Responsible finance response: Scottish Affairs Committee inquiry on access to financial services in Scotland

About Responsible Finance

Responsible Finance is the trade body for responsible finance providers (also known as Community Development Finance Institutions (CDFIs)). Responsible finance providers promote prosperity and address inequality by empowering people to take control of their financial futures. They offer loans and support to individuals, businesses and social enterprises 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.

About the Responsible Finance sector

Responsible finance providers play an essential role in ensuring people and businesses can access useful and affordable financial services. Access to finance alleviates the effects of poverty, and allows individuals to smooth out fluctuations in income and expenditure. It is also access to opportunity, and consumers who struggle to borrow from mainstream lenders often struggle to climb out of disadvantage.

The responsible finance industry is committed to supporting this low income, vulnerable and financially excluded segment of the market, often providing wraparound services to promote financial wellbeing and literacy and encourage saving.

We are actively working in Scotland and can support the Scottish Government to meet a number of challenges in financial exclusion and access to financial services, but to do this the responsible finance sector is actively seeking:

- Investment to innovate and scale-up, including investment in infrastructure and marketing
- Further investment to on-lend

Responsible Finance response

1) **What challenges are there to accessing financial services in Scotland?**

Access to appropriate and fair financial services is a key requisite for participation in today's society, however access to finance and financial exclusion continue to be significant barriers to individuals, households and businesses in Scotland and across the UK.

Demand for affordable credit often outstrips supply as personal lending responsible finance providers suffer from under-capitalisation. Options for other forms of credit are also reducing, as high-cost credit providers are increasingly tightening their lending criteria due to regulatory changes. Because of this, we welcome the Scottish Government's vital support for affordable credit through its £1 million contribution to Carnegie Trust's Affordable Credit Loan Fund. We also welcome the UK Government's proposals to extend the regulatory boundary to allow registered social landlords to effect fee free referrals to Credit Unions (CUs) CDFIs. We believe this should go further and all organisations should be exempted from needing a credit broking licence when making referrals to CUs and CDFIs. Firms in the high-cost market should also be required to make their customers aware of alternatives, such as responsible finance providers, and also debt advice services. This would increase choice and awareness for consumers when they need to access credit.

In Scotland there is an above average concentration of adults who hold high-cost loans, and 11% of individuals have no savings or investments. People often face a bleak choice of where they can access credit when they need it, and 8 million people across the UK rely on high cost credit to pay essential household bills[1]. Traditional lenders in the sub-prime market are folding or moving to higher income and less risky groups. At the same time, many individuals do not possess a digital footprint or have a poor credit score, and therefore are further hindered in their ability to open bank accounts and access mainstream financial services.

Across the UK, Banks are withdrawing from communities by shutting bank branches, and free ATMs are being closed or switched to fee-charging in their hundreds. Recent research by Which? Has found that 339 Scottish bank branches have closed since 2015. Research from 2017 shows that 61% of adults reported having used a bank branch in the last 12 months[2], indicating that many consumers still reply on branches for their banking needs. When branches close, ATMs are often lost with them. LINK reported that the UK lost more than 2,500 free-to-use cash machines last year. The recent Access to Cash review found that 17% of the UK population would struggle to cope in a cashless society, and poverty is the biggest indicator of cash dependency[3].

11% of the UK adults that are unbanked are in Scotland[4]. Awareness of basic bank accounts is often low and some banks do not market them because they are not profitable. Vulnerable customers are often poorly-served or excluded by the main high street banks. As profit driven institutions, unless mandated it is unlikely that banks will ever provide a range of appropriate and affordable financial products for those on low incomes. These markets are not sufficiently profitable to incentivise them to do so.

[1] Step Change (2017) The High Cost of Credit. Available: https://www.stepchange.org/Portals/0/documents/Reports/stepchange-affordable-credit-discussion-paper-july2017.pdf

[2] FCA (2018) Strategic Review of Retail Banking Business Models. Available: https://www.fca.org.uk/publication/multi-firm-reviews/strategic-review-retail-banking-business-models-annex-reports.pdf#page=3

[3] Access to Cash Review (2019) Final report. Available: https://www.accesstocash.org.uk/media/1087/final-report-final-web.pdf

[4] The FCA (2018) The financial lives of consumers across the UK, Key findings. Available: https://www.fca.org.uk/publication/research/financial-lives-consumers-across-uk.pdf

In addition, there is a significant and growing research gap on all financial exclusion issues. While think tanks and universities try to counter this, this cannot replace the systematic development and monitoring of a clear evidence base. This could be provided by creating a financial inclusion research fund, or the FCA could incorporate this into its Financial Lives survey to build and monitor the evidence base under its duty to 'have regard' to accessibility.

2) What impact have recent bank branch closures and the changes in ATM funding had on access to financial services in Scotland?

There is a diversity of needs when providing financial services, and the bank branch and access to cash are key parts of this. Research from consumer body Which? Has found that almost two thirds of bank closures have been in the poorest communities (with an average household income of less than £26,000). In addition, over half of all consumers who relied predominantly on cash during 2016 had total household incomes of less than £15,000 per year[5], and evidence has shown that the poorest communities are being disproportionately affected by ATM losses[6]. Low income consumers often rely on cash for budgeting, helping them to feel in control of their finances.

The declining availability of cash through bank branch closures, ATM losses, and ATMs being switched to fee-charging machines is removing choice for consumers, and there is a lack of research on where vulnerable people whose bank branches have closed go to access financial services. The use of cash will naturally decline if access to it is restricted, therefore headlines announcing the 'death of cash' should be considered in this context.

Banks should have a greater obligation to ensure that people who need face-to-face services can access them. The key is for the Government and the regulators to protect diverse provision. Banks must be mandated to carry out an impact assessment on branches before they close including information on footfall and amount of cash withdrawals. It should be mandated to publish its reasons for closure, and FCA approval should be required for any closure

3) How practical are alternative methods of accessing financial services such as online banking or mobile branch banking?

Technology is transforming the way consumers access financial services and manage their money, however it is not a substitute for physical financial service branches and face-to-face interaction especially for vulnerable consumers with complex needs. Technology is often designed for the mass market rather then for the poor and vulnerable. According to the Financial Conduct Authority, 12% of Scottish adults never use the internet, and fewer Scottish people use telephone (14%) and online (64%) banking than in the rest of the UK. Only 35% of Scottish adults use mobile banking[7].

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[5] UK Finance (2017) Cash and Cash Machines.

[6] The Telegraph (2014) Lack of free cash machines in Britain's poorest areas. Available: https://www.telegraph.co.uk/finance/personalfinance/bank-accounts/10546744/Lack-of-free-cash-machines-in-Britains-poorest-areas.html

[7] The FCA (2018) The financial lives of consumers across the UK, Key findings. Available: https://www.fca.org.uk/publication/research/financial-lives-consumers-across-uk.pdf

Online banking services are dependent on consumers having the technological capacity and means to capitalise on it. Some rural areas of Scotland have poor internet access, and elderly individuals sometimes struggle to adapt to technology. The recent cases of TSB and other banks locking their customers out of online banking have compounded the need to ensure a diversity of provision.

The Post Office network is valuable in its role as an access point for transactional financial services in communities that have seen the closure of bank branches. However, it is not a replacement for bank branches. Whilst many everyday transactions can be completed at Post Offices, there are restrictions on what can and can't be done. There are issues around the lack of regulation of Post Offices, and the profitability of franchises taking on banking services. There are also currently 35 fewer permanent Post Offices in Scotland today than there were in 2011.

There is increasing but still limited awareness of the Post Office as a physical banking access point for people who bank with different banks. Often Post Offices are very busy and have nowhere to go to have a private conversation. This kind of environment can be particularly distressing for people with certain kinds of mental health issues.

The Scottish Government needs to ensure there is a diversity of service provision which caters to the needs of the entire population.

4) What impact has reductions to the interchange fee had in Scotland?

Whilst cash withdrawals in Scotland are declining, they are declining at only 3.3% - one of the slowest rates in the UK[8], indicating that demand continues to persist for access to cash. The impact of the loss of machines is difficult to measure, as many of the reasons people rely on cash are often not quantifiable. Cash offers people control, and people are dependant on it for a number of reasons, including:

- Physical and mental health issues;
- The risk of overspending and going into debt;
- People who rely on others to buy things for them[9].

ATM closures have occurred at a faster rate than LINK anticipated since the announcement of the changes. The first 5% reduction was imposed on 1st July 2018. Hundreds of free to use cash machines have now been switched to fee-charging, and thousands more machines have been shut down. Monitoring and reporting on cash machines is also proving to be an issue; whilst many people are witnessing the decimation of the free network, up to date and reliable data is hard to come by.

Calls to protect access to cash are not intended to undermine the role of digitalised payment methods and fintech. Cashless payment options and money management apps and services are welcomed, however access to cash for people who rely on it must be preserved. Similarly, cashback is not an alternative to ATMs. Legislation is urgently needed to guarantee access to cash and acceptance of cash by retailers.

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[8] Access to Cash Review (2019) Final report. Available: https://www.accesstocash.org.uk/media/1087/final-report-final-web.pdf

[9] Access to Cash Review (2019) Final report. Available: https://www.accesstocash.org.uk/media/1087/final-report-final-web.pdf

5) **How effective have financial services regulators been in ensuring continued access to financial services in Scotland?**

We welcome the work of the FCA in the high-cost credit market and we are optimistic about its ongoing work to increase access to affordable credit across the UK and in Scotland. It is undertaking a range of activities to promote access to alternatives, including extending its fee concessions for Community Finance Organisations to exempt them from all payment of FCA fees. Despite this, responsible finance providers need further support to innovate and scale.

Responsible finance providers work with consumers that are furthest away from the mainstream credit market. Their customer demographic is weighted towards: adults of the age to have young children; people living alone including single parents; people socially renting; people on benefits often impacted by ill health/disability and facing child or other caring responsibilities as barriers to work. They report that the demand for finance in the sub-prime market remains at high levels. Macro-economic and societal trends suggest that this will not change with incomes stagnating, many people on zero-hours contracts and the introduction of Universal Credit. In the meantime, the cost of living continues to drift up, as does inflation and the cost of goods.

The impact of the FCA's cap on HCSTC has been to increase awareness about the cost of borrowing and the poor practices of payday lenders, and reduce the number of people who were being lent to who can't afford to repay. The profits of these firms are being eaten into and they are facing increasing numbers of compensation claims. Whilst we welcome this, one negative impact has been to limit the choice for consumers when they need to borrow.

A report from the FCA in 2017 indicated that 60% of declined payday loans applications had not turned to other forms of high cost credit or illegal money lenders[10]. More recent research with declined payday loans applications has found that people take a series of actions after they face decline. It found that the majority turn to their friends and family[11]. Responsible finance has concerns around this as it most likely means that low-income people are lending to other low-income people. A range of social implications can arise from this; the toll it takes on families and relationships has not been fully explored, but it has the potential to cause the erosion of trust, the loss of dignity and respect, and the risk of individuals being pushed into financial instability by feeling pressured to lend to family members or friends when they can't afford to. Because of this is it vital to bolster efforts to increase awareness of responsible finance providers so people know that there are other options available when they face decline.

Responsible Finance also believes that the Government and the FCA should work together to legislate for the mandatory release of granular data regarding lending (by not only banks, who currently release data at the postcode sector level, but all lenders including high-cost credit firms). This would empower the wider financial services industry, community interest civil society and local economics groups to identify market failure, inefficiency or consumer harm. These groups can then advocate for policy change on the behalf of low-income consumers and work to expand access to affordable and fair finance in the areas left out.

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[10] FCA (2017) High-Cost Credit, Feedback Statement. Available: https://www.fca.org.uk/publication/feedback/fs17-02.pdf

[11] L Appleyard, C Packman,J Lazell (2018) Payday Denied. Available: https://d1ssu070pg2v9i.cloudfront.net/pex/carnegie_uk_trust/2018/11/22104652/Payday-Denied-Report.pdf

6) **What consideration and planning has been made to minimise disruption, from the growth of digital financial services and increasingly digital payments marketplace?**

Technology is not a substitute for physical financial service branches and face-to-face interaction, especially for vulnerable consumers with complex needs. For example, in the consumer credit market assessing consumer vulnerability for online applications and over the telephone is much more challenging than meeting clients face-to-face. Looking at bank statements to see signs of financial abuse or vulnerability can provide some clues. However, this area is still being developed and our members report that interaction is often key when dealing with vulnerable customers.

Despite this, responsible finance providers are innovating and looking for new ways to improve their online service offering and minimise disruption for clients who chose to use digital financial services. They are working to find pioneering ways of offering the wraparound support online that they routinely offer in store, as well as developing products that can mould around modern life and working patterns. This includes looking at ways to engage with online customers to find out if they are potentially vulnerable, and if they are experiencing issues with problem debt. It is vital that responsible finance providers are offered investment so they can continue to innovate in this area.

Open Banking has the potential to be a game-changer in this area, and in assessing affordability, as long as the new technology is used carefully and all firms have an obligation to consumers. In this area it is essential that firms are more incentivised to develop products and services appropriate to those on low incomes

Case study

The case study below illustrates the essential work that responsible finance providers in Scotland do to ensure consumers have access to appropriate and affordable financial services.

Scotcash - https://www.scotcash.net/

Living with her son Jack, Marie struggled to cover the costs associated with being his full-time carer, whilst also trying to save in case of emergency or for special events. After years of turning to expensive lenders, Marie became aware that there were alternatives. Scotcash proved to be a different service all together. After turning to Scotcash, Marie found that she could easily afford to replace her broken tumble drier and buy presents for her son's birthday and Christmas, without the stress of extraordinarily high interest rates.

Affordable loans were not the only Scotcash service which helped Marie to take back control of her finances. With help from a Scotcash Money Adviser, Marie was able to access the Warm Home Discount to reduce her energy bills and a grant to help cover the costs of her mother's funeral, meaning she had less need to borrow and was lifted out of fuel poverty. Marie said that the support she has received from Scotcash has been invaluable, and feels fewer people would need to resort to high-cost lenders, or even illegal lenders, if there was more awareness of the responsible finance options available.