government’s ongoing commitment to the promotion of financial inclusion, with the objective of ensuring that everyone has access to the financial tools, understanding and confidence they need to be able to:

- manage their money on a day-to-day basis;
- plan for the future and cope with financial pressure; and
- deal with financial distress should it occur.

The Government has three goals for financial inclusion.

- The Government believes that everyone should be able to manage their money effectively and securely, through having access to a bank account, and the confidence and capability to get the most from it.
- The Government believes that everyone should be able to plan for the future with a reasonable degree of security. Therefore, affordable credit, saving accounts and simple insurance products should be available to all who need them.
- The Government believes that everyone should have the information, support and confidence they need to prevent avoidable financial difficulty, and to know where to turn if they do find themselves in financial distress.

To achieve this, the Government has announced that:

- there will be a new Financial Inclusion Fund in the next spending period;
- the Government commits to maintain the current level of intensity of action to promote financial inclusion, with the exact quantum of the new Fund to be determined in the forthcoming Comprehensive Spending Review;
- in addition to an ongoing focus on the current priorities of access to banking, affordable credit and free face-to-face money advice, access to saving and insurance products will now also be prioritised;
- a ministerial working group will be established to determine detailed priorities for financial inclusion policy and to publish a detailed action plan after the CSR;
- a continued Financial Inclusion Taskforce will evaluate progress and advise the Government, working to new terms of reference reflecting the post-CSR action plan; and
- financial inclusion policy will be mainstreamed into departmental budgets after the next spending period.

## Financial inclusion: credit, savings, advice and insurance (Twelfth Report of Session 2005–06, HC 848–I)

### The challenges of financial inclusion

**Recommendation:** Poor people end up paying proportionally more for their money. Promoting financial inclusion is crucial to the fight against poverty. An effective Government strategy to combat financial exclusion has a crucial role to play in enabling those on low incomes and others who are financially excluded to take their own steps away from poverty. (Paragraph 19)

**Response:** The Government agrees with the Committee’s analysis that financial exclusion imposes real and significant costs on those without access to mainstream financial services. *Financial inclusion: the way forward*, published today, presents new evidence showing that those on low incomes, and from other vulnerable groups, are disproportionately affected by financial exclusion. The document also sets out the Government’s high level strategy for taking forward work on combating financial inclusion.

### Access to affordable credit

**Recommendation:** We have received evidence suggesting that illegal and unlicensed lending represent real causes for concern. It is essential that measures we consider later to promote affordable credit are matched by effective action against the blight of illegal lending. We welcome the Government’s emphasis on putting additional resources into enforcement, but we also expect the Government to galvanise enforcement action against illegal lenders by stressing the high priority which it attaches to this matter, by stronger enforcement action by the DTI against illegal lending, and by extending the DTI’s pilot projects throughout the United Kingdom. (Paragraph 27)

**Response:** Enforcement of the provisions of the Consumer Credit Act 1974, which prohibit lending without a licence from the Office of Fair Trading is a matter for local enforcement authorities. The Government is, however, keen to ensure that illegal lending is tackled and has invested £2.6 million so far in funding pilot projects based in Birmingham and Glasgow. The teams have so far had a total of six successful prosecutions, with sentences of up to three years in prison, and have another 13 cases in the pipeline. In the most recent case an illegal lender was found guilty of kidnap, wounding, assault, blackmail and counterfeiting as well as illegal lending.

The 2006 Pre-Budget Report announced that, to build on the successes of the pilots, funding would continue into 2007–08, with additional funding to expand the projects to Liverpool, Sheffield and West Yorkshire. The new areas were amongst those identified as likely to have relatively high concentrations of illegal lending in the research report into the scope and extent of illegal lending in the UK, which was published on the DTI website on 1 December 2006.<sup>1</sup> More recently, the Government announced that the projects would be further expanded to every region in the country.<sup>2</sup> Extending and expanding the pilot will reinforce the message that the Government is serious about tackling illegal lending.

1 <http://www.dti.gov.uk>

2 [http://www.hm-treasury.gov.uk/newsroom\\_and\\_speeches/press/2007/press\\_07\\_09.cfm](http://www.hm-treasury.gov.uk/newsroom_and_speeches/press/2007/press_07_09.cfm)

Successful prosecutions and the resulting positive publicity will encourage victims and witnesses to come forward with information that can help secure further convictions.

In addition, the pilot teams will in future put greater emphasis on helping victims gain access to financial advice and affordable credit, in addition to prosecuting illegal lenders. This revised focus reflects the findings of the initial pilot evaluation and the Government's financial inclusion priorities.

**Recommendation: Promoting competition amongst providers of high cost credit can play an important role in reducing interest rate charges. We note the provisional findings of the Competition Commission that a lack of competition in the market means that home credit customers are being overcharged by up to £100 million a year. We expect due consideration of the full range of possible remedies followed by rapid implementation of measures to increase competition and benefit consumers. (Paragraph 30)**

**Response:** The Competition Commission published its final report on its inquiry into home credit on 30 November 2006. The majority of the recommendations are for the Competition Commission to implement. Its recommendations to DTI on transparency have been accepted and will be implemented in Statutory Instruments on Exemptions, Post Contract Information and Licensing, which the Government intends to make under the Consumer Credit Act 2006 in April 2007.

**Recommendation: We welcome the provisions of the Consumer Credit Act 2006 covering the unfair credit relationship test and the introduction of additional powers for the OFT. It is vital that the OFT exercises these additional powers in order to address persistent bad practice and excessive or unfair charges in the consumer credit market. We note the possible drawbacks of introducing an interest rate ceiling for credit, including the possibility that it could lead to increasing charges that would not be included in the APR and that a lack of sufficient alternatives could lead to people turning to unlicensed lenders. At this stage, we believe the Government should continue to encourage the development of measures to promote alternatives to high cost credit and assess the suitability of the new powers in the Consumer Credit Act 2006 before considering whether to impose an interest rate ceiling. (Paragraph 33)**

**Response:** The Government is exploring different ways of promoting alternatives to high cost credit. Details of the Government's strategy to support an increase in the supply of affordable credit by credit unions and other third sector lenders are set out in further responses below.

**Recommendation: Our current inquiry has demonstrated both the importance of effective data-sharing in enhancing access to affordable credit and the potential benefits of data-sharing beyond the traditional lending industries. We are disappointed that there is insufficient evidence as yet of concrete progress arising out of the proposals of our predecessors for increased data-sharing. We recommend that the DTI and the Financial Inclusion Taskforce investigate as a matter of urgency the benefits of wider data-sharing in increasing access to affordable credit and the barriers to such data-sharing. We further recommend that the DTI actively promote measures involving lenders and non-financial services organisations such as housing associations**

**and local authorities to ensure the development of more comprehensive data-sharing. (Paragraph 35)**

**Response:** The Competition Commission considered the question of data sharing in relation to the home credit industry and concluded that home credit lenders should be required to share data on the payment records of their customers through credit reference agencies (CRAs). The Commission will require any home credit lender with over 60 agents or £2 million in annual turnover from home credit loans to provide full data on all of its customers' new home credit and voucher agreements, and on all existing loans and voucher agreements on which they have the consent to share data, through at least two CRAs.

DTI has consulted on proposals for further and wider data sharing in the credit industry generally. The consultation closed on 11 January. It is now considering the responses and will publish the results of this consultation in due course.

**Recommendation: Third sector lenders—credit unions and Community Development Finance Institutions—have a vital role to play in increasing access to affordable credit and promoting financial inclusion. They also help by providing opportunities to save and to access money and budgeting advice. We welcome continued efforts to increase the professionalism of third sector lenders to enhance their sustainability. However, the coverage of third sector lenders remains limited, and the Government and the organisations themselves need to take continued action to improve their ability to grow and attract additional capital. (Paragraph 44)**

**Recommendation: We welcome support from the Government for third sector lenders in the form of the £36 million Growth Fund. We note that such support at present is only short-term in nature, and will only scratch the surface in terms of the overall need for affordable credit. We recommend that the Government consider how best to provide longer term funding for third sector lenders, and in particular how to maximise the ability of Government funding to act a lever to bring in private capital. The Government must also ensure that, as well as supporting established third sector lenders, additional money is provided to build capacity in financially excluded areas that currently lack established third sector lenders. To ensure value for money from the Growth Fund, we recommend that the Government consider providing technical support through programmes that enable third sector lenders to improve their lending practices and upgrade their IT infrastructure. (Paragraph 48)**

**Response (to paragraphs 44 and 48):** The Government agrees that third sector lenders have a vital role to play in making affordable credit more accessible to financially excluded people. Support for the third sector has therefore been at the heart of the Government's affordable credit strategy, including through:

- the £36m Growth Fund to provide capital and revenue support to third-sector organisations lending to financially excluded individuals—so far, more than 15,000 loans totalling over £6 million have been made;
- the Eligible Loans Deductions Scheme, which will complement the Growth Fund by reducing the cost and risk of lending to people on low incomes; and

- the increase in the regulatory cap on credit union interest rates, to increase flexibility to lend to financially excluded individuals, including those with no history of saving.

*Financial inclusion: the way forward* renews the Government's commitment to affordable credit, establishing a key objective of achieving a step-change in the coverage of third sector lenders. To this end, the Government:

- is providing a further package of £6 million to the third sector through the DWP's Growth Fund, to support additional lending activity (including for start-up lenders in areas not currently served), capacity building, and investment in transactional banking capability;
- has asked senior representatives from the banking sector to work with the Financial Inclusion Taskforce to consider how to achieve a nationwide increase in the coverage and capacity of third sector lenders; and
- will conduct a review of mutuals legislation, including the Credit Union Act, to ensure an appropriate and flexible regulatory framework is in place to support a step-change.

**Recommendation:** We note the consultation being undertaken by the Commission on Unclaimed Assets on the possible use of money from unclaimed assets in banks and building societies to establish a Social Investment Bank which in part could provide funding and technical support for CDFIs and credit unions. We expect to return to this issue as part of an inquiry into unclaimed financial assets early in 2007. (Paragraph 49)

**Response:** The Government is responding separately to the Committee's call for evidence for its inquiry into unclaimed financial assets.

**Recommendation:** Credit unions in Northern Ireland are well-developed and play an important role in promoting financial inclusion and access to affordable credit. The regulatory environment is currently preventing credit unions in Northern Ireland from expanding into areas such as insurance, mortgages and the provision of Child Trust Funds. We recommend that the Government take action to ensure that the regulatory regime supports the expansion of credit unions in Northern Ireland. We also note that credit unions in Northern Ireland have been unable to apply for Government support through the Growth Fund for third sector lenders. We recommend that the Government and the Northern Ireland Executive give consideration to the most appropriate ways to provide additional Government funding and support to credit unions in Northern Ireland. (Paragraph 54)

**Response:** Credit unions in Northern Ireland, unlike those in Great Britain, are not regulated by the Financial Services Authority (FSA), but by the Department of Enterprise, Trade and Investment of Northern Ireland (DETI). Expansion by a Northern Ireland credit union into additional regulated activities would require it to be regulated by the FSA for all of its activities, including those currently regulated by DETI.

DETI has examined with the FSA all the options open to the Northern Ireland Credit Union movement for the delivery of additional financial services. It was concluded that the only practical option was for the credit union sponsoring bodies to establish a separate legal entity on behalf of their members to provide these new services. This formula would

leave existing and new credit unions with their current financial services to operate under regulation by DETI, and the new business and the new services to be regulated by the FSA. All other options would have necessitated the transfer of regulatory authority from DETI to the FSA, a loss of local autonomy not generally welcomed by the Northern Ireland credit union movement.

While the Committee is correct to note that the Growth Fund is a GB-based initiative not extended to third sector lenders (including credit unions) in Northern Ireland, it should also be noted that the credit union sector in Northern Ireland is proportionally larger and more developed than its counterpart in Great Britain.

The Government notes that other forms of support have been made available to the credit union sector in Northern Ireland. DETI has fostered the development of a close and productive working relationship with the Northern Ireland credit union movement, through consultation on matters of mutual interest and regular meetings between DETI and credit unions sponsoring bodies and officials. DETI has worked closely with the credit union sector in Northern Ireland to introduce a number of new innovative services for members on a pilot basis, including:

- allowing credit unions affiliated with the Irish League of Credit Unions to accept social security payment by Electronic Funds Transfer (EFT);
- introduction of Pay Point facilities; and
- development, in partnership with the Bank of Ireland, of ATM facilities at credit union sites and therefore access to the wider ATM network.

DETI will continue to work closely with all sectors of the Northern Ireland credit union movement at removing barriers to development and growth when it is prudent to do so.

**Recommendation:** We welcome support from the banks for third sector lenders through the provision of capital and expertise. However, the level of support remains far lower than that provided in the United States. We recommend that the Treasury and the banks collectively give consideration to common ways of measuring and reporting on the extent of the provision of capital and support to third sector lenders by individual banks. (Paragraph 56)

**Response:** As indicated above, *Financial inclusion: the way forward* sets out the Government's commitment to the objective of achieving a step-change in third-sector lending, with the support of banks and other financial services providers. The Government notes the commitment to this aim expressed by representatives of the banks at the Committee's hearings last year. This is why the Government has asked senior representatives from the banking sector to work with the Financial Inclusion Taskforce to consider how to achieve a nationwide increase in the coverage and capacity of third sector lenders.

**Recommendation:** We welcome the introduction of Community Investment Tax Relief, although we note that the additional investment secured is still a very long way from the original target for such a scheme set by the Social Investment Taskforce. To promote the availability of affordable credit, we support the extension of the tax relief

to investments made in personal lending by CDFIs and to credit unions seeking subordinated capital. We recommend that the Government also consider the introduction of a matched funding scheme to provide incentives for housing associations and other charities to invest in CDFIs. More generally, there is a need for the Treasury to review the operation of the scheme to ensure that its potential for securing long-term investment is maximised. In particular, the Treasury should examine the treatment of commitments to lend and the overall cap on the size of loans. To promote long-term and sustainable investment, we further recommend that investors should be able to continue to receive the benefit of the tax relief if they retain their investment in the same CDFI for a second period of five years. (Paragraph 61)

**Response:** The Government notes the Committee's comments.

In response to representations received regarding the operation of the Community Investment Tax Relief (CITR), the Government announced on 16 November 2006 that it would be conducting a cross-departmental review of the delivery and operation of the CITR scheme. The review builds on the constructive engagement which Government has with the Community Development Finance sector. This has led to progress on a number of issues, including clarification that relief is available on further investment in the same CDFI after an initial five year period along with several further clarifications on the operation of the scheme; delivered through improved guidance from HM Revenue & Customs. As part of the ongoing review the Government announced in Budget 2007 that it will improve the flexibility of the scheme by relaxing the onward investment requirements after the third anniversary of accreditation to an average of 75 per cent. The CITR scheme's accreditation and reporting procedures will also be updated, to reflect the forthcoming change to the status of the Small Business Service.

The Government notes the Committee's support for an extension of the Community Investment Tax Relief to personal lending. Following consultation and further analysis, the Government does not consider that an extension of the tax relief is the most effective means of supporting third sector lenders at this time. As set out in *Financial inclusion: the way forward*, the Government will work with banks and other financial services providers, including third sector lenders, to develop alternative options for support of third sector lenders. The Government will also keep the case for extending CITR to personal lending under review.

**Recommendation:** Credit unions are playing a significant if limited role in combating the problems of high cost credit. Credit unions have the potential to play a far greater role in the future. Although the Government has made some welcome steps in recent years, we have received evidence that credit unions are being limited in their capacity to grow and develop by an outdated legal framework that has not changed in its essentials for 27 years. It is time for the Government to act in order to release the potential of credit unions. New legislation is needed to enable credit unions to accept organisational deposits, to support their ability to raise capital and to reduce their costs of operation. We recommend that the Treasury consult credit unions and other interested parties on a new Credit Unions Act to enshrine such measures as a matter of priority with a view to introducing such legislation in the course of the current Parliament. (Paragraph 64)

**Response:** On 9 November 2006, the Economic Secretary to the Treasury, Ed Balls MP, announced a review of the industrial and provident societies and credit union legislation. As indicated above, this review will be carried out during the course of 2007 and will make recommendations about the future development of the legislation. It is intended that there will be a full public consultation starting in April. Informal consultations with major stakeholders are already under way. The issues raised by the Committee will be included as part of the review.

The Credit Unions Act 1979 has had several significant amendments made to it since it was passed. The first of these was a Deregulation Order made in 1996. This order extended the powers of credit unions to receive deposits and make loans to their members. The Act was later amended in 2002 to make it compatible with the Financial Services and Markets Act 2000. Amongst other things this gave credit unions access to the Financial Ombudsman Service and the Financial Compensation Scheme and brought credit unions within a formal scheme of regulation. It was further amended by a Regulatory Reform Order in 2003. The principal amendments made by the Order were to include a new membership qualification or common bond in section 1(4) of the Act; it also permitted credit unions to charge their members a fee to recover the cost of providing ancillary services. In April 2006 the Treasury made an Order that increased the maximum interest rate that a credit union can charge from 1% a month to 2% a month.

**Recommendation: Cutting the cost and risk associated with lending to the financially excluded can reduce the interest rate paid by the borrower and improve the sustainability of third sector lenders. The evidence we have received indicates that direct deduction of repayments from benefits could be attractive, but principally when it is an active choice by the borrower rather than a mechanism of enforcing debt collection. We believe that the Government should explore this issue further. Such exploration should accompany a review of the wider application of the third party deduction scheme. We are not convinced that the Government's current proposals represent value for money and include appropriate safeguards. We recommend that the Government, in its response to this Report, publish a full breakdown of the planned expenditure of £10 million on the scheme, alongside details of the safeguards that will be in place to protect borrowers and evidence that such investment will improve the availability of affordable credit and the sustainability of third sector lenders. (Paragraph 72)**

**Response:** The Government introduced regulations<sup>3</sup> which came into effect on 27 December 2006, which will enable lenders from the third sector to participate in a scheme (now referred to as the eligible loans deductions scheme) intended to reduce some of the costs and risks of lending to financially excluded people. The scheme will allow lenders to apply for repayment by deductions from certain benefits where normal repayment arrangements have broken down. To date, 57 credit unions and 7 CDFIs have registered to join the scheme.

The principal rationale of benefit deductions is to safeguard the position of vulnerable people where they fall into arrears with essential bills. Deductions are also made under

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3 The Social Security (Claims and Payments) Amendment (No.2) Regulations 2006 No. 3188

wider powers to discharge debts which help in enforcing compliance with certain social and financial obligations. The scheme is working well in meeting these objectives.

Deductions are not intended to provide a method of paying bills or to be used as a budgeting tool. To do so would run contrary to the Government's aims to encourage personal responsibility and to reduce benefit dependency.

£10 million was allocated to the DWP from the Financial Inclusion Fund for the implementation costs of the eligible loans deductions scheme and the administrative costs associated with delivering the £36 million Growth Fund for third sector lenders. The final costs of implementing deductions from benefit are not expected to exceed £3 million with resources of £2.617 million approved, including running costs, estimated to be around £100,000 – £150,000 annually.

Projected total expenditure for implementation and running costs for the 3 year period 2005 to 2008 is £ 2.246 million. Final costs are therefore expected to come well within the allocation of £2.617 million. A detailed breakdown is given below.

#### Staff Costs

- £1.030 million (including £311,000 for IT contractors and £243,000 for live running costs)

#### Non-staff costs

- £1.216 million, including:
  - £985,000 for IT changes;
  - £194,000 for internal changes to guidance, training, IT implementation and communications;
  - £20,000 consultancy; £12,000 staff expenses; and
  - £4,065 conference costs.

The balance of the £10 million originally allocated to the DWP for implementing this scheme will be returned to the Financial Inclusion Fund, or retained by the DWP for use on other Financial Inclusion Fund initiatives.

The deductions scheme complements other financial inclusion measures, for example the Growth Fund. There has been a great deal of support and interest from third sector lenders with about 40 interested organisations attending two recent lender events. The Government believes this measure has potential to make a useful and cost-effective contribution to an expansion of third sector loan provision for people on low incomes in deprived areas. The Government will also engage with the Financial Inclusion Taskforce to ensure an appropriate monitoring and evaluation framework is established to assess the scheme's impact.

The scheme contains safeguards that will protect borrowers. Eligibility for the scheme will only be open to lenders who are able to demonstrate that they follow good lending and arrears management practice. This will be operated through a Memorandum of

Understanding between each individual lender and the DWP. The Memorandum of Understanding will set out the standards lenders are expected to adhere to. It will include a set of criteria relating to matters such as provision of debt advice; clarity and transparency about terms of lending; proper assessment of ability to repay including details of income and outgoings; and appropriate action where a borrower is experiencing difficulty in repaying.

Additionally, rules apply which prevent the benefit customer being over-committed through benefit deductions. The loan deductions are placed as the lowest of the priority order of all third party deductions, after essential costs such as housing, fuel, and water. A deduction will not be made where the customer is repaying an existing Social Fund loan, or where there is a recoverable benefit overpayment.

**Recommendation: The Social Fund plays a vital role in helping those on low incomes to access affordable loans to meet one-off items of expenditure. However, we note the comments of the relevant Minister in evidence to us that the “Social Fund does not punch its weight in terms of the financial resources the Government puts behind it”. The funding for the Social Fund should more clearly match the needs of those on low incomes. We have received evidence to suggest that the Social Fund is failing in its mission to assist those most in need of credit. It is essential that the Social Fund becomes more fully integrated with other provision of affordable credit for people on low incomes. Given that many people rejected by the Social Fund turn to unlicensed lenders, we recommend that the Government instigate arrangements to refer unsuccessful applicants to local credit unions and CDFIs where appropriate or other providers of affordable credit. We note calls for eligibility for the Social Fund to be expanded and believe that the Government should keep the funding of Social Fund lending activities under review, in particular if the intention to transfer some recipients of income support and jobseeker’s allowance to the tax credit system goes ahead. The DWP needs to instigate an open debate on reform of the Social Fund to ensure that the Social Fund can make a better contribution to improving access to affordable credit and become a more positive source of assistance for people on low incomes. We recommend that the DWP conduct a review to explore how the Social Fund’s contact with the financially excluded could be made more productive in order to make a longer term difference to the capabilities and inclusion of users. (Paragraph 81)**

**Response:** The Government is committed to ensuring that the Social Fund fulfils its aim of helping the poorest and most vulnerable people in society meet one off needs. Additional funding equivalent to £300m is being made available to the discretionary Social Fund between April 2003 and April 2008 to enable the scheme to provide more help to more people. Funding for the Social Fund is kept under review.

In April 2006 the DWP introduced a significant package of changes to simplify the loans scheme and make it more accessible to those who wish to use it. As a result of these changes the number of applicants refused a loan because of their existing debt will reduce and the introduction of lower repayment rates will make Social Fund loans more affordable. The Government does of course keep the functioning of the Social Fund under review.

The DWP shares the Committee's concern about people on low incomes turning to unlicensed lenders. Applicants are provided with information about sources of financial advice and information on the Jobcentre Plus website and in the decision letter sent to budgeting loan applicants. The DWP is also supporting the expansion of affordable credit provided by credit unions and community development finance institutions through administration of the Growth Fund and the eligible loans deductions scheme. The DWP is also delivering the national financial inclusion awareness campaign which encourages trusted intermediaries, such as housing providers and national and local charities, to work more closely to help excluded people access the advice and financial services they need.

The DWP has already made clear its willingness to talk widely to organisations with expertise and an interest in both financial inclusion and provision of affordable credit.

**Recommendation: Increasing levels of home ownership mean that improving access to secured lending needs to be addressed as part of the Government's financial inclusion strategy. There are cases where low-income homeowners face real financial difficulty. We note that progress has so far been slow in attracting lenders to provide home improvement loans to low-income owner-occupiers to help meet the Government's Decent Home standards. The provision of such lending could be an important role for CDFIs and other third sector lenders. We recommend accordingly that the Government consult on ways to expand the ability of such organisations to provide secured loans. (Paragraph 85)**

**Response:** *Financial inclusion: the way forward* identifies the importance of affordable credit as one of a number of financial products and services that people use to manage their finances and make plans for the future, in both the short- and long-term. The focus of the Government's strategy for affordable credit has been on its role in helping with short-term expenditure or income shocks, and this approach will continue to be a priority for the Government's financial inclusion action plan. The Government will, however, also consider whether there is a need to take action for longer-term types of credit, including mortgage finance and home improvement loans.

**Recommendation: Citizens Advice has presented evidence of abuses in the Right to Buy market. We recommend that the FSA view this as a priority area for examination as part of its enforcement of mortgage regulation. We further recommend that the Government clarify, in its response to this Report, what additional consumer protection stems from the system of specifying Approved Lending Institutions for the purpose of the right to buy scheme and whether the Department for Communities and Local Government is undertaking any monitoring of the record of these lenders or the number of complaints made. Finally, we recommend that the Government explore the possibility of transferring responsibility for approving and monitoring Approved Lending Institutions from the Department for Communities and Local Government to the FSA. (Paragraph 87)**

**Response:** Under the Housing Act 1985, tenants who buy their homes at a discount from social landlords under the Right to Buy scheme must repay some or all of the discount if they resell the properties within a specified period. This recoups for the public purse a share of any increase in market value received by early sellers who have benefited from public subsidy. However, the Act also offers protection to commercial lenders specified by

the Secretary of State as Approved Lending Institutions (ALIs) which have lent to tenants who exercise their Right to Buy. It provides that when the property is sold, it is the ALI's loan that has priority.

An ALI is a body listed in section 156 of the Housing Act 1985 or specified by the Secretary of State. The purpose of ALI designation was to encourage responsible lenders to enter what was in 1980 a new market, offering mortgages to council tenants to buy their homes. It also offers some reassurance to would-be purchasers, but it does not offer any kind of formal protection to borrowers. ALI status is therefore designed to protect the position of a lender vis-à-vis the local authority rather than specifically to regulate the conduct of lenders in their dealings with consumers.

In considering applications for ALI status, the Secretary of State aims to satisfy him / herself that the bodies concerned are (i) properly constituted, (ii) adequately resourced, and (iii) likely to conduct their business in a responsible manner. The Department obtains advice from the Office of Fair Trading, Companies House and its own internal accountants. The Department has received no complaints about the activities of any ALI since the activities of City Mortgage Corporation led to action against that company in 1997 by the Office of Fair Trading.

The Department for Communities and Local Government recognises that it does not have the powers or the expertise to monitor the activities of ALIs. It is therefore considering whether and in what circumstances reform of these arrangements might be appropriate; for example, by transferring the responsibility for conferring ALI status to another body that is better placed to supervise mortgage lenders, ending the need to seek approval as an ALI, or specifying that any body that met the regulatory requirements of the Financial Services Authority would have a first charge on RTB properties, and to remove the need for separate ALI status. Reform of these arrangements would require primary legislation.

## Saving for all

**Recommendation:** We are not concerned in the current Report with the general viability of the long term savings industry, although this is a matter to which we may well return. We are concerned with the narrower question of whether it is fit for purpose in terms of providing appropriate savings opportunities for the less well-off. Our inescapable conclusion is that it is not fit for purpose. The market may change in the future, but until it does, it is likely that non-market-led solutions will also be necessary to solve the problems of savings incentives and opportunities for the less well-off. (Paragraph 102)

**Response:** A new system of Personal Accounts, to encourage saving for retirement amongst those groups without access to good employer pension provision, was recommended by the Pensions Commission (November 2005) and announced in the Pensions White Paper (May 2006). The proposals include auto-enrolment into either a good employer pension scheme or Personal Accounts, to tackle behavioural barriers to saving and improve opportunities to save, along with mandatory employer contributions and low charges to improve incentives to save. The target group for Personal Accounts, due to be introduced in 2012, will be those with low to middle incomes who are currently most at risk of under-saving for their retirement.

Outside the pensions arena, the Government has taken regulatory steps to improve access to savings, including for people on lower incomes. The introduction of the Stakeholder suite and Basic Advice regime provided access to a range of price-capped, simple products and an appropriate sales regime. More widely, the introduction of a single regulator with a clear and robust framework for consumer protection has promoted consumer confidence in the savings industry.

As set out in *Financial inclusion: the way forward*, the Government agrees that saving is an important element of financial inclusion. The Government will consider what action is needed to promote saving and saving products as it develops the detail of its ongoing financial inclusion strategy, between now and the Comprehensive Spending Review.

**Recommendation: There is evidence from abroad and from the emerging findings of the Saving Gateway pilots that matched savings accounts such as those piloted as part of the Saving Gateway provide a clear and understandable framework of support for savers. They also provide clear incentives for those on low incomes who often cannot benefit from tax relief. The first pilot phase of the Saving Gateway showed that matching can encourage genuinely new savers and increased savings. We are concerned that the valuable lessons from the first pilot phase of the Saving Gateway must not be overlooked and that the Gateway must be promoted nationwide at an early stage as a framework for savings for all, although we recognise that in any national roll-out the Government will need to consider the overall match rate, which income levels the scheme should be focused on and the overall cost of the scheme. We recommend that the Government examine ways to encourage the development of matched savings accounts with contributions from the private and charitable sectors. (Paragraph 111)**

**Response:** Lower income households may be less likely to save than other households and may not have sufficient levels of savings to draw upon, either in times of adversity; for retirement; or to pursue other opportunities, such as lifelong learning. The Government has therefore been particularly keen to encourage saving among this group and has been piloting the Saving Gateway with the aim of bringing people on lower incomes into contact with mainstream financial services and promoting a saving habit. Evidence from the first pilot and the interim evaluation of the second pilot suggests that matching can provide a more understandable, transparent and equitable framework of support for savers. The final evaluation of the second pilot is due to be published in the Spring. The Government will both take account of evidence gathered through the pilots, and lessons learned from the review of hamper schemes conducted by Brian Pomeroy, chair of the Financial Inclusion Taskforce, when the Government makes an announcement on next steps for the Saving Gateway in Summer 2007.

**Recommendation: We welcome the increase in the capital allowances for benefits. We recommend that the Government review the rules on tariff income to ensure that the withdrawal rates for additional saving above capital allowances continue to encourage households on benefits to accrue additional saving. (Paragraph 113)**

**Response:** The graduated deductions are not intended to represent any return that could be obtained from investing capital. The system provides a straightforward method of calculating the weekly contributions which people with capital in excess of £6,000 are expected to make from those resources to help meet their normal living expenses. The

rules are designed to ensure that help is targeted on those who need it most, whilst not entirely denying benefit to those with only a modest amount of capital. The “cliff edge” effect of a simple capital limit is thus avoided. This method is simpler to administer than taking account of interest on savings, due to the wide range of investments at variable returns paid at various frequencies.

**Recommendation:** We recommend that the Government consult on the case for an exemption for Registered Social Landlords from the FSMA requirements to register as a deposit-taker. The Government should consider whether the appropriate degree of regulation could be accomplished through other bodies such as the Housing Corporation. (Paragraph 114)

**Response:** The Government accepts the Committee’s recommendation to consult on the case for an exemption for Registered Social Landlords from the FSMA requirements to register as a deposit-taker, and will do so in due course. The Government notes, however, that if such an exemption were introduced, supporting regulation—possibly issued by the Housing Corporation—would be needed to clarify the uses to which any deposits held outside the FSMA requirements could be put by Registered Social Landlords.

**Recommendation:** Saving is not accorded the same priority in the Government’s strategy for promoting financial inclusion as credit, advice and banking. The evidence we have received suggests that savings, and the problems of making saving worthwhile and beneficial for those on lower incomes, are integral to any effective strategy on financial inclusion. In our subsequent Report on the roles of the Government and the Financial Inclusion Taskforce and the overall strategy, we will consider further whether the terms of reference of the Taskforce ought to be amended to include access to savings and the role of savings clubs. In the present Report, we have set out a series of recommendations designed to ensure that saving is accorded a higher priority in the context of financial inclusion and that the particular needs of savers and potential savers are at the heart of Government actions to combat poverty and financial exclusion. (Paragraph 118)

**Response:** As set out in *Financial inclusion: the way forward*, the Government agrees that saving is an important element of financial inclusion. Access to saving accounts, alongside affordable credit and insurance products, provides people with an important tool to help them plan for the future and cope with financial pressures. Therefore, the Government will consider what action is needed to promote saving and saving products as it develops the detail of its ongoing financial inclusion strategy, between now and the Comprehensive Spending Review.

## Access to financial advice

**Recommendation:** We commend the work of the Consumer Credit Counselling Service, Money Advice Trust, AdviceUK and Citizens Advice Bureaux in providing debt advice. We welcome the additional £45 million of funding up to 2007–08 for debt advice allocated as part of the Financial Inclusion Fund, which will allow the recruitment of over 450 debt advisers and provide help for over 100,000 people. However, the short term nature of the funding offered so far places those debt advisers at risk of redundancy almost as soon as they have developed their expertise. We

**understand the constraints placed upon long-term commitments by the nature of the spending cycle. However, the Government could go a considerable way to assuaging concerns about funding by demonstrating its belief in the fundamental importance of, and necessity for, debt advice and by committing to assuming a leadership role in securing funding from its own resources and from the financial services industry to ensure that the necessary increase in debt advice is sustained. (Paragraph 123)**

**Response:** The Government welcomes the support given by the Committee to the Financial Inclusion Fund's debt advice programme. Advice providers had recruited 350 advisers by the end of 2006, who had seen over 18,000 financially excluded clients by the end of February, despite many being new trainees. The Government has built on this success by awarding an additional £2.5m, on top of the original £45m, in the 2006 Pre-Budget Report which will secure the recruitment of over 500 advisers in total.

The Government has also announced that there will be a new Financial Inclusion Fund in the next spending period and has committed to maintain the current level of intensity of action to promote financial inclusion, with access to money advice as a continuing priority. The exact amount of the new Fund will be determined in the forthcoming Comprehensive Spending Review. The Government has long taken a leading role in encouraging the financial services industry to help fund debt advice and this has proved very successful in areas such as the Money Advice Trust and the National Debtline.

**Recommendation: A key facet of promoting financial inclusion lies in ensuring that consumers have access to appropriate financial advice. We note evidence suggesting that 8 million consumers who earn between £10,000 and £22,000 find it difficult to access generic financial advice, separate from the sales process. It is clear that improving access to financial advice would have benefits for individuals, the Government and the financial services industry. All too often in pronouncements from Government and regulators, consumers are told to seek advice, but with little consideration as to where they should turn. The implementation of a National Pension Savings Scheme and moves to make individuals more responsible for their retirement planning will increase the need for many consumers to access generic advice and support in order to plan for their retirement. (Paragraph 127)**

**Response:** The Government welcomes, and agrees with, the Committee's assessment of the need for increased consumer access to generic financial advice. In January 2007 the Government published its long-term approach to financial capability.<sup>4</sup> The approach included an analysis of advice and product market issues, including the prevalence of information asymmetries between consumers and industry, growing product complexity, and the current limited access to financial advice for those on low to medium incomes.

The approach sets out the Government's long-term aspiration to ensure that all adults in the UK should have access to high quality generic advice to help them to engage with their financial affairs and make more effective financial decisions. The Government has asked Otto Thoresen, Chief Executive of AEGON UK, to lead an independent feasibility study to

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4 [http://www.hm-treasury.gov.uk/documents/financial\\_services/financial\\_capability/fin\\_cap\\_longtermapproach.cfm](http://www.hm-treasury.gov.uk/documents/financial_services/financial_capability/fin_cap_longtermapproach.cfm)

research and design a national approach to generic financial advice. The Thoresen review is now under way and will report around the end of the year.

**Recommendation:** Citizens Advice Bureaux and other advice centres will have a valuable role to play in any national network of financial advice centres. We welcome their willingness to expand their role into the provision of generic financial advice, but note that for them to take up additional roles in this area will require additional investment and funding. We recommend that the pilot project of Citizens Advice working with IFAs on a pro bono basis to deliver generic financial advice is expanded. In the short term, this could be accomplished by additional money from the industry, combined with any remaining resources from the Financial Inclusion Fund. (Paragraph 137)

**Response:** The Government recognises the valuable role played by existing third sector providers of both generic financial advice and debt advice. As outlined in the financial capability long-term approach paper, there are a number of operational and practical questions to consider in building a national approach. These include options for the model of advice delivery and identifying the best ways to reach those consumers who are most vulnerable to the consequences of poor financial decision-making. The feasibility study under Otto Thoresen has been asked to evaluate these options and carry forward engagement with both the private and voluntary sectors.

The Government also understands that the Citizens Advice pilot project to provide pro bono IFA services will be expanded over the coming year. The Government is keen for this evidence to feed into the Thoresen review.

**Recommendation:** We recommend that the Treasury assumes lead responsibility for taking forward discussions on the provision of generic financial advice and brokering an agreement between the FSA, the financial services industry and other interested parties on the way forward in terms of the most appropriate organisational framework to deliver and coordinate a national financial advice network and the issues of funding and charges that we consider next. We further recommend that this network target especially generic financial advice for people on lower incomes. (Paragraph 139)

**Response:** HM Treasury has assumed lead responsibility in driving forward the generic advice agenda. The feasibility study will address many of the issues identified by the committee and will work closely with stakeholders across Government, industry and third sector, including the most appropriate organisational framework for delivering generic advice. The Government has asked the review to make particular consideration of the needs of those most vulnerable to the consequences of poor financial decision-making, which may include those on lower incomes and the financially excluded.

**Recommendation:** The desirability of developing generic financial advice services is not in doubt. The major issue that needs to be resolved is how such services might be funded. Increased provision of generic advice will lead to benefits not only for the financial services industry, through a better informed and more engaged customer base, but also for the public sector, if consumers increase provision for retirement or reduce their reliance on the State benefit system. We therefore believe that increased provision could be funded through a partnership between the public and private

sectors, although the proportion of funding provided would need to be discussed. As a first step, we would expect the Government to take forward discussions with the private sector on possible funding options and, as part of those discussions, to indicate the extent to which Government funding might be available for such services. (Paragraph 142)

**Response:** The Government’s long-term approach set out the potential benefits to consumers, industry, Government and the wider economy of raising levels of financial capability. In light of this, the Government agrees with the Committee that there is a strong case for putting a generic advice funding arrangement in place that recognises the long-term benefits to all, including both the state and the financial services industry. The Government has asked the Thoresen review to explore this area in its recommendations, and will consider its own contribution within the Comprehensive Spending Review process.

### Access to insurance

**Recommendation:** Lowering the cost of insurance is substantially based on lowering risk. We recommend that the insurance industry and the Government examine the potential for pilot schemes focused on risk reduction. (Paragraph 148)

**Response:** The Government’s financial inclusion document sets out its intention to consider access to insurance products in consultation with the Financial Inclusion Taskforce and the insurance industry.

**Recommendation:** Insurance with rent schemes can reduce the cost of insurance and ensure easier access for low-income households. We recommend that the Government establish a stretching target to ensure that such schemes are available in more local authorities and housing associations. We further recommend that local authorities take action to promote the take-up of these schemes amongst uninsured households. (Paragraph 149)

**Response:** Public Service Agreements (PSAs), Departmental Strategic Objectives (DSOs), and any associated national level targets, are negotiated and agreed in the CSR process and published at the CSR. Proposals are still at an early stage of development.

The Local Government White Paper “*Strong and Prosperous Communities*”, published in October 2006, outlines a new local performance management framework, which will significantly reduce bureaucracy for local authorities and local service delivery partners and give them more room to manage performance locally.

There will be a decrease in the reporting burden for local authorities from about 600 to around 200 national performance indicators, underpinning all PSAs and DSOs to be delivered by local authorities (working alone or in partnership). From these indicators, local authorities, in conjunction with their local partners, will negotiate up to 35 improvement targets, reflecting decisions at the CSR on national priorities.

**Recommendation:** The Government must ensure that transfers of local authority housing to Arms Length Management Organisations (ALMOs) or to a housing association do not disrupt the administration of successful insurance with rent schemes. (Paragraph 150)

**Response:** The Department of Communities and Local Government was alerted in 2004 to concern that new arrangements for regulation of the general insurance industry by the Financial Services Authority, being introduced on 14 January 2005, would make it more difficult for some local authority tenants to access low cost home contents insurance. Under such “Insure with Rent” schemes, tenants benefit by being able to pay their insurance premiums in instalments with their rent and from insurance companies being willing to cover insured sums lower than they would do for the general public. Insurance companies benefit since local authorities collect the premiums and provide administrative support.

The new arrangements, enacted in the Financial Services and Markets Act 2000 (Regulated Activities) (Amendment) (No. 2) Order 2003 (SI 2003 No. 1476), require advisers and suppliers of general insurance to be authorised by the FSA, one criterion for which is that they should have adequate financial and management resources, including appropriately qualified staff. The Order exempts some organisations, including local authorities and Registered Social Landlords, on grounds that insurance is not part of their main business. However, it does not exempt Arms Length Management Organisations, which are companies having their own legal identity, managing housing stock on local authorities’ behalf. The concern in 2004 was therefore that ALMOs would not be able to justify paying the fees for FSA authorisation and staff training, so depriving tenants of access to low cost contents insurance or requiring the local authority to continue to be involved on a day-to-day basis in this one element of the housing service.

In the light of this concern, one ALMO (Hillingdon Homes) brought a test case with the FSA. The FSA’s reply, dated 6 January 2005, did not disagree with the ALMO’s view that, while it was likely to be carrying on regulated insurance activities, it was not doing so by way of a business. Other relevant facts were that the local authority, not the ALMO, tendered and awarded contracts with insurance providers and received any commission due under such contracts. The ALMO did not receive any benefit, its main role being to explain what insurance was available and put tenants in touch with the insurance providers. On this basis, there was no need for the ALMO to be authorised or exempt from FSA regulation. All ALMOs were made aware of the FSA’s reply so that they could choose to provide tenants with access to low cost home contents insurance on the same basis. Since 2005 the Department has received no further representations on this issue.

## **“Banking the unbanked”: banking services, the Post Office Card Account, and financial inclusion (Thirteenth Report of Session 2005–06, HC 1717)**

### **Background**

**Recommendation:** The evidence we have received indicates that those without access to a bank account are likely to be on a low income, the long-term inactive or unemployed, the elderly, lone parents and council and housing association tenants.

**Response:** the Government agrees with the evidence submitted to the Committee. Quantitative survey research commissioned by the Financial Inclusion Taskforce shows that respondents defined as unbanked are highly concentrated in low income groups, those renting from a social landlord, the unemployed, those living in the most deprived parts of the country, benefit recipients and single pensioners.

### **The overall approach**

**Recommendation:** The case for the imposition of statutory requirements relating to access to, or the provision of, banking services for the financially excluded is closely linked to analysis of the current performance of the banking industry and of individual banks. This Report makes a contribution to such an analysis. As matters stand, we do not consider that the case for such legislative action has been made. We agree with the Economic Secretary to the Treasury that more can be achieved at present by a voluntary partnership approach, and also with his important point that the willing participation of the banks will be essential in tackling financial inclusion regardless of legislative action. However, we also note the statement by the Economic Secretary to the Treasury that a legislative approach “is not off the table”, and our approach in this Report is based on identifying areas where we expect progress to be made by banks individually and collectively if they are to be able to satisfy the Government, legislators and the public in the future that the voluntary approach is the best way forward. This Report contains recommendations requiring action by the banks. We make such recommendations within the context of our wish to identify benchmarks by which to assess the effectiveness of the current voluntary partnership approach. We expect to monitor closely actions taken in response to those recommendations. (Paragraph 19)

**Response:** The Government welcomes the Committee’s endorsement of the approach that it has taken to working with the banking sector to promote financial inclusion. The Government looks forward to continuing to work in productive partnership with the banks, other financial service providers (including those from the third sector) and other stakeholders, in promoting financial inclusion.

**Recommendation:** Although we do not see a case at present for the introduction of legislation comparable to the US Community Reinvestment Act, we recommend that the Government, the banks and the Financial Inclusion Taskforce work together to prepare and then publish measures of engagement by the individual banks with the socially excluded, provided on a standard basis no later than the middle of 2007. More generally, the adequacy of the provision by banks of information which enables full and

**effective monitoring to be carried out will be an important criterion in determining the overall success of the voluntary partnership approach to combating financial exclusion in banking services. (Paragraph 20)**

**Response:** The Government recognises the importance of transparency, and welcomes the steps taken by a number of banks to improve their reporting on promotion of financial inclusion.

*Financial inclusion: the way forward* sets out a number of areas, including usage of accounts, and the importance of a bank account as a gateway into wider financial inclusion, in which the Government will be asking the banks to provide more information to allow for an assessment of the scale and scope of any ongoing problems, and to work with the Government towards determining appropriate new targets or goals.

### Opening basic bank accounts

The Government's priority for banking services has been to work with the banks towards a shared goal of halving the number of adults living in households without access to a bank account. Given the role of the basic bank account as a product designed to meet the needs of financially excluded customers, the Government therefore shares the Committee's view that the ability of customers to open basic bank accounts is crucial.

The Committee addresses a number of recommendations in its report to the banks, their trade bodies (including the Banking Code Standards Board and the Joint Money Laundering Steering Group), and the Financial Services Authority regarding action to increase the ease with which basic bank accounts can be opened. The Government welcomes recent developments, some of which deal with recommendations made by the Committee (for example, changes to Banking Code guidance regarding availability of account literature, time taken to open accounts, and provision of in-branch verification of identification), which will make it easier for basic bank accounts to be opened.

The Government awaits the findings of the Banking Code Standards Board's latest mystery shopping exercise for basic bank accounts, which will provide evidence on whether recent changes are making a difference on the ground. In the longer term, the Government will also be interested to see the outcomes of the 2007 Independent Review of the Banking Codes, and has submitted representations to the Review

**Recommendation:** There is evidence to indicate that steady progress has been made so far towards the target of halving the number of people without access to a bank account. Banks are collectively accountable for progress so far and in the future. However, it is also vital that each bank can be held to account individually for its contribution to meeting this target. This is not possible at the moment. Individual banks need to accept this responsibility, and accordingly we recommend that the Government, the Financial Inclusion Taskforce and the banks reach agreement enabling each individual bank regularly to publish figures for the numbers of basic bank accounts it has opened in each year. We would expect each bank to develop strategies for ensuring that it makes a proportional and appropriate contribution towards meeting the target, and we would also expect such strategies to take due

**account of the analysis which follows on the issues surrounding the opening of basic bank accounts. (Paragraph 26)**

**Response:** The Financial Inclusion Taskforce updated the Government on progress towards the shared goal at the last Pre-Budget Report.<sup>5</sup> This update supported the Taskforce’s earlier conclusion that steady progress is being made towards the goal. Early analysis of the Family Resources Survey data for 2005–06 supports the Taskforce’s conclusion that steady progress has been made. The number of the unbanked has fallen from 2.8 million adults in 1.9 million households to 2 million adults in 1.3 million households.<sup>6</sup> These data only became available on 27 March 2007, and therefore the Taskforce has not had the opportunity to conduct a thorough evaluation of the data. The Government awaits the Taskforce’s report with interest.

As indicated in the response immediately above, the Government believes that transparency is an important part of the banks’ responsibilities in the area of financial inclusion, and will be working with the banks to gather evidence on a number of issues relating to banking and financial exclusion. However, the Government does not believe that the case has been made for compulsory reporting of these or other data. The Government notes that the Committee has published these figures as part of the evidence from its inquiry.

**Recommendation: We recommend that the Government review the extent to which existing relationships with public sector organisations can be used to help the financially excluded prove their identity. We also expect the Government to encourage banks to develop links with public sector organisations and other third sector groups such as housing associations and to work proactively with organisations such as SAFE to develop solutions to help financially excluded people prove their identity. (Paragraph 50)**

**Response:** The guidance produced by the Joint Money Laundering Steering Group (JMLSG) and approved by the Chancellor on 13 February 2006 contains material on how banks can identify those customers who are financially excluded and who may not have standard forms of identification. This includes options that allow firms to use evidence of relationships between individuals and public sector organisations. Firms can also use confirmations from other appropriate persons as evidence of identification.

The Government has recently launched its campaign, entitled “now let’s talk money”, which will work with intermediaries (including public sector organisations, charity and community groups, and social landlords) to ensure that people without a bank account are provided with the information and support they need in applying for a bank account. The campaign is financed by £5.4 million from the Financial Inclusion Fund.

## Operating basic bank accounts

**Recommendation: Financial inclusion will require more than the achievement of numerical targets for numbers of accounts opened. Survey evidence indicates that a**

5 [http://www.financialinclusion-taskforce.org.uk/PDFs/taskforce\\_update\\_to\\_hm\\_treasury\\_dec06.pdf](http://www.financialinclusion-taskforce.org.uk/PDFs/taskforce_update_to_hm_treasury_dec06.pdf)

6 Family Resources Survey 2005-06, supplementary analysis.

**significant proportion of basic bank account holders withdraw all their money in cash on the day it is credited and gain little benefit from operating a basic bank account. There needs to be a greater focus on ensuring that the terms and conditions of basic bank accounts are appropriate and useful for those on low incomes. We make a number of recommendations below and expect the Treasury, the Financial Inclusion Taskforce and the banks to discuss and take forward appropriate measures for their implementation. (Paragraph 65)**

**Response:** The Government agrees with the Committee that opening a bank account, while very important, is only a first step in becoming financially included. In *Financial inclusion: the way forward*, the Government stresses the importance of account usage in financial inclusion. While steady progress has been made in reducing the number of people without access to an account, the Government agrees that more needs to be done to ensure that people are making appropriate use of their bank accounts in order to get the full benefit of being financially included from a banking perspective.

Therefore, to understand the scale and scope of the challenge posed for financial inclusion by the issue of bank account usage by low-income newly-banked customers, the Government and the Financial Inclusion Taskforce will work with the banks to collect data on account usage by basic bank account customers. This evidence will inform work with the banks to tackle the issue of usage, including a possible goal or target on usage.

**Recommendation: We note that five banks currently apply longer cheque clearing times to basic bank accounts and that there is some evidence that such an approach has been successful in reducing fraud. However, longer cheque clearing times represent a significant disadvantage to customers and we recommend that the OFT payment systems taskforce specifically consider the issue of longer clearing times for basic bank accounts as part of its report on the cheque clearing system. That report should lay out a clear timetable to reduce the clearing times for cheques paid into basic bank accounts. (Paragraph 72)**

**Response:** On 14 November 2006, the OFT Payment Systems Task Force published a report on cheques which made recommendations on how aspects of the current cheque clearing cycle could be improved, including for basic bank account holders. This report, which has been agreed to by banks, building societies and consumer groups, recommends the introduction of time limits for receiving interest on a cheque (no later than two working days after a cheque is paid in); being able to withdraw against a cheque (no later than four working days after a cheque is paid in-six days in the case of savings accounts); and being certain that a cheque will not bounce (no later than six working days after a cheque is paid in). These reforms, which will come into effect in November 2007, will apply UK-wide to all current accounts, including basic bank accounts. The Government welcomes these reforms, which will improve transparency and certainty for cheque users. This outcome means that, for the first time, all basic bank account customers who use or receive cheques will be treated on the same basis as other customers.

**Recommendation: A strategy that simply looks at the absolute numbers of accounts opened will not deliver meaningful financial inclusion. The Government and the banks need to take a broader approach and ensure that basic bank accounts are useful and appropriate for those who were previously financially excluded. The Government must**

ensure that the most vulnerable are considered and given appropriate help and assistance to enable them to open and operate accounts. In the medium term, the Government should establish a more sophisticated goal which should take account of actual usage of bank accounts by those who were previously financially excluded rather than focusing simply on the numbers with access to such accounts. (Paragraph 77)

**Response:** As indicated above, the Government's future strategy for financial inclusion will involve increased focus on the issue of how people use their bank accounts. In order to achieve this, the Government will work with the banks and other stakeholders, including the Financial Inclusion Taskforce. Work with the banks will consider the option of establishing new targets or goals for financial inclusion.

### Wider banking issues

**Recommendation:** Rising energy costs are increasing the number of pensioner and other vulnerable households in fuel poverty. This in turn reinforces the importance of low-income consumers accessing low-cost bill payment services if they are to avoid fuel poverty. Direct debits are currently unattractive to many people on low incomes. We believe there is a need for discussions between utility companies, banks and the Government to consider what improvements could be made to the direct debit system and whether an improved method of bill payment could be developed. In the near term changes to the third party deduction scheme could provide an easy way of improving the ability of those on benefits to manage bill payment. We recommend that the DWP carry out a full review of this scheme with a view to its expansion. (Paragraph 82)

**Response:** The Financial Inclusion Taskforce has been in discussions with the banks, utility companies and other regular billers, and BACS, the company which is responsible for running and marketing the direct debit and standing order schemes, in order to investigate ways of making low cost bill payments available to low-income customers. This work is ongoing. Furthermore, the issue of bill payment will be an integral part of the Taskforce study into bank account usage.

The primary purpose of third party deductions from social security benefits is to safeguard benefit claimants from the consequences of falling into arrears with essential expenses. For example, it protects vulnerable people on income-related benefits from disconnection of essential fuel and utility services, and from eviction where they do not pay their fuel, water or housing costs.

These types of deductions are only taken from benefit as a last resort. Their purpose is not to provide an alternative method of paying bills or as a budgeting tool. To do so would run contrary to the Government's aims to encourage personal responsibility and tackle financial exclusion. It is more desirable for people to be able to access a range of banking facilities which help them take charge of their financial commitments whether they are in or out of work.

The DWP will continue to keep the operation of third party deductions under review to ensure it balances the interests of benefit customers who have not paid their bills with those of their creditors. But the Government does not believe it is appropriate to extend the role

of the deductions scheme to one which provides a free method of payment for essential household bills.

**Recommendation:** We welcome the development of a credit union-based transactional bank account. We recommend that the Government actively support the development of this account through the Financial Inclusion Fund to enable more credit unions to offer an alternative to basic bank accounts in areas of financial exclusion. We further recommend that the Government give a commitment that it will work constructively with credit unions to maximise their contribution to improving access to banking services for the unbanked. (Paragraph 83)

**Response:** The Government welcomes the development of credit union current accounts, and recognises the potential of these accounts to make a real difference in tackling exclusion from banking in addition to connecting users to opportunities for accessing affordable credit and saving. As indicated above, the Government will be making an additional £6m available through the Growth Fund to support the activities of third sector lenders, which will include support for credit unions looking to invest in transactional banking capability.

**Recommendation:** Before rolling out Local Housing Allowance further, the Government must ensure that problems opening and operating basic bank accounts are resolved. In particular, the Government should confirm that there is widespread acceptance by the banks of local authority housing benefit letters as a means of satisfying the identification requirements of the money laundering regulations. Alongside the roll-out of the Local Housing Allowance, the Government must also provide funding for services operated by Citizens Advice Bureau or other advice agencies to help people open bank accounts and provide guidance on how to operate the account. The target for 90% of housing benefit claims being paid within seven days of being processed needs to be met by all local authorities to ensure that tenants do not incur rent arrears or significant bank default charges as a result of the move to Direct Payment. (Paragraph 85)

**Response:** The guidance for banks, produced by the JMLSG, contains provision for them to identify their customers through entitlement letters from local authorities. This guidance is approved by the Treasury, and is the common standard to which banks adhere. The FSA considers whether firms are following the guidance as part of its supervisory and enforcement activity.

As noted above, the Government has recently launched its “now let’s talk money” campaign, to work with intermediaries (including public sector organisations, charity and community groups, and social landlords) to ensure that people without a bank account are provided with the information and support they need in applying for one.

**Recommendation:** The evidence suggests that the great majority of financially excluded people do want to access bank accounts. However, in many cases, real or perceived barriers can outweigh any advantage that they think might come from accessing a bank account. There is a need for action to stimulate demand and to provide support to the excluded in accessing financial products. Trusted, community-based institutions, such as Services Against Financial Exclusion and Citizens Advice, can play a vital role in

**promoting financial inclusion and acting as intermediaries. Conventional marketing efforts may not be effective at reaching financially excluded groups, and banks must work in partnership with community organisations to help people to access basic bank accounts. We welcome the additional funding from the Financial Inclusion Fund for intermediary organisations such as charities and housing associations to help raise awareness and promote access to financial services. (Paragraph 88)**

**Response:** The Government recognises the importance of complementing supply-side initiatives that increase the availability and accessibility of financial services, with further work to increase demand amongst financially excluded groups. The funding to which the Committee refers is now on-stream, and is being used by the Department of Work and Pensions to deliver the “now let’s talk money campaign” in priority areas throughout Great Britain. *Financial inclusion: the way forward* also indicates the Government’s ongoing commitment to tackling demand-side factors such as low levels of information, understanding and skills, and cultural factors (such as familiarity) that may lead financially excluded people to seek financial products from outside the mainstream.

**Recommendation: Access to appropriate methods of transmitting money is important for financial inclusion, and flows from international remittances are an increasingly vital source of finance and a lifeline for developing countries. Small money transmitters can play a valuable role by providing remittance services to communities that may not be engaged with the mainstream financial services sector. A lack of coordination in the current regulatory regime is hindering the ability of small money transfer businesses to obtain business banking services. Closing down the business accounts of money transmitters increases the risk of activity transferring to illicit or illegal channels, as the FSA has recognised. The Treasury and the FSA must ensure that this issue is dealt with in consultation with the BBA and the Money Transfer Association. We welcome the review of the regulation of Money Service Businesses by the Treasury, which should seek to identify an appropriate balance between preventing money laundering and terrorist financing on the one hand and improving access to remittance services for honest users on the other. We recommend that this review explicitly address the issue of access by small money transfer companies to business bank accounts. (Paragraph 94)**

**Response:** The Government is concerned to ensure that the UK remittance services market should be competitive, efficient and sound. It is also committed to greater access to basic financial services for all communities.

The Government is aware that in evidence presented to the Treasury Select Committee last year, representatives of the money transfer industry have expressed concern that some banks are unwilling to offer account services to new remittance providers, or are refusing access to existing bank accounts held by money remitters. Clearly, refused access to bank accounts will have significant implications for money transfer operators and their customers. However, banks’ interpretation and implementation of money laundering guidance can affect their decisions to provide bank account services. The Government is aware that the BBA and the UK Money Transmitters Association have made initial contact on this issue, and strongly encourages both parties to continue their dialogue on the matter.

Following the public consultation on the Treasury’s review of money service business supervision, the Government announced further measures to tackle the risk of criminal exploitation of the sector in a risk-based and proportionate way, as part of a comprehensive strategy to tackle criminal and terrorist finance published in March.<sup>7</sup>

## The Post Office Card Account

Many of the Committee’s conclusions and recommendations relate to the future of the Post Office card account (POCA) and, the POCA’s “successor”. Since the Committee took evidence and published its subsequent report the Government has announced that after 2010 (when the current POCA contract ends) it will continue with a new account, which will be available nationally and customers will be eligible for the account on the same basis as they are now.

**Recommendation: The take-up of Post Office Card Accounts has been far greater than the Government expected, with 4.3 million people currently using the POCA to receive benefits, including 2.3 million pensioners. This appears to reflect both the difficulties in opening basic bank accounts and the perceived advantages amongst benefit claimants of using the Post Office. (Paragraph 99)**

**Response:** As the Committee points out, more than 4 million people have opened POCAs, significantly exceeding the Government’s original operating assumption. Independent research for the Department for Work and Pensions<sup>8</sup> has shown that more than eight out of ten people described the process for opening a card account as “easy”. In the same research, more than ninety per cent of people said that the information they had received from DWP about Direct Payment was “clear”.

Nevertheless, there is clearly more to be done to make benefit claimants aware of the advantages of opening and using a basic bank account as compared to the POCA. The DWP’s “now let’s talk money” financial inclusion campaign is providing people with the information and support they need to take up mainstream financial products.

Finally, as discussed above, the banks have made progress in making basic bank accounts more easily accessible. The Government will continue to monitor this situation.

**Recommendation: There are around 1.2 million people using Post Office Card Accounts to receive benefits who do not have access to another account. For any migration from POCAs to basic bank accounts to be successful, there needs to be significant progress in tackling the barriers to opening accounts identified in this Report. In particular, in view of the difficulties encountered by customers in proving their identity to satisfy the anti-money laundering regulations, we recommend that the Government investigate whether the provision of a statement from a POCA could be used to help people prove their identity. Substantial investment would also need to be made to provide help and support through Citizens Advice and other community-based institutions for people, many of whom may be pensioners, to enable them to open and operate basic bank accounts. Clear information that people will be able to**

7 [http://www.hm-treasury.gov.uk/media/042/B2/financialchallenge\\_crime\\_280207.pdf](http://www.hm-treasury.gov.uk/media/042/B2/financialchallenge_crime_280207.pdf)

8 “Customer Experience of Direct Payment”, In-House Report 150, published in September 2004

**continue to support their local Post Office by making withdrawals over-the-counter will also need to be provided. (Paragraph 110)**

**Response:** As indicated in earlier replies, the Government takes seriously the issue of tackling barriers to opening bank accounts, and welcomes the progress that has been made with identity and verification and the anti-money laundering regulations.

The JMLSG guidance allows for evidence of entitlement to benefits to be used as proof of identity.

To address the lack of awareness amongst some customers that they can use their bank account at the Post Office, DWP is working with Post Office Ltd to support it in its efforts to increase awareness of this amongst the 16 million benefit recipients and thus increase its customer base.

**Recommendation: There will clearly need to be a successor to the Post Office Card Account for those who cannot manage with or obtain a full bank account. We recommend that the DWP work with the Post Office to introduce a successor to the Post Office Card Account with greater functionality. (Paragraph 113)**

**Response:** The Government remains committed to allowing people to access their pension and benefit in cash at the Post Office if they choose to do so, and there is a range of accounts which make that possible, including all seventeen basic bank accounts and at least eight current accounts.

The current POCA contract ends in March 2010. The Government has decided that it will continue with a new account after 2010. This will be available nationally and customers will be eligible for the account on the same basis as they are now.

EU procurement rules leave the Government with no option but to tender competitively for this product, and it must ensure that best value for money for the taxpayer is achieved. Post Office Ltd will be well placed to put in a strong bid given the size of the Post Office network and the access criteria that DTI will be introducing as part of its restructuring of the network.

**Recommendation: The approach of the DWP to the future of the Post Office Card Account has been characterised by inadequate consultation and a lack of clear strategic planning. Sub-Postmasters and Citizens Advice were not consulted at an early stage about the migration pilots. The high street banks, which provided funding for the POCA and will be closely involved in any transition to basic bank accounts, have not been consulted. The DWP must develop clear plans for the future arrangements for the 4.3 million people currently receiving benefits through the Post Office Card Account, consulting widely with the Post Office, Sub- postmasters, high street banks and Citizens Advice and other consumer groups. We expect the DWP to publish a document outlining this strategy before 2007. (Paragraph 114)**

**Response:** The Government does not accept that there has been a lack of consultation or clear strategic planning.

Ministers and/or officials have met with a range of organisations during 2006 to discuss the POCA and related issues, including Post Office Ltd, sub-postmasters, Citizens Advice and the British Bankers' Association.

The DWP pilots were discussed at length with Post Office Ltd before they began. (The Post Office did not raise any objections.) Officials also briefed Colin Baker (the General Secretary of the National Federation of Sub-postmasters) on the pilots before they began.

The Government has listened to what customers, sub-postmasters, Parliament, the banks and other interested parties have been saying about the POCA. And it has now announced that after 2010 it will continue with a new account that will include similar features to the POCA. This will be open to customers on the same basis as the POCA is now.

**Recommendation: The Post Office's customer base, extensive branch network and trusted role in the local community mean that the Post Office can play a lead role in promoting financial inclusion. The Government is not maximising the potential of the Post Office in this area. The loss of the contract for the Post Office Card Account, whether these customers are eventually transferred to basic bank accounts or to an alternative Post Office product, is likely to result in a loss of income to the Post Office. If this income cannot be replaced by alternative services or products, then either Post Offices will close or Government spending on the social network payment will need to increase. This would result in a saving to the DWP but a corresponding increase in expenditure by the DTI. The Government needs to ensure a joined-up approach by the DWP, DTI and the Treasury to funding and providing services through the Post Office network. In view of its overall responsibility for public spending, we think that the Treasury is the appropriate lead department for developing this strategy. We recommend accordingly that the Treasury develop a clear blueprint for the role of the Post Office and financial support for it. The Government also needs to recognise the negative impact that further Post Office closures could have on financial inclusion. (Paragraph 117)**

**Response:** The Government remains committed to the Post Office network and providing services through it and is seeking a joined-up approach across government departments.

The Government has announced it will provide up to £1.7 billion funding to the Post Office to 2011 to support the network and to pay for restructuring to provide a firm basis for the network for the future. The new access criteria will ensure that 99% of the population will be within three miles of a post office. In rural areas, 95% of the total rural population will be within three miles, and 95% of the population in postcode districts within six miles of a Post Office. The government expects as a result of these changes about 2,500 post office branches will close. However, the remaining network of around 12,000 will still have more branches than the entire UK banking network.

The government will continue to allow people to access their state pension and benefits in cash at the Post Office if they choose to do so, and there is a range of accounts which make that possible, including all seventeen basic bank accounts and at least eight current accounts (see table below). The Post Office Ltd has also introduced one new savings account, and is developing other savings and banking products. Post Office Ltd currently allows customers to access their saving account through 55,000 ATMs nationally, and as

part of the restructuring announced in December 2006 it will introduce some additional 4,000 free-to-use ATMs across the network.

Basic Bank Accounts accessible at the Post Office (Source: FSA)	Current Accounts accessible at the Post Office (Source: Treasury Committee Evidence, HC 848–II)
Abbey: Basic Account	Alliance & Leicester
Alliance & Leicester: Basic Cash Account	Bank of Ireland
Bank of Ireland: Basic Cash Account (only available in Northern Ireland and Eire)	Barclays (in England and Wales)
Bank of Scotland: Easycash	Cahoot
Barclays: Cash Card Account	Clydesdale Bank
Clydesdale: Cashmaster	The Co-operative Bank
Co-operative Bank: Cashminder	Nationwide Building Society
First Trust Bank: Basic Bank Account	Lloyds TSB (in England, Wales and Scotland)
Halifax: Easycash	Smile
HSBC: Basic Bank Account	First Direct (Scotland only)
Lloyds TSB: Cash Account	
Nationwide Building Society: Flex Cash Card	
NatWest: Step Account	
Northern Bank: Northern Personal Access	
The Royal Bank of Scotland: Key Account	
Ulster Bank: Basic Bank Account	
Yorkshire Bank: Readycash	

With regards to POCA, in accordance with EU procurement rules there will be a competitive tender process for the replacement account when the current POCA contract ends in 2010. However, Post Office Ltd will be well placed to put in a strong bid given the size of the Post Office network and the access criteria being introduced as part of its restructuring of the network.

**Recommendation:** Universal banking services available through the Post Office are far from universal, with around 60% of current accounts not offering access to cash withdrawals at the Post Office counter. We note that while some banks have problems regarding the cost of such access, which presumably can be overcome through negotiations, for others the main barrier is the fact that the Post Office is a competitor in the sale of financial products. We recommend that the DWP and the Treasury discuss with the banks increasing access to Post Office counter withdrawals and ensure that further progress is made. (Paragraph 121)

**Response:** The Government further notes that, as indicated above, all seventeen basic bank accounts offered in the UK offer Post Office access. However, many customers are not aware that they can use their bank account at the Post Office. DWP is, therefore, working with Post Office Ltd to support it in its efforts to increase awareness of this amongst the 16 million benefit recipients and thus increase its customer base.

As the Committee notes, a number of banks also provide Post Office access for customers of their current or internet banking services. The Government must stress that this is a result of privately and commercially negotiated agreements between the parties involved. While the Government is generally in favour of banks offering their customers as many means as possible to access their accounts, any further negotiations between Post Office Ltd and the banks would be a commercial matter for the parties concerned, and it would not be appropriate for Government to intervene.

## Financial inclusion: the roles of the Government and the FSA, and financial capability (First Report of Session 2006–07, HC 53)

### Financial capability

The Government welcomes the Committee's continuing interest in the Financial Capability agenda and notes the importance of improving levels of capability for the financial inclusion agenda. The Government published its long-term approach to financial capability in January 2007.<sup>9</sup> A 'demand-side' focus on the skills and confidence of consumers complements the Government's established record of 'supply-side' reform—a stronger regulatory framework, the introduction of simplified stakeholder products including the Child Trust Fund, and the FSA's rules on product disclosure and promotion.

The Government's long-term approach will complement and be coordinated with the national strategy for financial capability, led by the FSA.

**Recommendation: Improving financial capability will be a long-term project and we welcome the Government's announcement of a 10 year strategy for financial capability. This must establish a lead Department and improve coordination between the various Government departments involved and consider how much additional Government investment is required. (Paragraph 22)**

**Response:** The Government published its long-term approach to financial capability in January. The Government's approach set out ambitious aspirations for raising financial capability through financial education, widening access to generic financial advice and ensuring that relevant Government programmes and services are focused on supporting capability. This approach complements the work of the Financial Services Authority's national strategy.

As part of its long-term approach, the Government has established a ministerial group on financial capability, chaired by the Economic Secretary of the Treasury. The ministerial group will work across departmental boundaries to develop and coordinate the Government's work on raising financial capability and brings together ministers from the Department for Work and Pensions, the Department for Education and Skills, the Department for Trade and Industry, Communities and Local Government and the Cabinet Office. The group will also work with other Central Government departments and the devolved administrations, and will coordinate with the FSA's national strategy steering group.

**Recommendation: Providing financial education in schools is an essential part of the FSA's National Strategy for Financial Capability. We welcome the change to address financial capability more explicitly in the 14-19 curriculum in England by including it in the new functional mathematics element of GCSE mathematics, although we are concerned that the content of this element will not be sufficiently focused on financial education. In over 70% of schools, personal finance education is only provided in the form of occasional lessons happening once or twice a term or less. It should be a priority for the Department for Education and Skills to ensure that the Qualifications**

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9 [http://www.hm-treasury.gov.uk/documents/financial\\_services/financial\\_capability/fin\\_cap\\_index.cfm](http://www.hm-treasury.gov.uk/documents/financial_services/financial_capability/fin_cap_index.cfm)

and Curriculum Authority and those responsible for delivering the school curriculum see financial education as a core issue. Improving financial education in schools needs to be a major objective of the Government's ten-year strategy for improving financial capability. (Paragraph 36)

**Response:** The Government's long-term aspiration is to ensure that all children and young people have access to a planned and coherent programme of personal finance education, so that they leave school with the skills and the confidence to manage their money well. The long-term approach document and the Qualifications and Curriculum Authority's consultation on its Key stage 3 and 4 review have already begun to put this in place. The 'economic well being' strand of Personal, Social, Health, and Economic education puts financial capability alongside enterprise education, at the heart of the secondary curriculum. Alongside this approach, the Government will look to support provision in primary schools, using the opportunity of the Child Trust Fund to bring financial education to life and take forward this work as part of the financial capability action plan.

### The role of the FSA

**Recommendation:** The FSA, as the statutory regulator for financial services, has an important role to play in promoting financial inclusion. It has been successful in some areas, notably in producing a proportionate regime for the regulation of credit unions and other third sector lenders. In other areas, such as in ensuring that the financially excluded are adequately prioritised within the National Strategy for Financial Capability, there is a need for much further progress. While we do not recommend any changes to the FSA's statutory duties under the Financial Services and Markets Act, we recommend that the FSA make a commitment to take account of the need to promote financial inclusion in all its activities and report annually on how this commitment has influenced its work. The FSA should also commission research into the markets it regulates to determine the extent of any problems of financial exclusion and where it could best focus its resources. The Government should commission the FSA to monitor the extent of financial exclusion. (Paragraph 47)

**Response:** The FSA has a statutory role to secure appropriate consumer protection and to promote public understanding of financial services and products. The Government notes the Committee's recommendation that the Government commission the FSA to monitor the extent of financial exclusion; as the FSA is an independent regulator, the Government is unable to change its remit without legislative amendments.

**Recommendation:** As part of the Government's agenda to promote savings it is vital that people are given confidence that their money will be protected. We note that the Farepak scheme was not regulated by the FSA and is outside the scope of the Financial Services Compensation Scheme. We recommend that as a matter of urgency the Government, in conjunction with the OFT and FSA, consider whether appropriate safeguards are in place to protect those who have entrusted their money to others. This should include examination of whether an expansion of the FSA's regulatory responsibilities is necessary, or whether the appropriate degree of regulation could be accomplished through other mechanisms. The Farepak case has highlighted a serious lack of consumer protection which could have much wider implications for savings products of this kind. Given the level of public concern, we want the Government to

**address this issue with urgency and we want to see evidence of substantial progress by the end of January 2007. (Paragraph 62)**

**Response:** The Government has great sympathy for those people who lost money as a result of the collapse of Farepak. The immediate need was to develop some practical assistance that could be delivered to those affected in time for Christmas. The Government worked closely with the administrators, with the Family Fund charity and with donors of administrative or logistical services. The Family Fund received donations totalling over £7 million to provide a goodwill gesture to those who were so badly affected. Vouchers and Farepak food packages, so far as these were available and deliverable, were sent out to Farepak agents in good time for Christmas. The Government is very grateful for all the donors, of money and services, who made this possible.

It is also important to establish exactly what happened in this case. Given the extent of public concern, it was decided that an investigation should begin straight away, and DTI's Companies Investigation Branch is investigating the circumstances surrounding the collapse of Farepak. Depending on the findings of the investigation, a report may be passed to appropriate regulators or prosecuting authorities.

The administrators will separately report to the Secretary of State for Trade and Industry any findings in respect of misconduct. Their findings will be considered alongside the CIB report. If the Secretary of State concludes that anyone is not a fit person to be a director, he may seek their disqualification for up to fifteen years.

Christmas clubs like Farepak are not providing financial services, because what is purchased is not money but goods or vouchers exchangeable for goods. They are not, therefore, subject to the special regulation which applies to financial services. However, all normal consumer, contract and insolvency legislation will apply. The Minister for Trade, Investment and Foreign Affairs asked the OFT to work with the Financial Services Authority and DTI officials to look at the regulatory framework in which Farepak operated, and consider options to address any issues raised.

The Government's immediate priority is to provide stability and restore consumer confidence in the hamper industry for this year. The DTI has secured agreement from the hamper industry to establish an industry-led scheme to ensure that consumers' interests are fully protected through the establishment of secure, ring-fenced accounts.

Furthermore, the Government also asked Brian Pomeroy, chair of the Financial Inclusion Taskforce, to carry out a review of hamper and other Christmas saving schemes in order to understand why consumers use such schemes instead of mainstream products. The review is published today and makes a number of recommendations to improve the Government's understanding of the informal savings market and to strengthen consumer understanding of the relative risks and benefits of more mainstream Christmas savings products. These include the following recommendations:

- the DTI should urgently ensure that secure arrangements are put in place by hamper scheme companies in order that customers' prepayments are effectively protected;
- the OFT should consider whether there are any competition issues that need to be addressed in the hamper scheme market;

- retailers should consider increasing the attractiveness of their Christmas savings schemes by giving customers greater protection in the event of the loss or theft of cards;
- the Government should encourage providers, particularly the Post Office and the credit unions, to compete in this market and to develop innovative ways of attracting hard-to-reach customers;
- informal savings schemes should be given greater emphasis within the scope of the Government’s financial capability and inclusion work, including the Thoresen review of generic financial advice, the DWP’s “now let’s talk money” initiative and the FSA’s financial capability work;
- in view of the uncertainty that has been caused over Christmas savings schemes, and the risk that this may prevent people who would otherwise have saved for Christmas from doing so, the Government should consider mounting a specific campaign to make consumers aware of their options; and
- the Government and its relevant agencies should ensure they become aware of, and well informed about, all methods of saving, whatever legal form they take, and that they consider them when thinking about risks and consumer protection. The Government should also take steps to improve the data available on the hamper scheme market and other forms of informal saving, possibly through the Family Resources Survey or the new Wealth and Assets Survey.

The Government welcomes the review’s recommendations, and responds to them in detail in *Financial inclusion: the way forward*.

## The role of the Government

**Recommendation:** We welcome the establishment of the £120 million Financial Inclusion Fund as a substantial Government investment. However, evidence we received suggested that, because the Fund’s resources have been administered by several different Government departments, with different portions coming on stream at different times, it has been difficult to join-up provision of affordable credit and money advice services. Given the substantial evidence of the benefits that could be achieved from a joined-up approach to promoting financial inclusion, this is unfortunate. In the future, we believe the Government should ensure that Government money invested in promoting financial inclusion is administered by one department or that the bidding process clearly supports joined-up provision. (Paragraph 74)

**Response:** A number of different departments have an interest in promoting financial inclusion, and the Government believes that that it is appropriate to involve as many parts of Government as necessary in delivery.

At the same time, the Government recognises the importance of co-ordination, which is why the Treasury has overall responsibility for determining financial inclusion priorities, and co-ordinating the delivery of policy through the most appropriate departments. Differential timing of initiatives going live has been a result of differing lead times for the projects, not because of a lack of co-ordination. The Government believes the approach it has taken to promoting financial inclusion has worked well, which is why it has announced

that it will continue with a new Financial Inclusion Fund, co-ordinated by the Treasury, with progress monitored by a continuing Financial Inclusion Taskforce. In addition, a ministerial working group will be established to determine detailed priorities for financial inclusion policy in the period up to the CSR.

**Recommendation:** In addition to supporting existing projects, the Financial Inclusion Fund and future Government investment in promoting financial inclusion should ensure that, in the allocation of funding, appropriate priority is given to localities that currently lack access to affordable credit and debt advice. The allocation should be informed by mapping existing provision of affordable credit and access to money advice, combined with analysis we recommend below aimed at identifying which areas of the country contain concentrated pockets of financial exclusion. (Paragraph 75)

**Response:** As indicated above, the Government has established a ministerial working group to consider next steps for financial inclusion policy, including future support for the provision of affordable credit and money advice. Future prioritisation of Government action will be determined with reference to a range of factors, including the extent to which current coverage of initiatives is adequately targeted on areas, and demographic segments, suffering from high levels of financial exclusion.

**Recommendation:** We recommend that the Treasury conducts analysis to determine which areas of the country and which cities contain concentrated pockets of financial exclusion. The Government should then use this information to target resources at these areas and share this information with the Post Office, advice agencies and other bodies which can help tackle the disadvantage faced by people living in these communities. (Paragraph 78)

**Response:** The Financial Inclusion Taskforce is commissioning research to map the incidence of financial exclusion around the country, alongside geographic mapping of bank branches, Post Offices, credit unions and other financial services outlets. The Government will use this information, where appropriate, in line with its response to the recommendation in paragraph 75.

**Recommendation:** We recommend that the Government and local authorities identify sources of seed funding to enable local communities to prepare business cases and support pilot schemes to bring in the support of mainstream financial institutions and to develop innovative models of delivery of financial services products. (Paragraph 79)

As made clear in the response below, in most cases Local Strategic Partnerships and New Deal for Community Partnerships have allocated some of their neighbourhood renewal funding towards tackling financial exclusion.

**Recommendation:** We recommend that the Department for Communities and Local Government ensure that financial inclusion is appropriately prioritised within the programmes administered by the Neighbourhood Renewal Unit. We welcome the recognition of promoting financial inclusion as an important role for local authorities and its inclusion in the Beacon Scheme. (Paragraph 80)

**Response:** The link between low incomes and social exclusion is well-documented and a driving force behind the National Strategy for Neighbourhood Renewal. Financial inclusion is a high priority within this strategy.

In most cases Local Strategic Partnerships (LSPs) and New Deal for Community Partnerships have allocated some of their neighbourhood renewal funding towards tackling financial exclusion. Examples include the establishment of **credit unions** and **community banks** which provide access to affordable credit and saving opportunities for local residents; **savings and loan schemes** which give people on low incomes easier access to loans—in one example the LSP and RSL has deposited a lump sum with a bank to provide a loan guarantee against which tenants can borrow; **insurance with rent schemes**—some LSPs and RSLs are offering insurance with rent schemes, which do not require individual assessment as they allow risk to be shared; **food and other consumer co-operatives** tackle the problems faced in many low income areas where the costs of basic necessities are inflated, either by local shops needing to charge higher prices or transport costs to cheaper supermarkets. The majority of these projects also work with people to increase their **understanding of financial issues**.

The Government has also incorporated financial inclusion into the Local Authority Beacon Scheme. Awards of beacon status under the theme “Promoting financial inclusion and tackling over-indebtedness” were made on 20 March 2007 to Leeds, Sheffield and South Tyneside .

**Recommendation:** We welcome the action taken in devolved administrations aimed at promoting financial inclusion. Given the evidence that financial inclusion represents a significant challenge in Scotland, Wales and Northern Ireland we expect that the devolved administrations will continue to attach priority to financial inclusion in their spending allocations, develop appropriate longer term strategies and set specific outcome based targets for areas in the sphere of their responsibilities. We recommend that the United Kingdom Government ensure that arrangements to share experiences and best practice for policies aimed at promoting financial inclusion are in place between the devolved administrations and the United Kingdom Government. (Paragraph 83)

**Response:** As indicated above, the Government is establishing a ministerial working group to develop detailed next steps for financial inclusion policy, in line with the principles published in its financial inclusion document. This working group will include input from ministers from the devolved administrations, to ensure that the learning from actions being taken in each country is applied throughout the United Kingdom.

### Scotland

The Scottish Executive continues to take forward activity on financial inclusion as part of its overall strategy to tackle poverty and disadvantage, *Closing the Opportunity Gap*. Under this strategy, eleven areas in Scotland are receiving support from the Scottish Executive Financial Inclusion Fund. Substantial progress has already made, for example, in reducing the proportion of households without a bank or building society account. The Executive will lead a review of its Financial Inclusion Action Plan in 2007. This will involve the other key players, both locally and nationally.

Evaluation of the Scottish Executive's strategy is based on strong outcome-based principles. Each area receiving funding from the Financial Inclusion Fund has agreed a set of outcomes with the Executive, which in turn must align with the Regeneration Outcome Agreements agreed by Community Planning Partnerships as part of the wider Community Regeneration Fund.

## Wales

The Welsh Assembly Government accords a high priority to financial inclusion as parts of its overall efforts to tackle poverty and disadvantage. The approach encompasses both immediate measures and longer-term change through education. The Assembly Government's Review of Over-Indebtedness, published in 2005, includes ten recommendations for specific action.

Financial literacy and education is a high priority, with new components due to be introduced to the secondary school curriculum by September 2008. A new Welsh Centre for Financial Education will support teachers and schools in delivering this.

The Assembly Government is also committed to improving access to debt advice, and has commissioned research on access to existing service provision. Work is also under way considering a referral network which will signpost to local money advice agencies.

The Review of Over-Indebtedness is closely aligned to the Assembly Government's Child Poverty strategy and Communities First, Wales' flagship community regeneration programme targeting the most deprived and isolated communities. Strong links have been forged with a range of partners, including the Wales Centre for Health, National Offenders Management Service, Citizens Advice Cymru, the Welsh Consumer Council, the FSA and the credit union sector. Moving forward, key priorities will be ensuring initiatives cover hard-to-reach groups, and investigating the effects of financial exclusion on health.

The impact of the review will be independently evaluated by a higher educational institution.

## Northern Ireland

The Northern Ireland Government's new anti-poverty and social inclusion strategy, *Lifetime Opportunities*, was launched in November 2006. Its two overall objectives are to:

- work towards eliminating poverty and social exclusion in Northern Ireland by 2020; and
- end child poverty by 2020-based on the estimate of approximately 130,000 children in Northern Ireland in relative income poverty in 1998/99, this means lifting 65,000 children out of poverty by 2010 on the way to eradication by 2020.

*Lifetime Opportunities* specifically highlights the work that is being taken forward to tackle problems associated with financial hardship, through a comprehensive support system for those experiencing consumer indebtedness. This involves the provision of 12 advisors to give face to face debt advice in local advice offices throughout Northern Ireland and will run through to March 2008. It is also proposed to publish a debt advice action plan in March 2007.

The strategy also sets a target to ensure that ‘by 2020, through integrated partnerships, every older person has access to the full range of support services, social networks and cultural and sporting activities available in their area, to ensure they have a satisfactory standard of living and guaranteed financial inclusion’.

Looking ahead, the Northern Ireland Priorities & Budget will be published in draft in the autumn of 2007 for consultation, following the announcement of the UK-wide Comprehensive Spending Review. As part of this process, NI Departments will be invited in the coming months to put forward spending proposals in line with priorities set by Ministers.

**Recommendation:** We welcome the action taken by the Government to promote financial inclusion and the progress that has been made on access to banking services, affordable credit and money advice. Longer term strategic planning and the involvement of all Government departments is vital in promoting financial inclusion. We recommend that, in consultation with key stakeholders and the Financial Inclusion Taskforce, the Government develop a long-term strategy for promoting financial inclusion. This should be published alongside the Comprehensive Spending Review. We recommend the Treasury take the lead in developing this strategy, although it is clear that, in order to be successful, policies aimed at improving financial inclusion will need to be implemented by all Government departments. (Paragraph 87)

**Response:** The Government has now published *Financial inclusion: the way forward*, which sets out the general principles for its developing financial inclusion strategy, including the continuation of the standalone Financial Inclusion Fund, the extension of the Financial Inclusion Taskforce, and an ongoing focus on the priority areas of banking, credit and advice, alongside consideration of insurance and savings.

The Government has also established a ministerial working group drawn from departments with a policy interest in financial inclusion. This group will work over the months, with the Taskforce and with other stakeholders, to develop a detailed next steps for financial inclusion policy. The group will report back after the CSR, once priorities have been agreed, and the amount of the new Financial Inclusion Fund has been determined.

**Recommendation:** Sustained and predictable funding for work aimed at promoting financial inclusion is essential. For example, if long-term funding is not forthcoming then the increase in the availability of debt advice as a result of the money from the Financial Inclusion Fund will not be sustained. It would be a wasted opportunity if the debt advisers with valuable expertise recruited as part of this initiative were made redundant. We welcome the Economic Secretary to the Treasury’s intention that financial inclusion should play an important part in the forthcoming Comprehensive Spending Review. We recommend that the Government initiate a wide-ranging debate about the key priorities for the Spending Review in terms of funding for financial inclusion programmes. This should involve full consultation with front-line professionals in the third sector and with the Financial Inclusion Taskforce (Paragraph 92)

**Response:** The Government has announced its intention to continue with the Financial Inclusion Fund, and to maintain a policy focus on the area of access to free face-to-face

money advice. While specific funding decisions will need to follow the CSR, the Government remains committed to money advice as part of its financial inclusion strategy.

As indicated above, a ministerial working group will, on the basis of the principles published in *Financial inclusion: the way forward*, be carrying out work to determine the detailed next steps for financial inclusion policy, and will consult widely.

**HM Treasury**

**28 March 2007**

## Appendix 2: Financial Services Authority response

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### Introduction

This note is submitted in response to the Committee's Twelfth and Thirteenth Reports of the 2005–06 Session and First Report of the 2006–07 Session on financial inclusion. In our response we refer to the relevant paragraphs in the conclusions and recommendations section of each Report.

### Twelfth Report of Session 2005–06, Financial inclusion: credit, savings, advice and insurance

#### Credit unions and Community Development Finance Institutions (CDFIs) – paragraph 13

We welcome the Committee's recognition of our success in developing a risk-based and proportionate regulatory regime for credit unions. We agree with the Committee that the third sector makes an important contribution to tackling financial exclusion. We are already contributing to the Treasury's review of credit union legislation.

#### Right to Buy lending – paragraph 17

The Committee highlighted evidence from Citizens Advice of abuses in the Right to Buy market and recommended that we view this as a priority area for examination within our mortgage regime.

Whilst the Right to Buy market is diminishing in scale, we recognise that it involves some financially inexperienced and potentially vulnerable customers. However, in our view, many of the issues which may lead to detriment in this area reflect broader concerns which extend beyond the Right to Buy market, such as the quality of financial promotions and firms' assessments of affordability. We therefore believe that they are best dealt with as part of our wider work. For example, our current project on sub-prime mortgages will include an examination of some Right to Buy cases. Should our general investigations bring to light particular problems in the Right to Buy market, we will consider whether further targeted work is appropriate. In the meantime, we will continue our regular dialogue with Citizens Advice and will take into account any intelligence they or others provide of malpractice in our regulated markets.

#### The basic advice regime – paragraph 18

We agree with the Committee that the Basic Advice regime needs to be reviewed. In October 2006 we published a consultation paper announcing our proposal to do this.<sup>10</sup> We have invited interested stakeholders to work with us in developing and formulating the remit of the Review. In the light of this Review we will decide what is the appropriate regulatory response, which should be proportionate for firms and should help ensure a fair deal for consumers.

We will announce the timetable for this review when we have examined responses to our consultation, which closes on 23 February. We will keep the Committee informed of progress.

### **Generic financial advice – paragraph 30**

The Committee called for further FSA work on defining generic advice—in particular, making clear how it differs from product-related advice—and on the accreditation of generic financial advisers.

Our August 2005 document *Financial Capability: developing the role of generic financial advice*, drawn up as part of the National Strategy for Financial Capability included the following definition:

*“Generic financial advice is a set of services and tools that use information about individuals’ circumstances to help them identify and understand their financial position and their needs and to plan their finances accordingly. Generic financial advice helps consumers identify:*

- Their current financial position and therefore the choices and possible priorities for action appropriate to their needs;
- How to take the next steps in addressing their priorities; and
- How to access other relevant sources of information and advice.”

In 2005/06 we worked with the Financial Services Skills Council and others to develop National Occupational Standards for Generic Financial Advice. These standards establish a set of core skills and competencies for those who engage in this activity, whether in the commercial or not-for-profit sector. They are intended to be the basis on which training for generic financial advice can be developed.

In January 2007 the Treasury published the Government’s Long-Term Approach to Financial Capability. This complements the FSA-led National Strategy for Financial Capability. The Treasury has announced the establishment of an independent feasibility study, led by Otto Thoresen, Chief Executive of AEGON UK, to research and design a national generic advice service. We will work closely with Mr Thoresen’s team and, as part of this, will examine how best to communicate effectively a clear definition of generic financial advice.

We will announce the second round of our Financial Capability Innovation Fund awards in March. We intend to use this opportunity to expand the range of partners with whom we work to provide straightforward money advice to further groups of consumers in priority need (such as the elderly, lone parents and those in social housing). We already provide basic information and signposting on our consumer website—[www.moneymadeclear.fsa.gov.uk](http://www.moneymadeclear.fsa.gov.uk)—and through other parts of the National Strategy, such as our ‘Make the Most of your Money’ initiatives in the workplace.

## **Thirteenth Report of Session 2005–06, “Banking the unbanked”: banking services, the Post Office Card Account, and financial inclusion**

### **Opening basic bank accounts – paragraph 10**

The Committee recommended that we monitor the implementation of the revised Joint Money Laundering Steering Group (JMLSG) Guidance and produce a report in the first half of 2007 on the variety of approaches taken by the banks, including an assessment of whether these have led to improvement.

As part of our programme of work on reducing financial crime, we conduct thematic work to assess money laundering and fraud risk. As part of this we will assess how the industry has implemented our new rules and the new JMLSG guidance and will give feedback. This review will involve visits to different types and sizes of firm across the financial services industry. In the course of this review we will assess whether firms have chosen to make use of the new opportunities to simplify identification requirements, in accordance with the new JMLSG Guidance. The timescale for completion of the review will depend on our early findings, which we expect will highlight areas for further work. When we have reviewed our early findings, we will consider if we can produce an earlier interim report addressing the issue of opening basic bank accounts.

The Committee also recommended that we take action if the procedures or practices of individual banks at branch level unreasonably deny access to basic bank accounts to those who cannot reasonably be expected to produce particular documentation as evidence of identity.

Our rules in this area are designed to reduce the capacity of banks and other financial services firms to be used for a purpose connected with financial crime. The Handbook text quoted in paragraph 43 of the Report is in fact Guidance, not a Rule.<sup>11</sup> Firms may take this guidance into account in deciding how to meet the requirements of our rules which require them to have effective systems and controls for countering the risk of financial crime. If a firm does not follow this Guidance, we would expect it to explain how it is complying with our rules.

More generally, we require firms to establish and maintain systems and controls appropriate to their business. Two of our Principles for Businesses are particularly relevant here: Principle 6 requires a firm ‘to pay due regard to the interests of its customers and treat them fairly’ and Principle 5 requires firms to ‘observe proper standards of market conduct’.

In this and other aspects of our work we take a risk-based approach, taking into account the likelihood of consumer detriment. Where we judge that, as a result of a bank’s non-compliance, there is a material risk of consumer detriment, we have a number of options, ranging from informal discussion, remedial action plans and private warnings, to public enforcement action such as fines, public censure and withdrawal of authorisation.

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<sup>11</sup> The Select Committee Report says that “The FSA rules require ‘appropriate measures to ensure that procedures for identification of new customers do not unreasonably deny access to its services to potential customers who cannot reasonably be expected to produce detailed evidence of identity’.” This text is from SYSC 3.2.6G G (5).

We are encouraging banks, for example through two open letters we have written to the Chairman of the JMLSG, to take account of the increased flexibility on identification processes. We will continue to highlight this issue in our communications with the industry.

### **Wider banking issues: Remittances – paragraph 33**

The Committee highlighted the important role which small money transmitters play in addressing financial exclusion for communities that may not engage with the mainstream financial services sector. It noted that a lack of coordination in the current regulatory regime is hindering the ability of small money transfer businesses to obtain business banking services and recommends that we and Treasury resolve this issue in consultation with other relevant organisations.

The decision whether a bank offers banking facilities to a money transfer business is a commercial one for it and not for the FSA. We believe the issues raised by the Committee on this point are best dealt with in the Treasury's review of the regulation of Money Service Businesses. We will continue to contribute to Treasury-led discussions on these issues, involving the UK Money Transmitters Association, the British Bankers' Association, the Department for International Development (DFID) and Her Majesty's Revenue and Customs (HMRC).

## **First Report of Session 2006–07, Financial inclusion: the roles of the Government and the FSA, and financial capability**

### **The FSA's National Strategy for Financial Capability – paragraphs 1–2**

The Committee expresses concern that our National Strategy for Financial Capability does not adequately address the needs of the financially excluded. Our Strategy aims to increase the financial capability of the UK population as a whole; we have already set ambitious targets to achieve this in all areas of our programme. For example, over the next five years we aim to reach 1.8 million children in 4,000 of the 6,000 schools in England, around 2 million young students in higher education, around 1m people not in education, employment or training, 4 million employees in their workplace, and 1.5 million new or prospective parents. Through this work we will reach many people who are financially excluded.

In addition, over the last two years we have been working with the Financial Inclusion Taskforce (FATF) in order to coordinate our respective activities. The FSA is now represented on the Advisory Group of 'Let's Talk Money' established by the FATF.

The Committee expresses concern about the progress we have made in identifying and drawing in extra funding for financial capability work and developing a wider funding strategy. As announced in our Business Plan published recently, in 2007/08 we will spend £17.1m on financial capability, a level which will need to be maintained over the course of many years if the necessary step change is to be delivered. This compares to a spend of £3.6m in 2004/05. This increased budget has been allocated to specific and measurable activities (as set out in *Financial Capability in the UK: Delivering Change*, which we

published in March 2006), in areas where the FSA’s intervention can make a real difference.

Many others are contributing additional resources in a variety of different ways, such as providing secondees to work on the Strategy, extra funding for specific projects or leveraging off our initial funding or resources by investing teachers’ time, allowing employees to attend seminars in work time, providing presenters, hosting our tools on their websites and allowing intermediaries such as university welfare staff to put into practice their newly acquired skills in the area of financial capability. However, the overall responsibility for literate and numerate adults lies with government and we welcome the Government’s recent launch of its long-term approach to financial capability.

### **Simplicity and clarity in marketing materials and communications – paragraph 5**

We agree that work on promoting financial capability needs to be complemented by efforts on the part of the financial services industry to make their marketing and other material clear for consumers. The Committee recommended that we attach greater priority to our work to simplify the disclosure regime and to ensure that financial services companies provide consumers with simple and clear information. It further recommended that the concept of summary boxes, giving clear and succinct information, should be expanded to more financial services products.

We remain committed to ensuring that consumers receive sufficient information to enable them to make informed decisions about whether or not to buy investment products and to promote competition by making it easy for consumers to compare products. We have recently reviewed our point-of-sale disclosure requirements and we have identified a number of areas where improvements can be made.

As part of this review we tested a number of different approaches to conveying key information, including a ‘Quick Guide’ approach consistent with the Committee’s ‘summary box’ concept. Despite extensive consumer testing, we have been unable to demonstrate sufficient benefits, in terms of improved consumer understanding or changed behaviour, beyond what can be achieved by the current documents to justify significant changes. We have concluded that much more can be achieved through improving the quality and user-friendliness of Key Features Documents (KFDs). This is consistent with our general move to a more principles-based approach to regulation.

We also set out specific proposals designed to improve the overall quality of KFDs:

- ii. reducing the overall number of disclosure documents that we require (we propose reducing the number of documents required from eleven to a possible five);
- iii. including a regulatory message, a prompt to help consumers recognise the importance of these documents and to make them aware that they should read them;
- iv. using our Financial Capability work to encourage consumers to read these
- v. documents; and
- vi. introducing a ‘Keyfacts’ logo to improve the prominence of these documents.

We will pursue these aims through our supervisory work, through engagement with trade associations and through a thematic project similar to the work recently carried out on improving the standards of mortgage KFDs. We will establish our baseline in Q2 this year. Following that, we intend to publish examples of good practice and, after the new rules are in force, we will follow this up to assess what improvements have been made.

In October 2006 we published a Consultation Paper which proposed simplified rules to allow greater flexibility for firms in tailoring these documents to the needs of their customers. It also proposed a requirement for firms to explain the nature and risks of any investment in sufficient detail to enable consumers to make informed investment decisions.

### **The role of the FSA – paragraphs 7–10**

The Committee recommended that we should make a commitment to take account of the need to promote financial inclusion in all our activities and report annually on how this commitment has influenced our work. Our Annual Report to the Chancellor, laid before Parliament and published in June each year, sets out our key achievements in pursuit of all our statutory objectives. We will consider how that Report could report more explicitly on the work we have done on financial inclusion. In this context we bear in mind that the legislation which established us has not given us a specific responsibility to promote financial inclusion.

The Committee also recommended that, in policymaking, our cost-benefit analyses should examine the benefits of financial inclusion and the costs of financial exclusion. To the extent that regulation may raise a firm's costs and hence affect the price of financial products, financial exclusion could indeed be affected. Regulation could also lower the price of some products, for example by encouraging greater competition, and lead to enhanced financial inclusion. Our methodology for cost-benefit analysis considers explicitly the impacts of regulation on the costs faced by firms and on the quantity, quality and variety of products offered and sold. In practice, our experience is that policy proposals subject to our statutory cost-benefit analysis impose additional costs that are only a very small proportion of firms' total costs. Moreover, the impacts of the proposed rules or sets of rules are typically spread across a number of economic markets, so the effect on the cost of specific products or services may be even more limited, although we are always vigilant to identify exceptions.

The Committee also recommended that we should commission research into the markets we regulate to determine the extent of any problems of financial exclusion and where we could best focus our resources. As a risk-based regulator, we focus our research activity on those areas that have the greatest potential impact on our statutory objectives. Financial inclusion was addressed by our Financial Capability Survey, carried out in 2005; it highlighted, among other things, the problem of indebtedness and the lack of financial capability among certain groups, particularly those who do not have a current account. As outlined above, our financial capability work programme will target financial exclusion in a number of areas, including services offered to young adults and to children through the school curriculum. We plan to repeat the financial capability survey every 4–5 years.

We have also undertaken and published research which evaluated the effectiveness of our Basic Bank Account leaflet. In addition, we work with a range of organisations whose research informs our work on financial inclusion. For example, the Financial Inclusion Taskforce seeks to monitor progress in tackling financial exclusion. This includes monitoring the provision of banking services to the financially excluded, the provision of affordable credit by third sector institutions and the provision of free face-to-face money advice.

The Committee noted our Treating Customers Fairly (TCF) initiative and recommended that this initiative encourage firms to improve access to, and develop products which meet the needs of, financially excluded consumers.

Taken together, our TCF and financial capability programmes may deliver improvements to financial inclusion. For example, as firms fulfil their obligation to design products to meet the needs of identified consumer groups, we may witness product innovation to meet the demands of the financially excluded. More confident and capable consumers from all sectors of society should, in the longer term, be better equipped to make informed financial decisions and participate in the marketplace.

The Committee recommended that through the TCF initiative, the FSA should encourage firms to develop products for financially excluded customers. We do not believe that it is an appropriate role for the regulator to encourage or require firms to offer particular products; that is a commercial decision for them to take. Whatever business firms decide to do, we expect them to treat their customers fairly when designing, targeting and marketing products.

**22 February 2007**

## Appendix 3: Banking Code Standards Board response

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The Banking Code Standards Board has reviewed the recommendations contained in the Committee's Report on "Banking the unbanked" insofar as they relate to the content of the Banking Code and its monitoring and enforcement procedures.

Let me confirm at the outset that the BCSB wholeheartedly supports your Committee's objective of reducing the number of individuals without access to a bank account. Basic Bank Accounts have an important role to play in financial inclusion and where they form a part of the product range of a Code subscriber and they are suitable, they should be available without obstruction or any dissuasion on the part of frontline staff. We note with concern the Committee's comment that there is evidence to suggest that people are still experiencing difficulties in opening a basic bank account, albeit reflecting branch decisions and attitude rather than head office policies.

The BCSB has a number of approaches to the monitoring of compliance with the Code. These range from full reviews of subscribers to the Code, themed reviews, to surveys, mystery shopping and intelligence gathered from a range of sources including our own helpline, FOS, consumer bodies and the media. Where breaches are identified we require action plans from subscribers to address the shortcomings and these are monitored by the BCSB for completion. Disciplinary action is taken over the most serious breaches.

Although we are in no way complacent, we are pleased to note that there has been a general improvement in performance by the basic bank account providers over the period that we have been undertaking mystery shopping and we feel that the fact that this has been achieved without the need for naming and shaming individual subscribers is positive. However compliance with the Code in this area remains a key area of our focus and we have further mystery shopping planned for early in 2007. I can assure you that the Code is respected and taken seriously by the senior management of subscribers.

As the Committee is aware, the Codes are reviewed every three years and the latest review commenced on 13 November. Mike Young, who has been appointed as the independent reviewer, has written to stakeholders seeking views on changes required to the Codes and we will be ensuring the Committee's recommendations are brought to his attention. A new edition of the Code is expected to become effective in March 2008 although certain changes, for instance the recommendations of the Payments System Taskforce on cheque clearing times (your recommendation 23), will come into operation before then.

Although the content of the Code and the accompanying Guidance are the responsibility of the sponsoring organisations in line with the principles of self-regulation, the BCSB has considerable input to and influence over both of these, and has responsibility for enforcement. The independent directors of the BCSB will be making a submission to the review and I comment below on those of the Committee's recommendations that we will be supporting. We do believe however that some of the recommendations are of a commercial or product design nature which would normally fall outside the scope of the Code and it is more appropriate that the providers of the products respond to these.

A number of the Committee's recommendations are, we believe, already covered in the Code. These are:

**(Recommendation 9). Banks should have lists of acceptable ID to ensure staff are able to guide applicants.**

As noted by the Committee, there is already a requirement in the Code to tell customers what information they need to provide to prove their identity and this will be tested in the proposed mystery shopping (see below). Banks may also in appropriate circumstances make reference to the BBA/BSA publication "Proving Your Identity", covering this.

**(Recommendation 14). Verification of identity documents to take place at branch level rather than applicants being required to send documents away to a central point. Additionally there should be a maximum time of 10 days for the account to become operational after the customer has provided appropriate identification.**

This has been incorporated into the Guidance and became effective on 30 September.

**(Recommendation 16). The Banking Code to be amended to require all banks to display their basic bank account literature in branches.**

Guidance which became effective on 31 October 2006 states that "subscribers who provide front of house literature for their current account range should ensure that such literature includes reference to the availability of the subscriber's basic bank accounts....".

**(Recommendation 17). The BCSB to investigate the extent and form of dissuasion of financially excluded people from opening basic bank accounts and to take action against those found to be dissuading consumers.**

Dissuasion would be in breach of section 3.1 of the Code where there is a requirement to offer a basic bank account if requested and it meets the need. Monitoring of this will be incorporated into the planned mystery shopping.

In their submission to the Code review, the independent directors of the BCSB will also be supporting the following recommendations:

**(Recommendation 13). Code to require that where applicants are declined, an explanation should be given together with what steps need to be taken to allow the application to be accepted.**

**(Recommendation 15). As basic bank accounts do not offer any credit, banks should not undertake credit reference checks—as opposed to electronic identity checks.**

**(Recommendation 15). The Banking Code should be amended to ensure that basic bank accounts are not unreasonably denied to those with debt problems, although we note that according to the FSA guide on basic bank accounts, only 2 of the 17 providers are shown as indicating that they will reject applications from those with bad debts.**

**(Recommendation 24). Banks Should not exercise their right of set-off from basic bank accounts where a repayment plan has been agreed and in all cases banks should leave consumers with sufficient money for day-to-day expenses.**

Although already covered by section 14 of the Code we feel the Guidance could be strengthened to cover the need to ensure adequate funds for reasonable living expenses.

The recommendation goes on to say that the ability of the banks to exercise a right of set-off needs to be made clearer to consumers in the literature issued or when accounts are opened. This will be recommended for inclusion in the Code.

As mentioned above, we feel that several of the recommendations fall outside the scope of the Code as they are commercial or product design issues and these should be responded to separately by the industry. These are:

**(Recommendation 15). All banks should review their policies where they deny an account to an undischarged bankrupt.**

**(Recommendation 20). All basic bank accounts should incorporate a £10 'buffer zone'.**

**(Recommendation 22). T & Cs of basic bank accounts to be amended to provide branch counter access.**

The Report also recommends that the BCSB conduct research as a high priority into the experience of consumers operating basic bank accounts. (Recommendation 26). We understand that the Financial Inclusion Taskforce has already commissioned BMRB to undertake such research.

I would now like to turn to Recommendation 7 relating to the Committee's wish to see the banks identified in the publication of the full results of the BCSB's next mystery shopping exercise on the provision of basic bank accounts.

As we explained when we gave evidence to the Committee, our rules do not permit us to disclose the results of our monitoring activity unless disciplinary action results and we do not intend to change these rules. However, in the light of the indications given to the Committee by the Chief Executives of the largest providers and your desire to see publication of the results, the BCSB has written to the Chief Executives of all those firms which provide basic bank accounts advising them of our intention to undertake a further mystery shopping exercise in Q1 of 2007. We have advised them that we will be undertaking an exercise of sufficient scale to allow them to disclose the results and confirmed that we are happy for them to do so. The research will be undertaken on behalf of the BCSB and will be independently conducted. I believe that voluntary disclosure by the individual banks will enable the objectives of the Committee to be met.

Finally, we note the Committee's comments on wider banking issues and you might like to be aware that the BCSB has recently agreed that Credit Unions who offer current accounts may become subscribers to the Banking Code. We are currently in discussions with ABCUL and hope that the first Credit Union will become a subscriber in the coming months.

I said at the outset that the BCSB supports fully the moves to achieve financial inclusion and we would very much welcome an opportunity to meet with you and some of your Committee.

**17 January 2007**