INCOME AND FINANCIAL INCLUSION

April 2017

WHO IS FINANCIALLY EXCLUDED?

Financial exclusion is an individual's inability, difficulty or reluctance to access appropriate mainstream financial services

Financial exclusion is caused by a complex set of factors which have an impact on a broad spectrum of the population in a number of different ways. However, low income individuals – those with household incomes in the lowest 10% bracket of the population – are deemed to suffer the most from the effects of financial exclusion.

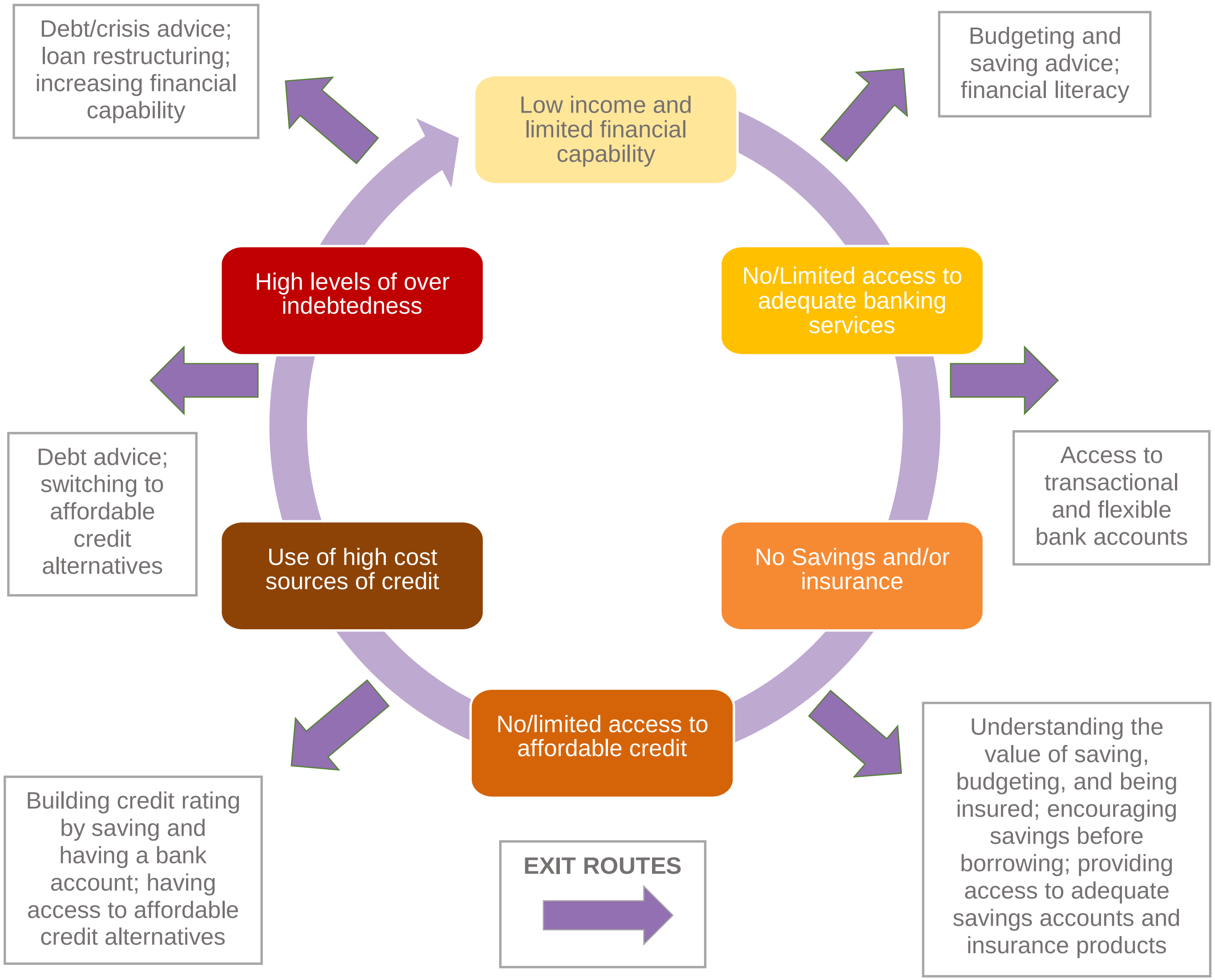
While cause and effect is hard to establish with financial exclusion, there are broadly four main drivers of financial exclusion for low income individuals:

1. An individual's inability or reluctance to exercise their full **financial capability**
2. Lack of access to **adequate banking services**
3. Lack of access to **affordable credit**
4. Lack of access to **other suitable financial, savings and insurance products**

THE CYCLE OF FINANCIAL EXCLUSION

In addition, low income individuals are prone to falling into a vicious cycle that exacerbates the effects of financial exclusion

The earlier that an individual's financial needs are satisfied, the lower the chance of them falling into, or continuing on, the vicious cycle of financial exclusion



SECTOR STAKEHOLDERS

Credit Unions (CUs)

- Owned and controlled by the members
- 350 CUs serve 1.2 million customers
- Can take deposits but interest rate cap of 3% pcm (42.6% APR) and common bond (geography, employer)
- DWP Credit Union Expansion Project under way, with goal of 1m new members and reach financial sustainability

New ventures

- Include challenger banks, specialised credit providers (e.g. responsible rent-to-own) and p2p platforms.
- Most are still at an early stage of development and some are not specifically focused on serving financially excluded individuals

Community Development Finance Institutions (CDFIs)

- 10 personal lending CDFIs serving around 40k individuals
- No interest rate cap but are not allowed to take deposits
- Need to raise external funding given their lack of access to funding from customer deposits
- Appear to be transitioning to a sustainable model quicker than their CU counterparts

Mainstream finance providers

- Include high street banks, high-cost short-term lenders and providers of wider financial products including insurance and asset leasing
- Most of which aim to maximise profits and often marginalise or charge a premium to financially excluded individuals

Debt advice providers

- Largest subset of institutions offering financial capability training and debt counselling - most are charities or not-for-profits
- Money Advice Service is being scrapped (£80m p.a overheads)
- Most CUs and CDFIs partner with debt advice providers to signpost or directly offer debt advice to their customers.

Government agencies and regulators

- Are increasingly tightening regulation for institutions providing credit and financial services to the financially excluded (e.g. FCA price cap for payday lenders)
- Government policy is also increasing the emphasis on individual responsibility, particularly with regard to pensions and universal credit

NOTABLE FEATURES OF THE UK MARKET

- Broad political consensus on need for financial inclusion
- Many actors aiming for similar objectives: need improved coordination
- Policy uncertainty undermines long-term strategy and planning

Capital	Capacity	Absorption
Major constraint on ability of high-performing institutions to scale.	Highly uneven capacity across sector.	Significant demand from individuals and SMEs for affordable finance
Generally low financial sustainability & high degree of grant support	Set of high-performing CDFIs, credit unions and impact investors.	Scarce data makes it difficult to quantify nature of problem.
Some leading CDFIs, credit unions and social investors can access commercial capital.	RGF and EFG compliance for CDFIs, and Credit Union Expansion Project, have accelerated professionalisation	Poor local community development coordination is reducing total impact.

CHALLENGES AND OPPORTUNITIES

Cause and effect is hard to establish with financial exclusion, so knowing where to focus investment to ‘solve’ the issue is not obvious

	Challenges	Opportunities
Financial Capability	• Mostly provided free-of-charge in conjunction with debt counselling • Currently looks best suited for grant funding or financed on a contract basis	• Significant potential in enhancing collaboration between providers of affordable credit and stakeholders offering and/or funding financial capability
Banking Services	• Compete with free-to-use bank accounts from mainstream banks, which are considered inadequate for the financially excluded • Need to pay rigid agency banking fees	• Investment opportunities exist in new ventures which need early stage funding • Advocacy could be focussed on liberalisation of the payments system
Provision of Credit	• Difficult to strike right balance between morally responsible and financially sustainable lending • CUs and CDFIs need to invest in their operations, realise efficiencies, and aspire to grow in a financially sustainable way	• CUs and CDFIs need development/patient capital and CDFIs also require access to lending capital • Specialised credit providers are emerging and require early stage funding
Other Financial Products	• Insurance and pension schemes are underdeveloped and difficult to implement in a financially sustainable way • lack of financial capability and low disposable incomes of financially excluded individuals	• Few investment opportunities exist in institutions offering other financial products • Collaboration with mainstream finance providers, who have an expertise and potential to cross-subsidize, should be encouraged.

CASE STUDIES

East Lancs Moneyline
Helping people who are financially excluded by providing access to affordable loans

Big Society Capital has invested – through Big Issue Invest – into East Lancs Moneyline (Moneyline).

Moneyline is a not-for-profit Industrial & Provident Society established in 2002 with a mission to provide fairly priced credit for low income consumers in and around Blackburn. Over the past decade, they have expanded their business and today are one of the largest personal lending CDFIs in the UK with 20 branches located across the North West, Midlands, East Yorkshire and the Humber and South Wales.

Average Loan size: £455
Amount Lent: £8.3m
Median net income of ELM borrowers: £12,324

Ffrees Family Finance
Unique type of current account that helps families to save as they spend

Big Society Capital has invested – through Nesta Impact Investments – into U (formely Ffrees).

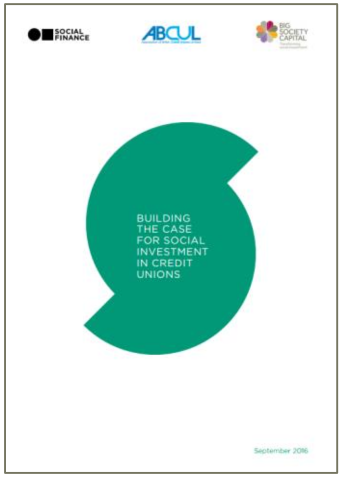
U is a digital current account that helps families to save as they spend. Customers receive points when they purchase through their account from Ffrees' network of providers. These points are placed into a separate savings account, which customers can then redeem as cash.

Services such as Ffrees Money Manager also help people manage their budget and put money aside that is ring-fenced to pay bills. The basic account is free to join and has no monthly fees, and anyone with a confirmed UK address can get an account regardless of financial or social status.

PRIORITIES FOR BIG SOCIETY CAPITAL

In the short term, we will continue working closely with relevant stakeholders and social investors, including intermediaries funded by BSC, to:

- Signpost organisations looking for investment to suitable sources of capital through general funds;
- Commission research, advocate for policy and regulation, and encourage collaboration that will support the case for social investment in the financial inclusion sector e.g. **Building a Case for Social Investment in Credit Unions (2016)**



In the medium to long term we expect to see the emergence of, and intend to support:

- Dedicated social investment capital pools which are tailored to the needs of the financial inclusion sector e.g. **Fair By Design**;
- The design and development of innovative financial technology (**FinTech**) products and services required by low-income households.

www.bigsocietycapital.com/social-investment-research-library

BIG SOCIETY CAPITAL