Household finances: income, saving and debt inquiry – Responsible Finance response

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About Responsible Finance

Responsible Finance is the trade body for responsible finance providers (also known as community development finance institutions (CDFIs)). Responsible finance providers offer loans and support to businesses and individuals who find it difficult to access finance from commercial banks. Responsible Finance's mission is to support the development of a thriving and sustainable sector that provides finance for underserved communities and, as a result, contributes to the increasing economic growth and prosperity of these communities.

Responsible Finance Response

The market segment that responsible finance providers primarily serve low income consumers with an average loan size of £400 over 9 months. Due to this specialisation, we have focused our responses on the questions relevant to this consumer group and debt.

Customer demographics

The responsible finance industry provides loans and wrap-around support to low income consumers who often have thin or poor credit files. The consumer base that the industry serves often does not have a savings buffer and therefore relies on credit for both daily needs and one-off expenses. Many of the consumers that borrow from responsible finance providers previously took out high cost credit such as payday loans, home credit, or rent-to-own products, and therefore borrowing from responsible finance creates significant cost savings. In 2017 the cost of borrowing from Provident was twice as expensive as borrowing from a responsible finance provider; on a £500 loan over 26 weeks consumers would save nearly £140.

The following summarises the demographics of consumers who borrowed from responsible finance providers in 2017:

- 33% were on household incomes below £15,000
- 47% were benefits recipients
- 40% were unemployed
- 32% had borrowed high cost credit in the past year
- 48% were social housing occupants

- 48% were women
- 28% were single parents

Approximately 4.4 million consumers,[1] or 6% of the UK population borrow from high cost lenders annually, so the potential benefit from supporting this consumer segment to save is significant.

Savings schemes

For consumers and households on low incomes conventional savings schemes such as pensions and ISAs are not fit-for-purpose given that individuals are likely not in full-time employment, are on zero hours contracts or change jobs frequently all of which make it difficult to be eligible for employer pension benefits or make regular contributions. Tax incentives designed to encourage saving are largely not applicable to individuals on low incomes as they do not pay tax. Similarly a large proportion are in rented accommodation and have little to no asset base and are unaffected by changes in house prices.

Affordable credit, savings and advice are all critical factors for financial inclusion and building financial capability. Responsible finance providers often combine these into a single wrap-around offer. They often have in-house debt and money advice professionals, or a close working partnership with StepChange or the local Citizens Advice Bureau. Similarly, responsible finance providers have partnerships with high street banks and credit unions to open current or savings accounts for customers that do not already have one. Many have 'round it up'[2] schemes in place, where a borrower can round their repayment amount up and deposit the difference into a savings account (e.g. rounding a weekly repayment of £27 up to £30 over 26 weeks would enable the borrower to deposit £78 into a savings account over that period. Responsible finance providers helped their customers deposit £3 million into savings accounts this way in 2017. This savings buffer means that consumers who typically do not have the discretionary income to save regularly now may not need to borrow for unexpected expenses in the future.

In 2017 over 40% of loans made to consumers by responsible finance providers were to help pay for emergencies (such as repairing appliances or cars) or special events (such as Christmas or school uniforms), indicating that this segment of consumers does not have a savings buffer to absorb these costs. This lack of 'savings to spend' can also lead to unsustainable debt when consumers borrow from high cost lenders to cover these expenses, and that borrowing becomes unaffordable.

Responsible finance providers' 'round it up' schemes and other initiatives that help build a savings buffer, such as the government's Help to Save scheme and banks' jam jar accounts use the same principles of encouraging savings habits by making small but regular deposits.

The approach used by responsible finance providers is particularly effective, as consumers agree to a one-off opt-in, after which the deposits happen automatically. For these schemes to work well and have national coverage the following is needed:

- The responsible finance sector needs to be well capitalised to have the scale and reach into every community across the UK. 'Round it up' schemes are effective and are easy to implement in face to face interactions with consumers. To gain scale and reach

[1] http://responsiblefinance.org.uk/download/consumers-credit-and-scaling-affordable-lending-a-literature-and-evidence-review/
[2] https://www.scotcash.net/our-services/savings-accounts/; https://www.moneyline-uk.com/faqs/

responsible finance providers have been moving to online lending, which is not as conducive to promote the savings scheme. Having a physical presence and in-person interactions with consumers is a more expensive model, so the sector needs to be well capitalised and have scale in order to reinvest into its operations. Responsible Finance is calling on the Government to create a £150 million responsible finance fund that will enable the sector to leverage in commercial capital and grow its impact.

- Partnerships in place between responsible finance providers and credit unions and banks. In 2017 Responsible Finance released research on developing effective partnerships to deliver better customer outcomes, such as increased savings.[3] For this segment of the market, government can support responsible finance providers and other locally-based organisations that have reach and consumer trust through funding and awareness raising, to build positive behaviour around saving.
- We support the Government's proposals for breathing space[4] which will help over-indebted consumers stabilise their finances. However we recommend that responsible finance providers are exempt from suspension of repayments during the breathing space period, as to not compromise the sustainability of the responsible finance sector and its ability to effectively serve this consumer group.

Advice

In terms of advice, responsible finance providers work closely with debt and money advice agencies. Responsible finance providers signpost consumers who are declined for a loan because they are over-indebted to debt advice. As such advice tends to be primarily sought in crisis situations rather than to proactively manage personal finances. Any replacement for the Money Advice Service must link closely with frontline organisations such as responsible finance providers to reach consumers before the point of crisis.

Linking borrowing and saving: Case study

Arlene is a single mother with three young children and works full time. She had passed responsible finance provider Scotcash's office in Glasgow on a number of occasions and saw adverts in various places, so when she got a leaflet in the GHA Key magazine she decided to try for a loan rather than use the high cost lender (Provident) that she was used to.

She used her Scotcash loan to pay for her kids' Christmas gifts, food and get her through an expensive time of year. She also decided to save alongside her loan with the Credit Union as a saving fund was something she had thought about in the past with the view to borrowing from them in the future. Arlene is still a customer with Scotcash and has gone on to take future loans to pay for her holidays while still saving and now borrowing from the Credit Union.

[3] http://responsiblefinance.org.uk/download/tackling-financial-exclusion-through-local-finance-partnerships/
[4] https://www.gov.uk/government/consultations/breathing-space-call-for-evidence