

Financial Services Policy Issues

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Attachments: Appendix A: Financial Services programme
Appendix B: Response to the Joint Committee

FINANCIAL SERVICES WORK PROGRAMME

This paper reviews Consumer Focus priorities in the context of the Independent Commission on Banking (ICB) and the passage of the Financial Services Bill which could lead to significant and far reaching changes to the way the financial services market operates.

The success of our advocacy for consumers will make a real difference in the extent to which these changes have the needs of all consumers at their heart.

The Board endorsed the annual plan for 2011-12, which divided our work into project areas. Since then, however, we have had to review our work plan in the light of changing circumstances.

The two major changes are firstly the high level of reactive work the team is involved in relating to financial regulation and the ICB, and secondly the reduction in staff resources to a team of two, instead of three.

Proposed priorities for our future work on financial services are summarised below under the five project areas. Unless otherwise stated, the Board is asked to endorse the approach outlined.

We particularly invite the Board to consider the issues around Basic Bank Accounts and the recommendations laid out to take our advocacy forward on these products.

PROJECT AREAS

1 Financial services regulation & reforms of regulatory architecture

- We propose to remain active to keep positive amendments in place and to lobby for additional changes as the Bill passes through Parliament. We also intend to respond to the call for evidence by the Treasury Select Committee on this topic. We also propose to respond to government proposals in the area of consumer credit regulation and the Mortgage Market Review.
- We propose to work in line with our response to the Joint Committee on regulatory reform and to continue to prioritise our work on reform to the regulation of Financial Services.
- Our super-complaint on pensions contained a recommendation that consumers be able to transfer small pensions pots into their NEST pension. Consumer

Focus should continue work to advocate for this change to the NEST specification.

2 Banking and the customer experience

The Independent Commission on Banking (ICB)

- We plan to respond to the Treasury Select Committee which has called for evidence on the implications of the ICB recommendations for the banking sector and consumers.
- We will continue to advocate for diversity, transparency and better regulation as more concrete solutions to the issues that matter to consumers.
- We plan to keep a watching brief on these issues rather than carry out new research in this area.

Disclosure and Consumer Responsibility

- We propose to conduct market research into how financial services products are sold to consumers and how consumers interact with the product information and sale processes. The research will gauge the extent to which the current emphasis on disclosure and information as the primary means of consumer protection enables consumers to make good choices in the products they purchase.
- We have previously considered researching packaged bank accounts but events have overtaken us in this area with the FSA announcing new proposals around the sales process for these products.

Payments: 1) Faster Payments 2) Cheques 3) Payments regulation

- Consumer Focus makes a contribution in this area both through its advocacy and as a member of the Payments Council's Users Forum. Given that our work in financial services is closely intertwined with regulation of and developments in Payments Systems it is important that we keep a watching brief on this area and respond reactively to key emerging issues.
- While innovation offers new ways of allowing consumers to access their money and pay for goods, a key issue in the development of these services is how to ensure that low income consumers do not unfairly pay a premium for accessing products and services that allow them to exert control over their finances. We propose to continue our membership of the Payments Council's Consumer User group and our watching brief on developments in this area.

3 Consumer empowerment

Complaints

- The new Financial Services Bill and regulatory structure offers further opportunity to promote our policies. Complaint handling is clearly already a priority for the regulator and there are potentially fewer areas of change needed than elsewhere within the regulatory architecture. We now have fewer resources within the team, any resources devoted here will have to be weighed against other priorities and

we therefore propose to discontinue proactive work in this area. We will continue to contribute to CF's cross sector work on complaints and complaint handling.

4 Cost of credit

Future work on High Cost Credit

- Government is currently considering how it can reform the British consumer credit market to make sure it is fit for the future. Without a third team member we are unable to do further research into access to credit.
- We propose to continue with our evidence based advocacy work with Government and parliamentarians and the media to promote mainstream solutions for access to lower cost credit. Government has announced a review of high cost credit providers which will provide an opportunity for advocacy and we will continue to work towards regulatory reform in the Payday loan area.

Payday Loans Forum

- Following publication of our report '*Keeping the Plates Spinning*', the industry established a forum to draw up a Code of Practice. A Lending Code for Small Cash Advances was drawn up and the CFA launched it in July 2011. The Code did not address key issues for the protection of vulnerable consumers which our research had identified. We therefore were not able to lend our support to the Code or to the launch. Our continued involvement runs the risk that we will need to distance ourselves from a revised Code or other policy, to avoid our involvement in the Forum being taken as endorsement for such the policies.
- It is of particular concern because this is an area where we are seen to have taken a lead and to have a high level of expertise. Given the limited achievements of the Forum and the constraints on the team's resources we propose to withdraw from the Forum but to continue our advocacy programme.

The Board is asked to support the decision to withdraw from the Payday Loans Forum

Rent-to-own forum

- There is a similar issue in relation to the rent-to-own market, where we have been involved in a working group convened by Church Action on Poverty aimed at improving practice in the rent-to-own market. However, we have concerns that it will not be possible for a voluntary code to protect vulnerable consumers in this market and that our continued participation may lend a Code adopted by industry a credibility that lenders will be able to use to justify their unfair practices.
- We propose withdrawing from the working group, on the grounds that continued participation is not the best use of limited resources. We will continue with occasional advocacy in this area and have recently written to OFT about the need for regulatory oversight of the insurance products sold alongside these products

The Board is asked to support the decision to withdraw from this Forum

5 Tackling the poverty premium

Basic Bank Accounts

- We propose to continue our calls for agreed minimum standards for Basic Bank Accounts on functionality and/or design and consideration needs to be given to the mechanism for implementation of minimum standards.

The Board is asked to consider the issues and recommendations on this issue

- To agree our call for agreed minimum standards for Basic Bank Accounts
- To agree which features should be identified in such standards
- To consider whether a minimum standard Basic Bank Account should be supported through industry agreement, regulation or a USC in banking

Policy and Market Context

The Basic Bank Account was initiated by the Financial Inclusion Taskforce (FIT) and was a voluntary measure. The programme was initiated in good economic times, with buoyant bank profits and a preference for voluntary as opposed to regulatory solutions.

The voluntary approach has not responded to product design flaws, nor has it protected the Basic Bank Account against further reductions in functionality. As the recent RBS decision shows, Basic Bank Accounts need support in the current climate. The FIT has been disbanded and the focus of the coalition Government lies elsewhere, for example in the expansion of credit unions.

The FSA has begun to take a tougher approach. Under its draft 'Approach to Regulation' it intends to regulate more intensely including new powers in *Product Intervention*. It also sets out how and why the new regulator will confront issues around financial inclusion where it previously did not have powers. The new regulator is likely to be more active in the design of products and it is possible it will focus on detriment from the perspective of price and inclusion of Basic Bank Accounts.

In many ways the provision of Basic Bank Accounts is a success. In 2004, the major banks agreed to half the number of those without a bank account and that was surpassed by the deadline in 2009. According to the last estimates there are 8,423,000 Basic Bank Accounts. This represents a significant portion of the UK banking population. Each year, the number of Basic Bank Accounts grows.

| | end-December | 2005 | 2006 | 2007 | 2008 | 2009 | Thousands 2010 |
|---|--------------|-------|-------|-------|-------|-------|-------------------|
| Basic Bank Accounts | | | | | | | |
| Net increase ^(a) in number of accounts in the year | | 660 | 597 | 675 | 540 | 572 | 518 |
| of which: accessible at Post Office counters | | 616 | 550 | 636 | 544 | 553 | 499 |
| Number of accounts upgraded ^(c) in the year | | 68 | 154 | 115 | 97 | 90 | 66 |
| of which: accessible at Post Office counters | | 64 | 145 | 109 | 94 | 87 | 64 |
| Number of accounts at year end ^(d) | | 6,390 | 6,707 | 7,260 | 7,677 | 7,832 | 8,438 |
| of which: accessible at Post Office counters | | 2,367 | 2,868 | 3,483 | 4,172 | 7,453 | 8,054 |
| | end-April | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 |

Why we require minimum standards

The failure to require a minimum set of standards meant that each bank has set the specific features of its account. As a result, very few Basic Bank Accounts offer everything that consumers identify as being essential to them¹. Consumers seeking a Basic Bank Account therefore have to make tradeoffs about those features they value and prioritise most.

The lack of standards means they are not products that all lower-income consumers trust. Even though the amount charged for a missed payment has fallen dramatically in recent years (£34 in 2007 to £14 in March 2011), since all Basic Bank Accounts allow Direct Debits (DDs) and Standing Orders (SOs) accounts can be charged if a DD or a SO is refused due to lack of funds.

The Financial Inclusion Taskforce (FIT) research shows that four in ten of the newly banked suffered a net loss after an opening an account, mainly as a result of penalty charges from unmet DDs - an average loss of £140 per annum in penalty charges. For the poorest of the newly banked the shift to DDs has resulted in a higher cost overall.

The research suggests that while the target to reduce numbers of people without an account has been met. Yet the greater goal of financial inclusion has failed to be realised in a similar way since some consumers have reacted to design flaws by preferring to be unbanked or not using their account to manage their money for fear of charges, thus negating the benefits of a transactional bank account.

Unbanked: The FIT found 60% of the unbanked have previously had a bank account but abandoned it, often due to unexpected charges. *On the Margins* found that bad experiences with DDs, resulting in a build up of penalty charges, or of debt via an overdraft or credit cards meant that people preferred the security and visibility of cash money management.

The 2008/09 Family Resources Survey found unbanked households were concentrated at the bottom of the income distribution, with 36 per cent of them being found in the lowest two deciles and 77% in the bottom half of the income distribution. Average monthly incomes for unbanked respondents were far lower (£635) than for the newly banked respondents (£955).²

Dormant accounts: Financial inclusion requires not only a bank account but the confidence to use the account for day-to-day money management. FIT research shows 45% of the newly banked (Basic Bank Account or full PCA customers) continuing to manage their money mainly in cash, citing lack of flexibility and transparency, as well as the threat of payment charges.

Some consumers have stopped using their new accounts altogether (15 per cent, including 19 per cent for those on the lowest incomes).³ FIT research and *On the Margins* suggest poor product design leads to many consumers choosing to remain, or return to being unbanked, or to leave their account largely dormant. To retain control, many consumers are choosing to manage in cash.

Benefits of greater standardisation of Basic Bank Accounts

It might avoid market distortion

¹ A range of transactional features are seen as being essential, including but not limited to the ability to receive all payments, access to High St bank and PO branches, ATM access, a debit card, bill payment, and account information. CF *Opportunity Knocks*

² 2008/09 Family Resources Survey in: FIT (2010) *Banking services and poorer households*, p5, <http://bit.ly/hNYtOt>

³ Financial Inclusion Taskforce, 2010, *Banking services and poorer households*

The lack of standards distorts the market for Basic Bank Accounts. Those firms that offer better Basic Bank Account products are punished because they end up with a larger share of a less profitable or even loss-making product.

Without a requirement for consistency across all providers there is no incentive for banks to offer a well-designed Basic Bank Account that meets consumers' needs because it would result in carrying an undue burden. Indeed, many agencies advise their low income clients to go to the Cooperative Bank for a Basic Bank Account and consequently it has a disproportionate share of the Basic Bank Accounts market despite having a much smaller share of the current account market. Thus, those providers that currently offer the best Basic Bank Accounts have typically seen a larger market share than other banks. By offering the fairest, most comprehensive product, they are actively disadvantaged in this market segment raising fears of a race to the bottom in terms of basic bank accounts.

As banks look to cut costs reducing the service associated with the Basic Bank Account is a clear target for greater economies moving forward as it does not hurt the bottom line.

Would low income consumers use them more?

The perceived risk of DD charges and lack of control over outgoings have been identified repeatedly as a reason to become, or remain, unbanked. It is possible that if the threat of excessive charges for going overdrawn due to Direct Debits were removed it would encourage Basic Bank Account customers to use their account for day to day management.

Table 1 – Unbanked (without access to transactional account)

| Year | Households without transactional account - Positively affirmed no account (000, % of total) | Adults without access to transactional account - Positively affirmed no account (000, % of total) |
|---------|---|---|
| 2008/09 | 1,140 (4%) | 1,540 (3%) |
| 2007/08 | 1,280 (5%) | 1,750 (4%) |
| 2006/07 | 1,410 (5%) | 1,920 (4%) |
| 2002/03 | 2,570 (10%) | 3,570 (8%) |

The FIT found that 52% of unbanked respondents would definitely or probably like a bank account. *On the Margins* identified that around half of the unbanked sample could see benefits to banking but were wary of being drawn into the wider banking services such as revolving credit and Direct Debits. As a result, they were extremely averse to risk and debt, and were keen to avoid any banking facilities associated with debt, interest or penalty charges. They expressed a desire to have a bank account with clear barriers and safety nets to protect them from the risks associated with it. The report concludes “banks should remain responsible for serving this group of consumers and recognise their own past shortcomings by developing appropriate services which better meet their needs in the future”.

This is not a solution of all the unbanked

Although the proposed measures would reduce the costs associated with DD charges, the wider consumer issues associated with control over outgoings would not be fully resolved.

We do not have specific evidence on how many may return to banking if the DD problem was remedied, or indeed the potential benefits to inclusion of any other form of prescription

in the design of a Basic Bank Account. For some unbanked consumers, who do aspire to a bank account, the improvements outlined here may not address the deeper issues of budgetary control and the importance of any transactional account being offered from a wider range of providers than the existing retail banks.

Must be part of a wider strategy

Basic Bank Accounts must be part of a range of measures to enable low income consumers to have access to the benefits of transactional banking. This reflects CF's wider approach to improving access to banking services for low income consumers. Consumer Focus continues to push for a transactional product to be offered through post offices, an expanded role for credit unions and the development of technological alternatives to mainstream banking for the significant number of the remaining unbanked for whom mainstream banking is likely to continue to be unattractive.

Resistance from banking industry

If the Government decides to opt for minimum standards for Basic Bank Accounts it is likely that many banks will argue for those standards to be as minimal as possible. If the banks win this argument then for some banks this may mean that the current offer is reduced. However given the current on-going reductions in what Basic Bank Accounts offer this argument is less of a concern. We also know that some banks like the Cooperative and perhaps Barclays would be likely to exceed minimum standard if they were lower than currently offered.

What features of a Basic Bank Account could be subject to some sort of standardisation

- Charges at cost reflectivity for any credit usage as part of a DD or SO or charges for refusing a DD
- Minimum standard design to ensure functionality - debit cards, phone/internet banking, full LINK ATM access, Post Office access, free electronic payments, counter access and access and no ability to go overdrawn (unless temporarily)

This would be potentially expensive for the banks who are reliant on the revenue from charging UOCs and there are undoubtedly tradeoffs between functionality and costs to be made. However without minimum standards there is a real risk to an appropriate banking proposition for many low income consumers. The question remains how best to deliver standards, through a self regulatory solution, regulation, or Government social policy potentially through the vehicle of some form of Universal Service Commitment.

This work should also be considered in the context of "*free in credit*" banking. The old system of cross subsidies between those in credit, those overdrawn and those on basic bank accounts is no longer sustainable and any settlement with the industry in terms of basic bank accounts needs to reflect this bigger issue.

Since the Basic Bank Account market now constitutes a significant market share, any benefits to this product are likely to be cross subsidised on an even greater level from the current account market, especially if there is a transition from current accounts to Basic Bank Accounts if the design was safer and therefore more appealing to lower income consumers wishing to avoid penalty charges. One option would be for small upfront charges in return for security over the product design that meets the clarity, trust and avoidance of credit discussed above. Research for Social Finance's *Jam Jar* account suggests some consumers would be willing to pay a small sum each month.

Universal Service Commitments (USCs)

The Treasury Select Committee provisionally rejected the idea of a Universal Service Obligation (USO) in 2006 on two grounds:⁴

- a) *The Banking sector was more competitive than other sectors where there was a USO*
- b) *The then voluntary approach under the Financial Inclusion Taskforce should run its course before opting for the tougher option if and when necessary.*

Recommendations for a USC in banking have been made recently by the FS Consumer Panel, and Age UK who state “*transactional banking services fulfil the criteria set at European level for an essential service and are equivalent to other services in the UK for which a universal service obligation already exists*”.⁵ Neither have pursued the agenda aggressively however.

The previous Government announced a USO with regards Basic Bank Accounts in its final budget in March 2010 and again as part of its manifesto. It aimed to give consumers a right to a Basic Bank Account. Yet, banks rejecting applications or poorly sign-posting to a Basic Bank Account, is no longer a major problem. The point is many consumers choose not to have one because of the Basic Bank Accounts fundamental design or do not use the account fully due to design problems. A USC thus defined will not deal with the problems exposed by the FIT and our own research.

⁴ <http://www.publications.parliament.uk/pa/cm200506/cmselect/cmtreasy/1717/171706.htm>

⁵ Age UK, *The Way We Pay*, p8