IN BRIEF:
FINANCIAL INCLUSION & FINANCIAL CAPABILITY EXPLAINED

Financial services play a key role in most people's lives. The vast majority rely on bank accounts to pay their bills and receive their salaries or benefits. Products such as mortgages enable them to purchase their homes and pensions and savings enable them to save for the future and plan for unexpected expenses. This makes the ability to make sound financial decisions an essential life skill, one that enables people to manage their day-to-day expenditure, cope with unforeseen emergencies and plan for their retirement. Such skills are becoming even more important as the financial services market becomes more complex. Yet many people lack both the access to basic financial products and services, and the essential skills to manage their finances. This is often at a great cost to their financial well-being and the wider **financial health** of the nation. Having access to such products is termed **financial inclusion** and not having access is termed **financial exclusion**. Having the knowledge, confidence and skills to manage your finances is referred to as **financial capability**.

Key Facts

- Approximately 1.5 million adults do not have access to a transactional (current or basic, not savings) bank account[1]
- 7.8 million people in the UK are unable to access mainstream credit[2]
- In a recent poll by the Resolution Foundation, 45% of respondent reported that they had had to make cutbacks on saving as a result of the recession, leaving them vulnerable to drops in income or unexpected expenditure[3]
- Total consumer debt in the UK stood at £232 billion at the end of February 2009, with the average household debt standing at £9,500 (excluding mortgages)[4]
- It has been estimated that people on low incomes pay a 'poverty premium' of around £1,000 a year in accessing basic financial services and utilities[5]
- In a recent poll by the Resolution Foundation, only 43% of respondents had made provision for a drop in income while 51% or respondents had not[6]
- Half of the poorest households do not have home contents insurance, this is more than twice the rate for households with average incomes[7]
- If seeking general financial advice, 45% of respondents say they would go to friends or family, while 29% would go to their bank or building society and 20% would go to an Independent Financial Advisor[8]

What do we mean by financial inclusion?

There is no one authoritative definition of financial inclusion, but many useful definitions exist. Transact defines **financial inclusion** in the following way:

A state in which all people have access to appropriate, desired financial products and services in order to manage their money effectively. It is achieved by financial literacy and financial capability on the part of the consumer and access on the part of financial product, services and advice suppliers[9]

Transact defines '**financial exclusion**', the opposite to financial inclusion, as: *a state where individuals cannot access the financial products and services that they need*[10]

People experiencing financial exclusion typically exhibit one or more of the following characteristics:

- A lack of key financial products such as a bank account, insurance, savings products and pensions and the financial services that come with them
- A reliance on alternative forms of credit such as doorstep lenders and pawnbrokers

Traditionally, the government has defined the field of financial inclusion and led the way through various initiatives. This has been done in partnership with charities and in particular, charities providing debt advice. Charities have and always will play a key role as they often work directly with people experiencing financial exclusion. The other party that is key to furthering financial inclusion is the financial services. Targeted product development, specialist training of staff and partnership with client facing organisation are just a few of the ways that the financial services work to increase inclusion.

Who typically experiences financial exclusion in the UK?

Financial exclusion can be the result of a number of factors. These include but are not limited to: financial products that do not meet the needs of low income consumers, high interest rates and other charges, lack of information, self-exclusion, disability, geographical factors and cultural barriers. However, it is most closely associated with poverty and low income:

Key Facts

- Around two-thirds of households with no bank account have an annual income of under £14,500[11]
- 7% of those with weekly incomes below £100 do not have a bank account, compared with 2 per cent of those with incomes of £400-£500[12]
- People on benefits borrow an estimated £330 million a year on home credit, paying £140 million in interest[13]

Financial exclusion tends to be concentrated among certain groups of people:

Key Facts

- More than one in ten lone parents do not have a bank account (are unbanked), which is over double the average[14]
- A fifth of the unbanked are lone parents, roughly double the proportion among the population as a whole[15]
- Around 60% of unbanked households rent accommodation from a local authority or housing association[16]

It also tends to be geographically focused, with large numbers of financially excluded people living in areas of high deprivation, which often means they also lack access to other key services. The highest concentrations of financially excluded people are found in parts of East and South East London, Middlesbrough, Manchester, Bradford, Birmingham, Glasgow and Liverpool.

However, financial exclusion does not always just affect the poorest. For example, the 2009 recession created an environment in which credit tightened and fewer products became available on the market. Such a change creates a shift in who is affected. The Consumer Credit Counselling Service (CCCS) for example, found that debt problems have spread to the more affluent: 12 per cent of those seeking help have net household incomes of more than £30,000 a year and nearly half (47.4%) of those seeking help were homeowners.[17]

The costs of financial exclusion

Financial exclusion is closely associated with poverty and social exclusion and imposes significant costs on individuals. Those who are unable to access basic financial services often pay more to manage their money, find it difficult to plan for the future, and are more likely to become over-indebted.

In the words of the Treasury Select Committee:

Too many people cannot gain access to appropriate financial products and services at present: they struggle to obtain affordable credit or helpful financial advice and face barriers in opening and operating bank accounts. Financial exclusion blights the lives of many millions of people; it increases the costs they bear for basic services; it makes them vulnerable to illegal or high cost lending; it reinforces social exclusion.[18]

Some examples of the costs of financial exclusion are:

- People without direct debit facilities pay an extra £70 a year for their energy bills[19]
- The average APR charged by home credit providers is 177%, while loan sharks can charge over 1,000 per cent[20]
- Those without bank accounts incur fees, often of 10% or more, for cashing cheques.
- A quarter of all withdrawals from fee-charging ATMs are for £20 or less and the average charge for a withdrawal is £1.50[21]
- Having a bank account is also a pre-requisite for many jobs, so people without a bank account can also be excluded from employment

Financial exclusion also impacts heavily on individual financial health as well as the wider financial health of the UK. In Short Changed, New Philanthropy Capital writes:

Financial exclusion hurts individuals, disrupts families and burdens society. It makes living on a low income more expensive, unstable and stressful than it otherwise would be, and acts as a barrier to personal development and economic progress.[22]

What do we mean by financial capability?

The term 'financial capability' has emerged relatively recently. For many years, policy-makers referred to 'financial literacy', which the National Foundation for Educational Research defined as 'the ability to make informed judgements and take effective decisions regarding the use and management of money'. More recent thinking has emphasised people's ability to choose and utilise financial products, as well as their understanding of financial issues. This wider concept of financial capability was defined by the Treasury in 2007 as:

"…a broad concept, encompassing people's knowledge and skills to understand their own financial circumstances, along with the motivation to take action. Financially capable consumers plan ahead, find and use information, know when to seek advice and can understand and act on this advice, leading to greater participation in the financial services market."[23]

The Financial Services Authority (FSA) identifies five key areas of financial capability:[24]

1. Being able to manage money
2. Keeping track of finances
3. Planning ahead
4. Choosing financial products
5. Staying informed about financial matters

These five areas formed the basis for the Baseline Survey, a national survey of over 5,000 people published by the FSA in 2006. The survey was commissioned from the Personal Finance Research Centre at Bristol University and was the largest of its kind ever undertaken. The findings from the survey led the FSA to express serious concerns about current levels of financial capability and identify 'a clear need for the FSA and others to take action, particularly to help people plan ahead more effectively and make better product choices.'

It is important to note that some agencies (such as Toynbee Hall) view financial capability as part of financial inclusion while others (such as HM Treasury) view the two as separate but related areas.

Financial Product Holding

Consumers have access to an ever-increasing choice of financial products. At the time of the baseline survey, 98 per cent of people held at least one type of financial product:

- 89% of people had a current account
- 69% had a savings account, while 46% held at least one type of investment product
- 67% of people had some kind of unsecured credit product, with 56 per cent possessing credit cards
- 66% of people had contents insurance, 56% had buildings insurance and 61 per cent had motor insurance
- 47% had life assurance, while only 18% had income protection insurance[25]

The Resolution Foundation's research shows that although people on low to moderate incomes tend to have the basic financial products they need, they are much less likely than those on higher incomes to be saving for their retirement or to have life assurance or income protection products.

- Nearly one-third of low earners have no savings and a further 26% have less than £1,500 saved[26]
- Only 53% of people on low to moderate incomes are members of an available employer's pensions scheme compared to 81 per cent of those on high incomes[27]
- 48% of low earners aged over 40 say they "worry a lot" about not having enough income in retirement, compared to 33% of the over-40 population as a whole[28]
- Only 40% of low earners have life insurance compared to 58% of higher earners. Less than half as many have income protection products[29]
- Low earners are much less likely than high earners to purchase payment protection, income protection, critical illness and life insurance. This means that they are more exposed to changes in circumstances[30]

The benefits of financial capability

People can find the financial services very difficult to navigate. As Ed Balls MP said:

'Financial decisions are difficult. Financial products are complicated and there can be too much jargon. This puts people off, or they can end up buying something that is not right for them. Sometimes people just want to discuss their financial options and not buy anything'[31]

For the consumer, improved financial capability leads to better product choices, saving them money in the short term and, in the long term, offering the opportunity to improve their income in retirement. By enabling them to purchase products that are appropriate to their needs, it reduces the likelihood that they will fall into debt, minimises the stress and anxiety associated with financial problems and ensures that they have the means to cope with unexpected events.

- Research by the FSA showed that the typical consumer can save between £70 and £710 a year by making better financial product choices[32]
- The Resolution Foundation's research showed that increased access to financial advice could boost retirement income among low to moderate earners by up to £1,500 a year[33]
- 48% of clients of a national credit counselling service in the United States reported that their health improved after they received financial counselling[34]

Improved financial capability has wider benefits for society and the UK as a whole. It would mean significant benefits to the State by helping to promote personal responsibility reduce welfare dependency and support policies to promote financial inclusion, reduce overindebtedness and encourage people to save for their retirement.

- With over 7 million people currently under-saving for retirement, financial capability has a crucial role in supporting the Government's pension reforms[35]
- Evidence from the United States suggests that receiving financial education as a child can result in people being up to £32,000 better off between the ages of 35-49
- The Resolution Foundation identified potential savings of up to £100 million a year within 10 years of establishing a generic financial advice resource, as better financial decision-making lifts people clear of the threshold for receiving Pension Credit

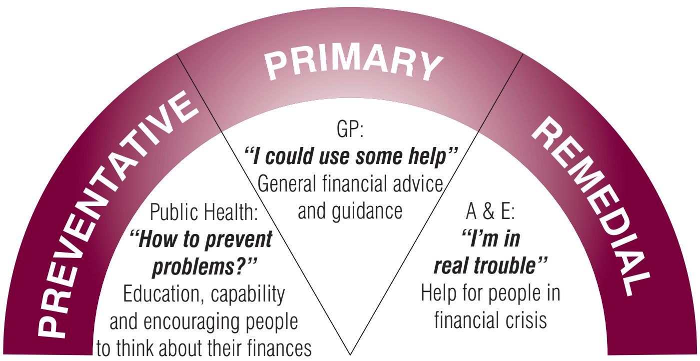
What do we mean by financial health?

Financial health is a newer concept developed by the Resolution Foundation that describes the financial well-being of an individual or society as a whole. Good financial health depends on positive financial choices as well as the absence of financial difficulty. It is influenced by such factors as environment, lifestyle, availability of financial services and personal choice. The term financial health can refer to the financial health of an individual (as regards product holding, debt management, saving for the future, etc.) as well as the health of society as a whole (as regards national levels of personal debt, provision of financial advice, saving habits of the nation, etc.).

In much the same way as health in general, financial health can fluctuate over time and is not a static condition. A person is not necessarily in a state of 'good' or 'bad' financial health 100% of the time; their level of financial health and their needs can change according to life circumstances and priorities. Because of this, it's useful to draw comparisons between a health model and our model of financial health. This can be broken up into three areas:

1. ***Preventative***: taking steps to educate yourself about money, budgeting and saving for the future
2. ***Primary***: recognising that you may need help in some areas, for example, if you feel your bank account isn't the right one for you, or you're not sure where you can access credit
3. ***Remedial***: recognising that your money troubles have become unmanageable and seeking help

Figure 1: Financial Health Framework



Going forward

In the words of Kitty Ussher MP, former Economic Secretary to the Treasury:

"This Government is committed to ensuring that at every age people have the education, support and skills they need to make the right money choices, plan for their future and provide financial security for their families."[37]

As part of their on-going commitment to financial inclusion and financial capability, the Government launched their new money guidance service 'Moneymadeclear' in April 2009. The service is being piloted in the North East and North West of England, and the 2009 Budget announced that a national roll-out is planned for 2010. 'Moneymadeclear' will be key to improving the levels of financial capability in the UK, by aiming to change the way people engage with, and manage their financial affairs. The service is available via the web, telephone and face-to-face and covers areas such as budgeting, weekly or monthly spending, saving and borrowing, insuring and protecting people and their families, retirement planning, understanding tax and welfare benefits and jargon-busting.

There are many other initiatives promoting financial inclusion and financial capability that are led by different Government departments and other key stakeholders. Below is a summary of the key players and some of the major initiatives currently underway.

Key Players

Third Sector

The third sector has been invaluable in driving the areas of financial inclusion and financial capability forward. Many third sector organisations also work directly with individuals experiencing financial exclusion which makes their knowledge and their contribution to the sector all the more important.

Financial Services

The financial services play an important role in financial inclusion and capability by taking steps to understand their customers and their needs.

HM Treasury

The Treasury sets the Governments' financial and economic policy and determines budgets for other government departments. The Treasury also lead the government strategy for financial inclusion. They work with key stakeholders from the financial services industry, the third sector, and elsewhere to deliver strategic policy objectives.[38] The Government's key goals in this area are to enable people to manage their money on a day-to-day basis, plan for the future and cope with financial pressure, and to deal effectively with financial distress. Some key publications produced by the Treasury are: *'Promoting financial inclusion'*[39], *'Financial Inclusion: the way forward'*[40], *'Financial Capability: the Government's long-term approach'*[41], *'Helping you make the most of your money: a joint action plan for financial capability'*[42]

FSA

The FSA is an independent, non-government body that has the legal powers to regulate the financial services industry. The FSA leads the national strategy for financial capability and is involved in a range of financial capability projects, including 'Moneymadeclear'. Please see http://www.fsa.gov.uk/financial_capability/index.shtml for more information about the FSA's financial capability work.

Financial Inclusion Taskforce

The Financial Inclusion Taskforce advises government on financial inclusion issues at a strategic level. There are currently 15 people on the Taskforce from the financial services industry, the voluntary sector and academia. The Taskforce was established by the Treasury. To see a full list of the Taskforce's research and to find out more information, please see http://www.financialinclusion-taskforce.org.uk.

Department for Work and Pensions

The DWP manages the welfare benefits system and aims to help people into employment and 'end poverty in all its forms'. The DWP is leading the Financial Inclusion Champions Initiative (see below) and the Growth Fund. In 2007 it ran the 'now let's talk money' Campaign (see below).

Important Initiatives

Savings Gateways

The Savings Gateway is a savings account where the government puts in 50p for every £1 saved up to a limit of £25 per month. The Gateway is set to be launched in 2010 and is available to people on the lowest incomes, both in and out of work. For the latest information and to see who qualifies, please see http://www.direct.gov.uk/en/MoneyTaxAndBenefits/ManagingMoney/SavingsAndInvestments/DG_10010450.

'Moneymadeclear'

'Moneymadeclear' is the name of the money guidance pathfinder launched in April 2009. The pathfinder is a pilot taking place in the North East and North West of England and full national roll-out is planned for 2010. Please see http://www.moneymadeclear.fsa.gov.uk to find out more about the services available through 'Moneymadeclear'.

The Growth Fund

The Growth Fund was originally established in 2004 as a fund of £36 million to increase the availability of affordable personal loans through the third-sector (not-for-profit) lenders such as credit unions and community development finance institutions. Following subsequent investment, the Growth Fund now stands at £80 million. For more information on the Growth Fund, please see http://www.dwp.gov.uk/advisers/growthfund.

Save Xmas Campaign

Following the collapse of the Farepak hamper company in 2006, the OFT was asked by the Treasury to carry out an awareness campaign to help consumers understand their options when saving for Christmas. The campaign is called 'Save Xmas' and was launched on 1 June 2007. It works through organisations delivering financial advice, principally Citizens Advice, with support from Transact. The aim of the campaign is to give consumers the information they need to make the right decision for their personal circumstances. For more information and to see what progress the Campaign is making, please see http://www.oft.gov.uk/news/campaigns/savexmas.

Financial Inclusion Champions

The Financial Inclusion Champions scheme is a continuation of the 'now let's talk money' Campaign run by the Department for Work and Pensions. The Champions cover geographical areas in the UK and there are also thematic Champions for Housing, Rural Areas and Home Contents Insurance. The Champions work across their areas to build and coordinate partnerships to promote financial inclusion. In particular they aim to stimulate the demand for, and increase the supply of, basic financial services for those experiencing financial exclusion.

For more information on Government initiatives and financial inclusion and capability, please see the Transact web-site www.transact.org.uk.

For a map of where the various initiatives and organisations lie within the broader picture of financial health, please the Resolution Foundations Financial Health Map at http://www.resolutionfoundation.org/FinancialHealthForum.php.

The Shared Goal on access to bank accounts

The Shared Goal was established in November 2004 when the Government and major UK retail banks agreed an aim of housing the number of adults with access to a bank account and remains an important measure of financial inclusion in the UK. The baseline for the shared goal was set by the Family Resources Survey (FRS) data for 2000/03 when 2.8 million adults in 1.8 million households where found to have no access to a bank account.

The figure for the unbanked previously included respondents who did not state whether they had an account, as well as those who positively affirmed that they did not have an account. For further information please see www.hm-treasury.gov.uk/financial_inclusion_bankaccounts.htm.

Sources of further information

- **Association of British Credit Unions Ltd (ABCUL)**
  www.abcul.org
- **Citizen's Advice**
  www.citizensadvice.org.uk
- **Competition Commission**
  www.competition-commission.org.uk
- **Consumer Focus**
  http://www.consumerfocus.org.uk
- **Department for Work and Pensions**
  www.dwp.gov.uk
- **Financial Inclusion Taskforce**
  www.financialinclusion-taskforce.org.uk
- **Financial Services Authority**
  www.fsa.gov.uk
- **Financial Services Research Forum**
  www.nottingham.ac.uk/business/forum
- **Friends Provident Foundation**
  www.friendsprovidentfoundation.org
- **HM Treasury**
  www.hm-treasury.gov.uk
- **Joseph Rowntree Foundation**
  www.jrf.org.uk
- **Money Advice Trust**
  www.moneyadvicetrust.org
- **Personal Finance Education Group**
  www.pfeg.org
- **Personal Finance Research Centre, University of Bristol**
  www.pfrc.bris.ac.uk
- **Services Against Financial Exclusion (SAFE)**
  www.toynbeehall.org.uk
- **Social Exclusion Taskforce**
  www.cabinetoffice.gov.uk/social_exclusion_task_force
- **The Resolution Foundation**
  www.resolutionfoundation.org
- **Transact**
  www.transact.org.uk

Endnotes

[1] www.hm-treasury.gov.uk/financial_inclusion_bankaccounts.htm
[2] *Home credit: examining whether doorstep credit works well for consumers on low incomes*; National Consumer Council, 2006
[3] You Gov poll, March 2009, for the Resolution Foundation
[4] Credit Action Debt Statistics, April 2009 www.creditaction.org.uk/debt-statistics.html
[5] *The poverty premium: how poor households pay more for essential goods and services*; Save the Children/Family Welfare Association, 2007
[6] Ibid
[7] The Poverty Site www.poverty.org.uk
[8] Ibid
[9] See www.transact.org.uk
[10] Ibid
[11] *Promoting financial inclusion;* HM Treasury, 2004
[12] *Family Resources Survey 2007/08*
[13] *Affordable credit: a model that recognises real needs;* National Consumer Council, 2005
[14] *'Third Annual Report on the Shared Goal for Banking'* (December 2008) Financial Inclusion Taskforce
[15] Ibid
[16] Ibid
[17] *Statistical Yearbook 2008* (CCCS) cited in *Debt Facts and Figures – 1st May 2009* (Credit Action)
[18] *Financial inclusion: credit, savings, advice and insurance*; Treasury Select Committee, Twelfth Report of Session 2005-06
[19] Memorandum submitted by the Fuel Poverty Advisory Group to the Treasury Select Committee inquiry into financial inclusion
[20] *Home credit: examining whether doorstep credit works well for consumers on low incomes*; National Consumer Council, 2006
[21] *Special cash machine report*; Nationwide Building Society, 2005
[22] Ibid
[23] *Financial capability: the Government's long term approach*, HM Treasury, 2007
[24] Financial Services Authority (2006) 'Financial Capability in the UK: Establishing a Baseline'
[25] Ibid
[26] Ibid
[27] Based on analysis of the British Household Panel Survey: see *Closing the advice gap: providing financial advice to people on low incomes*; Resolution Foundation, 2006
[28] Ibid
[29] Ibid
[30] Resolution Foundation (2009) 'Squeezed: The low earners audit
[31] HM Treasury press release (January 2007) accessible at www.hm-treasury.gov.uk/press_04_07.htm
[32] *Losing interest: how much can consumers save by shopping around for financial products?* FSA occasional paper series 19, 2002
[33] *A national dividend: the economic impact of financial advice*; Resolution Foundation, 2006
[34] *Health, financial well-being and financial practices of financially distressed consumers*; O'Neill et al, 2005
[35] *Security in retirement; towards a new pension system*; DWP, December 2006
[36] ippr press release, 23 August 2006
[37] HM Treasury press release (July 2008) accessible at http://www.hm-treasury.gov.uk/press_73_08.htm
[38] HM Treasury, http://www.hm-treasury.gov.uk/fin_inclusion_index.htm
[39] http://www.hm-treasury.gov.uk/d/pbr04_profininc_complete_394.pdf
[40] http://www.hm-treasury.gov.uk/d/financial_inclusion030407.pdf
[41] http://www.hm-treasury.gov.uk/d/fincap_150107.pdf
[42] http://www.hm-treasury.gov.uk/d/fincap_jointactionplan070708.pdf

Resolution Foundation

2 Broomhouse Lane, London, SW6 3RD
Telephonel: 020 7731 9140
Fax: 020 7731 9141

Email: info@resolutionfoundation.org
www.resolutionfoundation.org

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