

FinTech for All



Ensuring that everyone benefits from innovative financial services

Benjamin Barnard and Jos Henson Grič

Foreword by Claire Coutinho MP, Gareth Davies MP and Richard Holden MP

Afterword by Lord Darling of Roulanish



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Contents

About the Author	2
Acknowledgements	3
Foreword	6
Executive Summary	8
Recommendations	11
Introduction	14
Financial inclusion powered by FinTech	16
Chapter One: What is FinTech?	17
Introduction	17
1. Disrupting traditional market dynamics	21
2. The Growth of FinTech in the UK	24
3. Visualising the Sector	26
Chapter Two: A Change in Approach	30
Introduction	30
1. The Traditional Approach	30
2. Measuring Government Success	33
3. A New Approach	35
4. Myths that policy makers should ignore	37
Chapter Three: Inclusion in Banking	40
Introduction	40
1. Scale of Exclusion in Banking	40
2. Why people are excluded from banking	45
3. A FinTech Path to Inclusion	48
4. What Can Government do to help?	54
Chapter Four: Universal Credit	55
Introduction	55
1. UC banking vouchers	56
2. Universal Credit Payments Dashboard	59
3. ID Documents and making it easier to onboard	62
Recommendations	63
Chapter Five: Inclusion in Credit	65
Introduction	65
1. Exclusion from Credit	66
2. How to address exclusion from credit	69
3. A FinTech Path to Inclusion	75
4. What Government can do to help?	78
Chapter Six: Savings and Insurance	82

Introduction	82
1. Exclusion in Savings and Insurance	82
2. Why are low income people excluded from insurance and savings?	84
3. A FinTech Path to Inclusion	86
4. What Can Government Do to Help?	90
Chapter Seven: Financial Education	94
Introduction	94
1. The Scale of Exclusion from Financial Education and Debt Advice	95
2. The limitations to the Government's approach	97
3. A FinTech Path to Inclusion	98
4. What can Government do to help?	101
Afterword	103
Glossary	104
Appendix A	110
Appendix B	112

Foreword

Claire Coutinho MP, Gareth Davies MP and Richard Holden MP

The UK's FinTech sector is booming. Investment into UK FinTech is at record highs, accounting for over a third of all investment into the sector in Europe. Last year, London had more people working in FinTech and a greater number of venture-capital investment deals than any other city in the world. The overall amount invested in the sector was second only to San Francisco.

This reflects a decade of growth and innovation in UK Fin Tech solutions. Our start-ups are now global brands, leading a market that is expected to reach \$820bn by 2025. As one of the most digitally connected nations in the world, where smartphones and internet access are near universal, it is no surprise that the UK is home to four of the top five mobile banks in Europe, which are already expanding internationally from Singapore to Australia and now America.

Amidst this surge in technology, there is an opportunity to address a long-standing undercurrent working against Britain's lowest earners: to develop a financial services market which works for the traditionally underserved. This is no small problem. There are an estimated 10 million people, largely on a low income, who are underserved by their bank.

This has led to a chronic poverty premium with a higher overall cost of banking and poor-quality insurance and savings products for people on the lowest incomes. Lack of access to affordable credit has driven people towards high-cost short-term loans. For our lowest income households, a broken washing machine can quickly spiral into an endless cycle of crushing debt.

Although successive governments have made progress in tackling the systemic drivers of problem debt, more needs to be done for people on low incomes. Low income customers are not well served, in part because they tend to be loss-making under the traditional banking model. Unburdened by the legacy costs of older banking providers, FinTech providers can and do see low-income consumers as sought after valuable customers. This gives them the ability and incentive to provide more accessible, more tailored and cheaper services.

This report sets out a series of ambitious solutions to help encourage the development of FinTech services and products for people on low incomes. The hard-won Conservative majority now gives us the parliamentary time and space to focus on such solutions. The recommendations in this report

should be carefully looked at by those in the Conservative party who would like to bring about real change in our left-behind communities.

The changes set out would allow people on low-incomes to fully share in the advances in banking services as they continue to develop. From access to affordable credit, bespoke budgeting tools, savings and insurance products, a new wave of FinTech offerings could transform the way we approach Financial Inclusion in the UK and ultimately lead to low income individuals getting the banking services they want and need.

The UK FinTech industry presents an exciting growth opportunity for our economy to push new boundaries in technology and to allow access to good quality financial services for all. We must support these change-makers if we are to truly unleash Britain's potential on the world stage.

Claire Coutinho, MP for East Surrey (Elected in 2019)

Gareth Davies, MP for Grantham and Stamford (Elected in 2019)

Richard Holden, MP for North West Durham (Elected in 2019)

Executive Summary

The Problem

Financial exclusion remains a serious problem in the UK. 1.23 million adults do not have access to a fully functional bank account. A further 10 million, who are mostly on a low income, are underserved by their bank, meaning that they can do less with their money than other customers. Moreover, around 12 million cannot access affordable credit or insurance services, leaving them exposed to over-indebtedness following financial shocks and crises. Despite spending more than £2.5 billion since 2004, successive governments have only alleviated the worst symptoms of financial exclusion.

FinTech and Financial Inclusion

FinTech (or “financial technology”) can help to address financial exclusion. FinTech companies use new technology to gain a competitive advantage in the provision of financial services. The innovations that such companies have pioneered allow them to provide customers with better financial products with advanced features that allow their customers to make their money go further. Crucially, the cost-efficiencies that arise from the integration of new technology into the provision of financial services also make it possible to serve customers who would not previously have been considered to be commercially viable. Since the majority of FinTech advances are operational, or utilise back-end efficiencies, even those with poor digital skills can benefit.

This paper shows how government can harness London’s status as the FinTech capital of Europe to improve access to financial services across the UK. It shows how a new approach to financial inclusion, with FinTech at its heart, would allow the Government to address the cause and not just the symptoms of financial exclusion. It also demonstrates the importance of market forces in ensuring low-income consumer demand is well served. If people have access to a wider range of products, which are designed to match their personal circumstances, then they will not only adopt financial services but also will be able to use them more effectively.

Banking

People are excluded from banking because the dynamics of the banking market don’t necessarily work for those on low incomes. Despite the fact that the Government has made having a bank account a requirement for the receipt of pensions and Universal Credit, banks often

fail to generate revenue from low income customers and can lose money by serving them. As a result, banks operating under a traditional banking model have a reduced incentive to serve low-income customers well, or at all. Most importantly, the often limited service that they provide reduces the incentives for those without bank accounts to open accounts even if they cost nothing.

FinTech can help to solve this problem. FinTech drastically reduces the costs of providing banking services, meaning that it is possible for banks to serve customers profitably who would not previously have been commercially attractive. Moreover, FinTech allows banks to provide better services which, particularly when tailored to the needs of low income customers, can not only help those on low incomes to do more with their money but can also increase their incentives to adopt and use financial services.

Credit

The cost of borrowing for the 10-12 million on a low income is substantially higher than for middle and higher-income borrowers.

Although this should be expected, as some people are riskier to lend to than others, one of the reasons why some people are excluded from affordable credit is that, inevitably, credit-scoring systems look only at a limited range of data when making loan decisions. This means that people with different levels of risk are sometimes unfairly aggregated with those more likely to default on their loans, increasing the cost for both. Changing the ownership models of the companies providing loans, or subsidising these loans, is less effective for this subset of customers than improving the accuracy of their initial risk assessments.

FinTech can help low income customers to access cheaper credit. FinTech allows companies to look at data about customers' spending habits more effectively, thereby allowing them, where it is appropriate, to lend to people on low incomes at a cheaper rate. In addition to allowing customers to access credit, FinTech innovations around payroll systems can also allow customers to access their wages before payday, preventing those in need of short term-credit to resort to High Cost Short Term loans.

Savings and Insurance

This research shows how people on low incomes are effectively excluded from insurance and savings services. The traditional business models for savings disadvantage those who cannot afford to make larger deposits and who need instant access to their savings. Similarly, the traditional risk-pooling model for insurance means that, as with credit, people with low incomes are sometimes aggregated with those who are in reality riskier to insure - particularly in home and car insurance. Moreover, some low income customers are excluded from the insurance market because the only products on offer are surplus to their preferences, and have a high price point as a result, or are otherwise mismatched needs.

FinTech companies can make the savings and insurance markets

more accessible and useful for low-income consumers. FinTech firms make saving easier for consumers by allowing customers to choose to make savings “automatically” by rounding up every transaction they make and placing the difference lodged in a digital ‘piggy bank’ (either an e-Wallet or savings product) or by using advanced algorithms to predict how much they can afford to set aside each month. They can also bring down the cost of insurance by using data more effectively and end ‘overinsurance; offering insurance packages tailored to their customers’ needs and incomes, often included as part of their banking services or via a trusted point of contact with support services.

Financial Education and Debt Advice

It is widely recognised that there is a shortfall between the demand and the provision of debt advice. To meet the Government’s own estimates of the number of people who currently lack debt advice but are in need of it, would cost in excess of £1.1bn. Moreover, financial education in Personal, Social, Health and Economic (PSHE) classes is inconsistent across the country.

FinTech can help to address these shortfalls. As the Sergeant Review rightly pointed out in 2011, financial products should be simple to understand. User experience is at the heart of many of the financial products designed by FinTech companies, reducing the need for education to access and understand financial products. FinTech companies can also give *personalised* debt and financial advice through mediums that customers already use, like Facebook Messenger. This has been made possible as a result of the regulatory changes collectively known as ‘Open Banking’, which have made it easier for customers to share their financial data, improving the affordability, accuracy and accessibility of debt advice.

Recommendations

- **Universal Credit (UC) claimants should be provided with a UC banking voucher funded by a financial inclusion levy.** This voucher would be included as part of their single monthly UC payment (covering the cost, or at least part of the cost, of a bank account) and could be redeemed by the provider of the bank account into which they choose to have their UC benefits paid. Fiscally neutral, the vouchers should be funded by a levy on the largest banking providers who could recoup their contributions if customers eligible for the voucher choose to bank with them and if their products are judged to serve the needs of UC customers well. Such vouchers could also be used to open new accounts with FinTech providers and would kickstart the FinTech banking market for those on low incomes. It would give those in receipt of UC the capacity to choose banking services that are tailored to them and which include advanced features. It would also help the Government to tackle economic or financial domestic abuse by encouraging every UC claimant to open a bank account, even though UC payments are made on a household, rather than on an individual, basis.
- **To help improve access to savings, the DWP should move towards a wider range of FinTech providers for the Help to Save scheme.** This savings account allows certain people entitled to Working Tax Credit or UC to get a bonus of 50p for every £1 they save over 4 years up to £1,500. At the moment, this service is provided by the National Savings and Investment Bank. Although this partnership has worked, moving to a wider range of providers would open up the scheme to companies that use the latest FinTech innovations to help people on low incomes to save money more effectively. The Government should also allow claimants to make “catch-up” deposits, paying out top-up bonuses more regularly, and work with the Behavioural Insights Team to improve the product to encourage people to save.
- **Government should also amend the Help to Save specifications to allow claimants not only to save, but also to borrow, during the two-year duration of the savings account scheme.** The specifications should include specific loan to value (LTV) ratios so that claimants could borrow more if they saved more. For example, an LTV ratio of 1:3 would allow somebody who had saved £100 through Help to Save to borrow up to £300 through the scheme.

The same ratio would allow somebody who had saved £300 to borrow up to £900. This would increase the incentives for those on UC to save through Help to Save and would bring down the cost of borrowing for those who are eligible for the scheme.

- **The Government should allocate funding towards the creation of a Universal Credit Payments Dashboard.** This would take the form of a digital payments platform (similar to PayPal) that would allow people on UC to track their benefit payments. It should be run privately and would allow claimants to access a wider range of products by allowing them to share their claimant information and financial data with a range of financial services through an API framework compatible with the Open Banking Standard. This, in turn, would drive innovation in banking, credit and insurance markets to serve people on a low-income. A UC Payments Dashboard could have a number of benefits:
 - **Improve the credit histories of those in receipt of Universal Credit.** A payments dashboard would increase the amount of information about low-income consumers and make it easier to share this data. Providing a proof of their income, including from benefits, would reduce the risk of lending to UC claimants, thereby bringing down the cost of providing them with credit and allowing them to build up their credit history.
 - **The UC Payments Dashboard could be optimised to enable people to access their benefit payments in a more flexible way.** FinTech innovations allow workers to gain access to their accrued (already earned) income before payday. By paying a small fee to access these funds, those in work can gain access to their paypacket before payday, negating the need for short-term high-cost credit. The dashboard could enable FinTech companies to provide the same service for claimants by allowing them to access their benefits in advance. The DWP should explore partnerships with the companies providing these services.
 - **The UC Payments Dashboard could allow claimants to access various forms of cheaper credit provided by FinTech companies through ‘voluntary priority payments’.** This would reduce the cost of lending by allowing claimants to set aside a small proportion of their benefits each month to access credit provided by private companies. The size of voluntary priority payments (relative to the size of a claimant’s benefits) should be strictly controlled, as should the type of credit that this could be used to access. This would build upon the Social Fund and ensure that those rejected for budgeting advances can have access to cheap credit. It could also be used to help UC claimants pay for rental deposits.
- **The Department of Work and Pensions should work with the**

Post Office to develop and fund a POCA transition scheme. This would encourage the roughly 1.3 million people who rely on Post Office Card Accounts or POCAs (a basic banking service which is subsidised by the government) to switch to more sophisticated banking products, powered by FinTech. Government has already announced that it plans to end the POCA contract with the Post Office by 2021. A transition scheme would prevent people losing access to banking services altogether after the current contract ends.

- **Improve the DWP Social Fund.** This allows people who have been on certain benefits for the past six months to apply for interest-free budgeting loans which are repaid from future benefit payments. The main limitation of the Social Fund is not the risk of its users defaulting, but the cost of administering its operation. The DWP should try to bring down these costs by expanding the fund to allow it to lend to people it currently excludes owing to their stronger financial circumstances. It should also explore whether the administration of the system (either by the DWP or via a third party) could be covered through minimal interest rate charges on loans provided to richer borrowers.
- **To enhance financial education and debt advice, the Government needs to focus its efforts on funding a scalable model of financial advice through FinTech.** Government should set a plan for delivering any grant-funded debt advice and financial skills-training in a way that is capable of growth and makes the best use of innovative FinTech services. Specifically, it should explore how fair share contribution models for debt advice can supplement its current approach to debt advice.
- **HM Treasury, in partnership with DWP, should reform the regulation of credit unions to allow them to invest in a collective pool.** This would allow credit unions with surplus funds to lend to people from other credit unions or other responsible lenders and would increase the overall coverage of credit unions in the UK.

Introduction

Financial Inclusion in 2019

In the UK, banking is now an ‘essential service’ on a par with electricity, water and housing. It is almost impossible to operate entirely with cash if you wish to be employed, housed or claim government welfare benefits – particularly Universal Credit (UC).¹ And without a bank account, low-income households are excluded from other financial services such as credit, insurance and savings.

Despite this, financial exclusion affects many in our society. After 20 years of research and government intervention, in modern Britain as many as 12 million adults, primarily low-income consumers, still lack access to such basic financial services as a bank account, home insurance and credit. They lack choice, and the few products that are available to them are either prohibitively expensive or unsuited to their needs. This can not only aggravate financial hardship and persistent debt problems, but can also contribute to social and economic exclusion.²

There are three main types of financial products from which people are excluded:

- **Banking products** provide a secure means of receiving, storing and sending money, as well as the ability to monitor and prioritise the flow of income and expenditure
- **Credit products** allow people to manage income fluctuations and to spread or defer the cost of large-value purchases over time
- **Savings and insurance products** can be linked in so far as they allow people, particularly those on low income, to minimise their exposure to large, irregular and unexpected costs.

1. Money Advice Service, “Choosing a bank account for your benefit payments”, Accessed 12 September 2019, [link](#); Access to Cash Review, December 2018, [link](#)

2. House of Lords, Tackling financial exclusion: A country that works for everyone?, 25 March 2017, [link](#)

Financial Exclusion in the UK

Banking

- 1.2m people do not have access to a fully functional bank account³
- 60-67 per cent previously had an account⁴
- 800,000 have no account at all⁵

Credit

- Between 10-12 million lack access to affordable loans from “standard lenders”⁶
- More than three million users of high-cost credit are in serious financial difficulties⁷

Savings

- A study suggests around 12 per cent of UK adults (around 7.7 million) have no substantial savings⁸
- One in ten admit that they are “terrible with money”⁹

Insurance

- 60 per cent of those on low incomes lack home contents insurance¹⁰

Debt and Debt Advice

- Over 8 million people are struggling with problem debt, but only 1.1 million get advice¹¹
- Households have fallen behind on their essential bills, such as council tax and utilities, by an estimated £18.9 billion¹²

The consequences of financial exclusion have been documented extensively over the past 20 years.¹³ They extend far beyond exclusion from any one specific product or the direct financial hardships that result from inflated prices.¹⁴ Financial exclusion has knock-on effects, including limiting a person’s social and economic opportunities as well as impacting on mental health and relationships.¹⁵ It does not just harm those who are excluded and their dependants: it has a negative impact on the entire UK economy.

The Consequences of Financial Exclusion

How financial exclusion affects people:

- One in five people struggling with problem debt report losing their job as a result¹⁶
- Almost half of debt-advice clients say it has affected their health¹⁷
- One in four debtors say it harmed their relationships¹⁸

How financial exclusion affects the economy:

- Over-indebtedness costs the UK economy around £900m annually¹⁹
- Low levels of financial capability cost the UK economy £3.4 billion each year²⁰
- Policy interventions such as credit-union subsidies have cost over £2.3bn since 2004²¹

Financial Inclusion is a long-standing goal for the UK government.²² Ensuring that people have access to useful and affordable financial services

3. HM Treasury and Department for Work and Pensions, Financial Inclusion Report 2018-9, March 2019, [link](#)
4. Financial Inclusion Commission, The Facts, Accessed 12 September 2019, [link](#)
5. CHASM, Financial Inclusion Annual Monitoring Report, 2018, [link](#)
6. Provident Financial, Annual Report and Financial Statement, 2016, [link](#)
7. Centre for Social Justice, Future Finance, 2015, [link](#)
8. FCA, Financial Lives, 2017, [link](#)
9. Independent, “A quarter of British adults have no savings, study reveals”, 20 March 2018, [link](#)
10. BBC, “Insurance gap penalises poor households”, 15 November 2017, [link](#)
11. The Money Advice Service, Press Release, 10 March 2016, [link](#);
12. Citizens Advice, Press Release, 21 August 2018, [link](#)
13. Policy Action Team, National Strategy for Neighbourhood Renewal (PAT 14: Financial Services), 1999, [link](#); HMT, Promoting Financial Inclusion, 2004, [link](#); House of Lords, Tackling Financial Exclusion, 25 March 2017, [link](#)
14. Centre for Social Justice, Future Finance, June 2015, [link](#)
15. Centre for Social Justice, Future Finance, June 2015, [link](#)
16. Legal Services Research Centre, Helping Hand: The Impact of Debt Advice on People’s Lives, 2007, [link](#)
17. Legal Services Research Centre, Helping Hand: The Impact of Debt Advice on People’s Lives, 2007, [link](#)
18. Relate, In too deep, 2017, [link](#)
19. The Guardian, Personal debts “shear almost £900m off British economy”, 6 September 2018, [link](#)
20. Centre for Economics and Business Research, Potential benefits of implementing financial education, 2012, [link](#)
21. Policy Exchange Analysis of Government spending announcements from 2004-2018. See Appendix A for a breakdown of these costs.
22. HM Government, Financial Inclusion Strategy, 2017, [link](#)

is also recognised by the World Bank as a stepping stone for global economic progress and the continued improvement of living conditions in the developing world.²³ Both the UK Government and the World Bank recognise that FinTech can radically improve access to financial services for low-income customers. This report explains how to put FinTech at the heart of the Government’s policies on financial inclusion.²⁴

Financial inclusion powered by FinTech

What is FinTech?

- FinTech – a combination of the words ‘financial technology’ – describes the use of new technology to improve and automate the provision and use of financial services.
- The latest wave of FinTech is distinct and provides new opportunities in the area of financial inclusion. It is arguably even more transformative and groundbreaking than previous waves, in that it is driven by a large number of small startups and makes use of almost ubiquitous smartphone devices to connect directly with consumers.

London is the undisputed FinTech capital of Europe. Over a third of European venture capital funding goes to London FinTech firms - almost double that of any other European city - making it the fastest-growing sector of the London economy.²⁵ FinTech companies can deliver better and more cost-effective services to low-income customers. This means that FinTech companies can transform the market dynamics of banking, credit and insurance. Nonetheless, despite government recognition of the role that FinTech can play in growing the economy, and the strength of the UK’s FinTech sector, very limited progress has been made in harnessing its power for the benefit of low-income consumers.

The primary cause of financial exclusion is that low-income customers are not commercially attractive to companies providing financial services. Government intervention across all parties (despite its considerable achievements) has, as yet, failed to tackle this core issue in financial services. If the Government is to fulfill its ambitions on financial inclusion, it must adopt a new approach that encourages and takes maximum advantage of FinTech innovations.

This research sets out a new FinTech-led approach to this entrenched social and economic issue. Indeed, the final question of the House of Lords Select Committee on Financial Exclusion report asked, in its call for further evidence, “does the Government have a role to play in ensuring that the development of financial technologies (FinTech) and data capture helps to address financial exclusion? If so, what should this role be?”²⁶ This report aims to answer these questions and to explain why financial inclusion policy in the UK has achieved only limited results in some areas. It demonstrates the importance of market forces in ensuring low-income consumers’ preferences are well served and the potential of new innovative technologies in financial services to improve low-income customers’ economic, social and life outcomes.

23. The World Bank, Briefing, 18 July 2018, [link](#)
 24. HM Treasury, Department for Work and Pensions, Financial Inclusion Report 2018-19, March 2019, [link](#); World Bank, The Global Findex Database 2017: Measuring Financial Inclusion and the Fintech Revolution, 2017, [link](#)
 25. MarketsMedia, “Fintech Is Fastest Growing Sector In London economy”, 4 April 2019, [link](#)
 26. House of Lords, Tackling financial exclusion: A country that works for everyone?, 25 March 2017, [link](#)

Chapter One: What is FinTech?

An Introduction to the fastest growing sector of the UK economy

Introduction

“FinTech” is not a new phenomenon. Throughout history, companies have tried to use new technology to improve the efficiency and delivery of basic financial services. Some academics have taken issue with the most recent use of the term, due to the fact that it implies that the concept is inherently new.²⁷ Previous “waves” of technological innovation have led to widespread changes in the financial sector and how consumers use financial services. For example, the arrival of automated cash machines, the modern credit card and the switch to electronic transaction records all represent the use of the latest available technology to improve financial services.²⁸

The latest wave of FinTech innovation is fundamentally different to those before it. It has the capacity to transform completely the financial sector and how it operates. The latest “wave” of innovation has been driven by four key elements:

1. **Highspeed internet connections**, allowing for “cloud computing” and online platforms
2. **Exponential increases in computing power**, unlocking new algorithms and data sources
3. **Widespread adoption of smartphones**, providing a new channel for 24/7 services via apps
4. **Regulatory changes**, known collectively as “Open Banking”

These “core” technologies underpin almost every recent FinTech innovation. Especially when combined together, they bring innovations in financial services directly to consumers while also decreasing the barriers to entry into financial services for new firms. As the FCA has noted, “levels of innovation by major banks have until recently been low” because “traditional banks have until recently not built capability to enable them to look holistically at the data they hold on customers”.²⁹

These technologies have paved the way for a more diverse FinTech “ecosystem”. Previously, “FinTech” developments such as the creation of BACS, the UK’s electronic interbank payments service, were led by a small group of banks and financial institutions.³⁰ Although they are still players,

27. Executive, “It’s a fine time for FinTech”, 31 July 2015, [link](#)

28. Finance Innovation Lab, “FinTech for Financial Health”, 5 April 2017, [link](#)

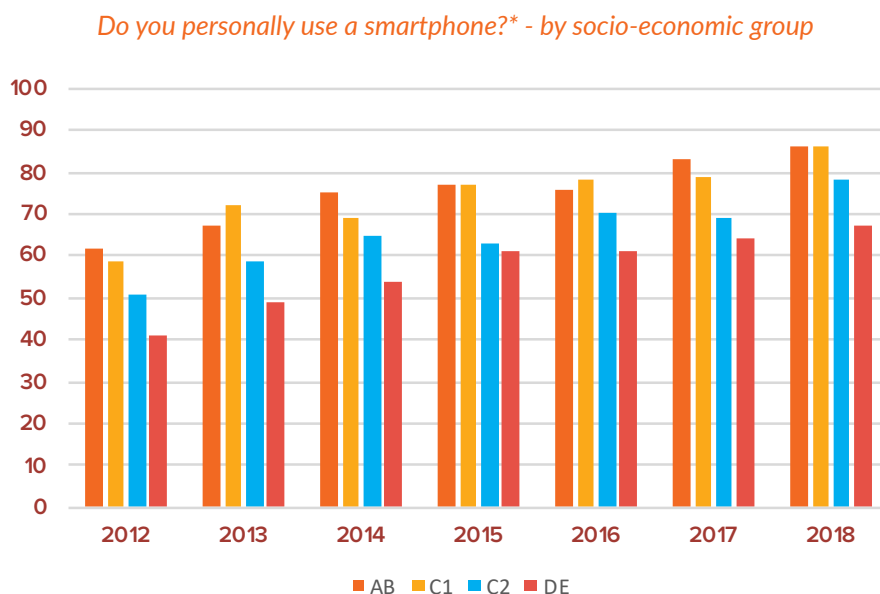
29. FCA, Strategic Review of Retail Banking Business Models, December 2018, [link](#)

30. BACS, “History of Bacs”, [link](#)

the most recent wave of innovation is primarily characterised and led by a large number of small startups, which are often run initially by just a few people.

Smartphones

FinTech has been powered by smartphones. The dramatic spread of smartphone ownership in the UK over the last decade amongst all demographics, even the over-75s, has created the opportunity for many recent innovations.³¹



Source: Ofcom

This penetration has been aided by 4G networks and the rollout of Fibre Optic broadband services.³² While more powerful than ever before, smartphones are now so affordable and popular that for lower-income customers their mobile phones are likely to be their primary source of connectivity to services.³³

Smartphones have created new opportunities for customers to engage with financial services. People typically carry their smartphones with them at all times.³⁴ A specific example of how this has been used by FinTech companies is the development of apps that provide immediate “push notifications” (a means by which an app can send information to a phone even if the app is not in use) about transactions, upcoming payments, balance notifications or even nudges to save money.³⁵ Banking apps offered by the mainstream banks still typically lag behind in this area, with a degree of uncertainty for customers even about such simple information as the amount of money they actually have in their account at any given time.³⁶

31. Deloitte, Deloitte Mobile Consumer Survey 2018, [link](#)

32. Department of Culture Media and Sport, Digital Strategy, 1 March 2017, [link](#)

33. Ofcom, Communications Market Report, 2 August 2018, [link](#)

34. Ofcom, A decade of Digital Dependency, 2 August 2018, [link](#)

35. LeanPlum, “4 Engaging Messaging Campaigns For Fintech Apps”, 31 August 2017, [link](#)

36. Which?, “The Monzo effect: how traditional banks are challenging the challengers”, 19 April 2019, [link](#)

Cloud computing services

Cloud Computing

- Cloud computing is the delivery of computing services that include servers, storage, databases, networking, software, analytics and intelligence by remote servers on the Internet (“the cloud”).
- It is sold on demand, it is elastic (a user can have as much or as little of a service as they want at any given time) and the service is fully managed by the provider: the consumer needs nothing but a personal computer and internet access.
- Cloud service-providers often employ redundant resources to ensure resilient storage and to keep users’ important workloads running - often across multiple global regions.³⁷

Cloud technology offers FinTech companies storage space and immense computing power. Unlike traditional IT systems, it does not require vast upfront investment. Instead, pre-configured “cloud computing services”, the most well known of which are Amazon Web Services (AWS) and Microsoft’s Azure, are highly secure, have relatively low initial fixed costs and allow businesses to access reliable back-end services at affordable prices.³⁸ Indeed, over 30 per cent of banks worldwide have said that more than 50 per cent of their expenditure over the next 24 months will be on new cloud-based applications.³⁹

Cloud computing allows banks to scale their use of services up or down very quickly. This, in turn, enables them to avoid service outages related to an influx of new customers or a spike in demand, whilst avoiding the need to pay high fixed monthly costs when the business is small or service use is low. This allows businesses immediately to fine-tune their product offerings according to user demand and means that small FinTech companies can compete with larger financial institutions which are still struggling with legacy IT systems.⁴⁰

APIs and SDKs

APIs and SDKs have created a highly diverse FinTech “ecosystem”. The ability of developers to access Application Programming Interfaces (APIs), Standard Developer Toolkits (SDKs) and open source code (which is publicly accessible and can be modified and shared), means that almost no piece of software is now actually built from scratch. Instead, each new service or app builds on the work already done by others, while pulling in data from a wide range of sources.⁴¹ This allows services to provide customers with the most relevant data in a new or innovative way. For example, bank account aggregation services allow people to aggregate information about all of their accounts in one place.⁴² Such applications would not have been possible without simple user interfaces with common standards.

37. TechTarget, “What is cloud computing”, accessed 9 September 2019, [link](#)

38. Microsoft Azure, [link](#); AWS, [link](#)

39. PWC, Unpacking the Cloud, [link](#)

40. AkeoLending, Impact of Cloud Computing on Fintech companies, 7 January 2019, [link](#)

41. BBVA, “What is open banking and why is it important?”, 6 May 2019, [link](#)

42. Yodlee, [link](#)

What are APIs and SDKs?

- API stands for “Application Programming Interface”. APIs allow one set of software to interact with another. Think of APIs as resembling the Rosetta Stone, a tablet by which two vastly different languages (in this case two different instruction sets) can be translated and transferred for mutual understanding. APIs allow different IT systems to “talk” to each other and share data securely with any other system that has added the same API. As these communications are automated and use standardised formats; they can operate 24/7 without security risks or costly manual labour.⁴³
- SDK is the acronym for “Software Development Kit”. These bring together a group of tools that enable the programming of mobile applications.

This development has been in part aided by the de-facto duopoly that exists between phones running the Android and iOS operating systems, developed by Google and Apple respectively.⁴⁴ Developers need only to create two versions of their mobile app, with a significant proportion of the code being transportable between the two, to ensure they can offer services to almost every adult in the UK market. Similarly, development time as well as the availability and usability of these apps is significantly increased due to the tools and app marketplaces provided by Apple and Google, which give apps a consistent look and feel across devices manufactured by a wide range of companies such as Samsung, Sony and newer more price-competitive Chinese brands that are establishing a reputation for providing great value-for-money phones at the lower end of the market.⁴⁵

Open Banking and Open Data

The recent advances in FinTech have been aided by a collection of regulatory changes known collectively as “Open banking”. Competition and innovation in financial services has been driven by opening up customer banking data to third parties. This is taking place both across the European Union, through the revised Payment Services Directive (PSD2) and in the UK where the Competition and Markets Authority (CMA) has mandated the UK’s largest banks to adopt the Open Banking Standard.⁴⁶ The Open Banking Standard, which emerged from recommendations made by the Open Banking Working Group and supported by the Competition Markets Authority, went a step further than PSD2 and required that banks establish a *common* API standard instead of making their data available through different technical standards, thereby removing an additional layer of complexity that might hinder competition.⁴⁷ This has made it easier for customers to switch between current account providers and has allowed third parties to create new products that meet unmet needs, using new data sources to meet demand.⁴⁸

43. Big Commerce, “Understanding the API Economy and its Role in Ecommerce”, [link](#)

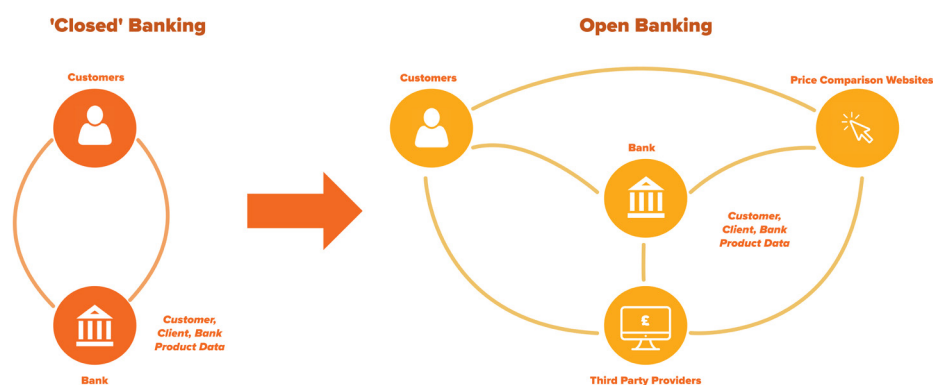
44. Patently Apple, “With Apple and Google App Stores owning 95% of all Mobile App Spending, the DOJ may want to end this Duopoly”, 5 June 2019, [link](#)

45. Wired, “Meet the Chinese phone brands vying to be the next OnePlus”, 28 January 2019, [link](#)

46. European Central Bank, The revised Payment Services Directive (PSD2) and the transition to stronger payments security, March 2018, [link](#); Open Banking, Welcome to the Open Banking Standard, accessed 12 September 2019, [link](#)

47. Open Banking Working Group, The Open Banking Standard, February 2016, [link](#); Competition Markets Authority, Retail Banking Market Investigation, 9 August 2016, [link](#)

48. Deloitte, Open banking: How to flourish in an uncertain future, 2019, [link](#)



FinTech companies can also provide more effective services using Open Data, which is available for everyone to access, use and share. By combining Open Data (pertaining, for example, to government services) with personal data (such as bank accounts or credit cards), firms can provide better, more customised services to customers subject to their consent. Open Banking APIs allow this to be done without manual data entry, exposing a range of data to third-party financial-service-solution providers including payment initiators, account aggregators, and other emerging “FinTechs”.⁴⁹ Moreover, firms can use the power of cloud computing to identify trends relevant to individuals and groups of customers.⁵⁰

1. Disrupting traditional market dynamics

FinTech companies can operate profitably on a smaller scale than traditional banks. Their small size does not prevent them from offering their services, either directly or indirectly, to thousands or even millions of consumers, due to the near-zero marginal costs of scaling up internet-based and data-driven financial services. The decentralised nature of the financial innovations being developed by small startups has allowed new entrants to “disrupt” the large incumbent banks and international financial institutions. One of the clear advantages FinTech firms have over traditional branch-based banks is that by operating exclusively via an online platform or a mobile app, their operating costs are significantly lower and they can grow very quickly. Unlike some traditional banks, they can ‘on-board’ thousands of users in a matter of hours.⁵¹

49. BBVA, “How does the fintech sector use APIs?”, 15 July 2019, [link](#)

50. Monzo, “Laying the Foundation for a data team”, 29 November 2016, [link](#)

51. Signicat, “The Battle to Onboard II: The European Perspective on Digital Onboarding for Retail Banks”, 2018, [link](#)

Case Study: A Comparison of Metro Bank and Revolut

Metro Bank was founded in 2010, and has less than 1 per cent market share in active personal current accounts as of 2014 and only 3.2 per cent market share after eight years of established and continuous operation, with 1.6 million customer accounts and 3,900 employees across 66 branches in 2018.⁵² This is despite having the considerable advantage of being funded initially by £75 million of private equity, allowing it to operate with a large financial cushion and to raise £641 million via a stock market listing.⁵³ Despite not recording its first annual profits until 2018, the company is valued at £1.5 billion.⁵⁴ At one stage in March 2019, it became the second most shorted company on the UK stock market. In May of the same year it suffered a plunge in its share price after a social media scare undermined trust in the bank.⁵⁵

In comparison, Revolut was launched publicly in 2015 and has over 7 million customers with 1.6 million in the UK alone.⁵⁶ It has had thirteen funding rounds and raised £1.01 million in July 2016 via the crowdfunding platform Crowdcube: these crowd investors realised returns of around 1,900 per cent on their initial stakes.⁵⁷ Despite being one of the largest FinTech firms, it has achieved all of its successes with an initial staff of 20 and has now grown as of September 2019 to approximately 1,300 people and £337 million in investment.⁵⁸ In October, Revolut hired JPMorgan to oversee a \$500 million equity raise and \$1 billion convertible loan after securing a global deal with Visa to expand into 24 new markets and boost staff numbers. It is reported that Revolut is aiming for a valuation of between \$5 billion and \$10 billion from the capital raise.⁵⁹

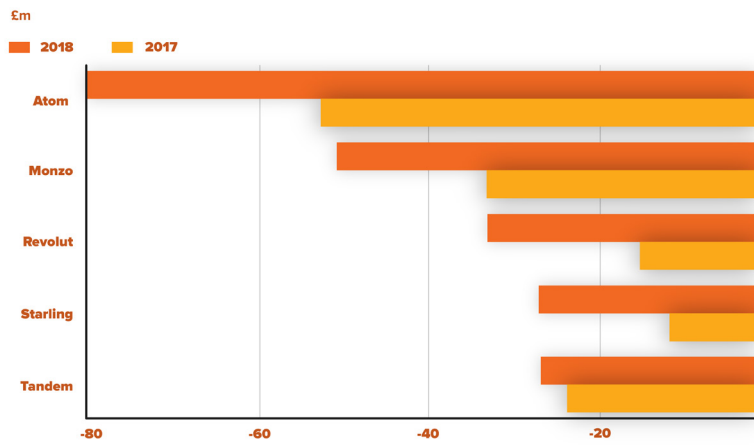
New technology has changed the core dynamics of the business model for financial services. While FinTech firms can grow extremely quickly, they can also operate as a viable business on a much smaller scale by offering a niche product that serves thousands rather than millions of customers. A FinTech firm, such as a mobile banking app, can be viable with a substantially lower volume of users and transactions than ever before. By “piggybacking” on existing technologies FinTech firms can reach a “break-even” point with only marginally higher revenue from each customer - through subscription fees or other revenue streams - than the costs of providing services. This is especially true of new “mobile banks”, which are in reality closer to payments firms and e-wallet-providers like PayPal than actual banks, as most cannot accept physical cash deposits or make loans.⁶⁰

Most FinTech firms seek investment from venture capital (VC) firms. They often raise millions in funding with only a few thousand users, rather than set out to operate profitably at a small scale.⁶¹ This is a long-term strategy aimed at challenging large incumbent providers - as seen with firms like Monzo and Starling - as it allows them to build their product and brand, run large marketing campaigns and operate at a loss for several years.⁶² During this time startups and their investors hope the firm will reach a sufficient critical mass to operate profitably by capturing a significant share of an existing market like banking or consumer lending.

The increasing size, potential profitability and cost efficiencies of FinTech banks are demonstrated by the following graphs.⁶³ It is important to note that their heavy expenditure on systems and infrastructure investment could be viewed as long-term investment. If restated on this basis, their reported losses in early, high growth phases would be significantly reduced.

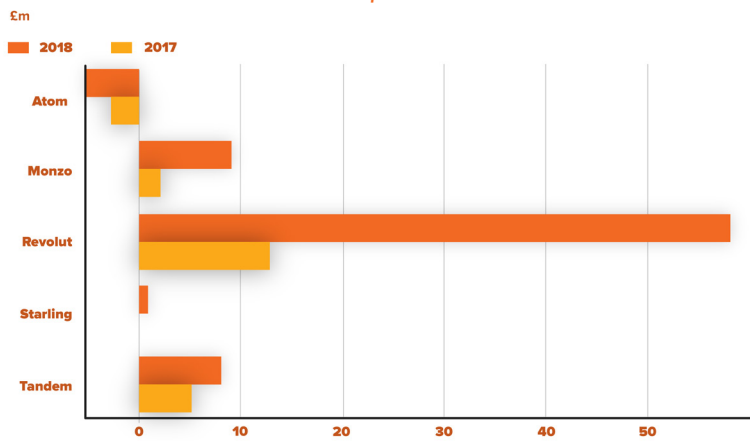
52. Competition & Markets Authority, Personal Current Accounts: Market Study Update, 18 July 2014, [link](#); Metro Bank, Annual Report and Accounts 2018, 10 April 2019, [link](#)
53. BBC News, “Metro Bank: Sublime or Ridiculous?”, 29 July 2010, [link](#); Daily Telegraph, Metro Bank raises £387.5m as it postpones IPO plans, 19 January 2014, [link](#)
54. Financial Times, 21 February 2018, [link](#); Reuters, 23 January 2019, [link](#)
55. BBC News, 19 March 2019, [link](#); The Economist, 16 May 2019, [link](#)
56. BBC News, 2 April 2019, [link](#)
57. Crunchbase, 4 September 2019, [link](#); Crowdcube, 2 August 2019, [link](#)
58. CNBC, “Inside Revolut’s bid to be the Amazon of banking”, 5 July 2019, [link](#); Financial Times, “Revolut plans hiring spree in customer service and compliance”, 1 September 2019, [link](#)
59. Finextra, 14 October 2019, [link](#)
60. Business Strategy Hub, How Does PayPal Make Money?, [link](#)
61. Balderton Capital, Investment Portfolio, [link](#)
62. Warc, Monzo shows the power of brand (though losses increase), 9 July 2019, [link](#)
63. Financial Times, 5 October 2019, [link](#)

Fintech start ups: pre-tax profits



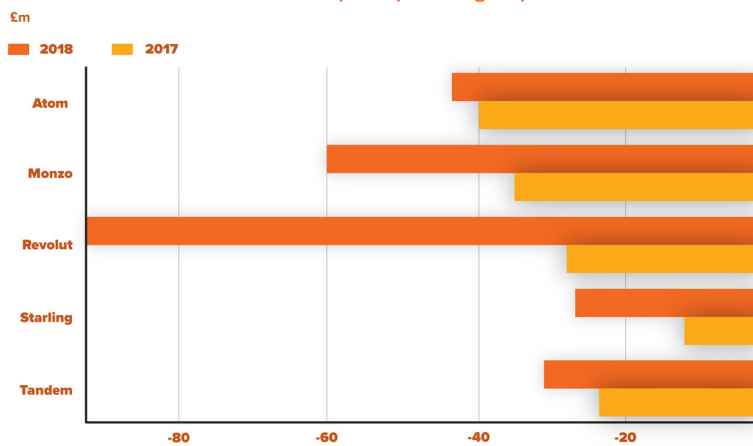
Source: FT

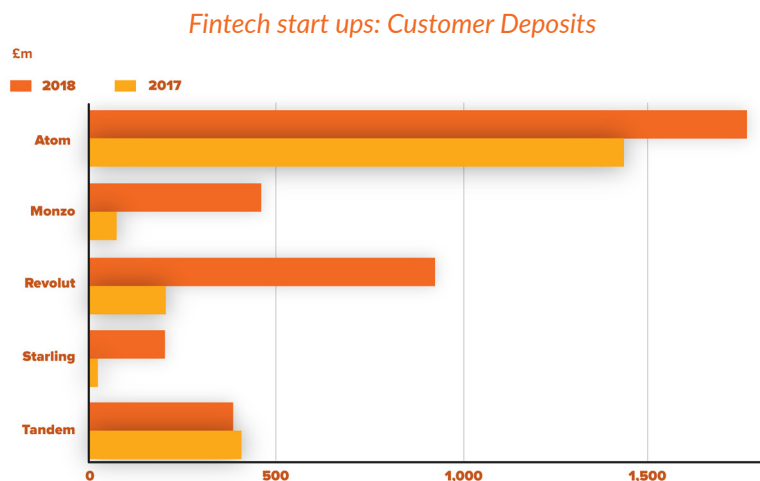
Fintech start ups: Net Revenues



Source: FT

Fintech start ups: Operating Expenses





2. The Growth of FinTech in the UK

The success of FinTech startups is illustrated by a variety of statistics. These are extensively documented in research published by Government, the Financial Conduct Authority (FCA), and industry trade bodies such as TechUK and Innovate Finance.⁶⁴ Nonetheless, the most commonly cited statistical indicators about the FinTech sector and firms within it broadly fall into four main categories:

- **Market Size:** Total revenue and annual turnover
- **Fund Raising:** Growth and amount of investment in FinTech startups
- **Competition:** Market share and customer acquisition
- **Economic Impact:** Number of new firms and jobs created

The United Kingdom excels in all four of these areas.

64. Department for International Trade, UK Fintech - State of the Nation, [link](#); McKinsey, Synergy and disruption: Ten trends shaping fintech, December 2018, [link](#); InnovateFinance, FinTech Nation 2018, 18 March 2018, [link](#)

FinTech in the United Kingdom

Market Size

- Fintech firms generated £6.6 billion in revenue in 2015⁶⁵
- Average revenue growth for FinTech firms was over 22 per cent between 2014-2016⁶⁶
- The UK has over 1,600 FinTech firms in the UK as of 2019: some estimates expect this figure to more than double by 2030⁶⁷
- London hosts 17 of the top 50 international FinTech firms⁶⁸
- As of 2019, the UK has a 42 per cent FinTech adoption rate, compared to a global average of 33 nper cent⁶⁹

Growth and amount of investment in FinTech startups

- FinTech investment in the UK has reached US\$20.7bn (up from US\$5.6bn in 2017), representing over half of the total US\$37.5bn total FinTech investment across Europe⁷⁰
- In 2018, UK FinTech firms attracted \$3.3bn of private equity and corporate and venture capital⁷¹
- In 2018, UK investment in high growth digital tech firms increased by 61 per cent, to just under £5 billion:⁷² the UK experienced the highest FinTech funding round of 2019 when Softbank invested \$800 million in supply chain finance lender Greensill⁷³

Market share and customer acquisition

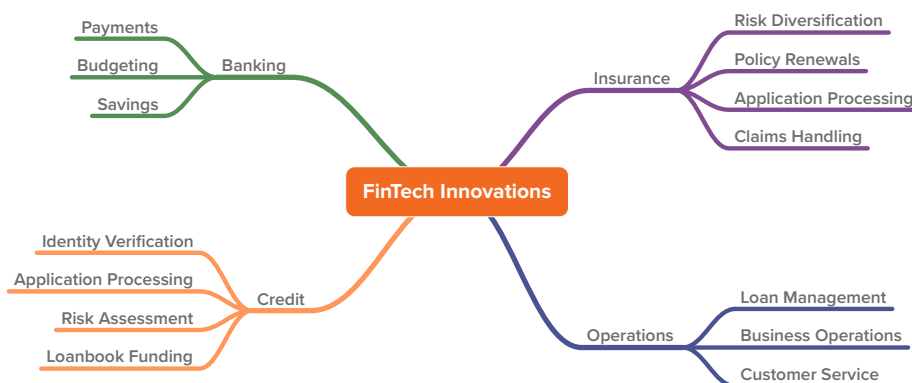
- FinTech services are used by over 70 per cent of UK customers to manage their money⁷⁴
- FinTech firms account for 36 per cent of the foreign transfer market
- 96 per cent of global consumers know at least one FinTech service that they can use to transfer their money and make payments⁷⁵
- 75 per cent of global consumers have actually used a money transfer or payments service provided by FinTech⁷⁶
- In 2019, 30 per cent of global customers gave as primary reasons for using a FinTech alternative that they make it easier to set up an account and 27 per cent cited more attractive rates/fees⁷⁷

Number of new firms and jobs created

- 76,500 people work in FinTech UK-wide.⁷⁸ This is forecast to grow to 105,500 by 2030⁷⁹
- There are over 1,600 FinTech firms in the UK⁸⁰
- By 2030 there are expected to be 3,300 firms operating in the UK⁸¹
- In the first six months of 2019, London startups constituted 90 per cent of all investment into the Fintech Sector⁸²

65. Department for International Trade, UK FinTech State of the Nation, [link](#)
66. InnovateFinance, 5 November 2018, [link](#)
67. Department for International Trade, UK FinTech State of the Nation, [link](#)
68. Business Chief, 2 November 2018, [link](#)
69. Department for International Trade, UK FinTech State of the Nation, [link](#)
70. Department for International Trade, UK FinTech State of the Nation, [link](#)
71. Department for International Trade, UK FinTech State of the Nation, [link](#)
72. TechNation, [link](#)
73. Finance Feeds, 16 July 2019, [link](#)
74. EY, 3 June 2019, [link](#)
75. EY, 3 June 2019, [link](#)
76. EY, 3 June 2019, [link](#)
77. EY, 3 June 2019, [link](#)
78. Department for International Trade, UK FinTech State of the Nation, [link](#)
79. Innovate Finance, [link](#)
80. Innovate Finance, [link](#)
81. Innovate Finance, [link](#)
82. Finance Feeds, 16 July 2019, [link](#)

3. Visualising the Sector



FinTech can transform almost every aspect of financial services. FinTech is much more than just “fancy budgeting apps”.⁸³ App-based “banking” makes up a very small part of the FinTech sector. Indeed, most FinTech innovations are designed to improve the “back end” (operational) capabilities of financial services, thereby allowing them to serve customers in a more efficient and cost-effective way.⁸⁴ For example, the FinTech sector’s official and highly influential trade association, Innovate Finance, has a diverse membership body of 250 FinTech firms across all areas of financial services. Only 9 of them offer an “app” to consumers.⁸⁵

Banking	
Service	Transformative technology
Payments	<ul style="list-style-type: none"> Prepaid card, e-wallet and mobile payment systems like ApplePay or GooglePay, which utilise NFC (Near Field Communication) technology to facilitate contactless payments. P2P (Peer-to-Peer) currency exchange services such as TransferWise, Midpoint, CurrencyFair or WorldFirst. Fast cross-border bank transfers like the SWIFT and SEPA systems. App-based “banking” services like those provided by Monzo, Starling, Revolut, N26, Monese and the highstreet banks.
Savings	<ul style="list-style-type: none"> Automatic e-wallets like Moneybox, Oval and Acorns, which automatically “round-up” transactions and save the difference. Automatic regular “affordable” saving e-wallets such as Plum or Chip.

83. FT, 23 April 2019, [link](#); Twitter, 23 April 2019, [link](#)

84. Monzo, 19 September 2016, [link](#)

85. Innovate Finance, Accessed on 29 August 2019, [link](#)

Budgeting	<ul style="list-style-type: none"> • Predictive budgeting e-wallet apps such as Due and Onedox. • “Singleview” personal financial management apps like Cleo or Emma. • Automated price comparison/switching services like Flipper, Moneysupermarket.com or Lookaftermybills.com.⁸⁶
Cloud-based “banking” services	<ul style="list-style-type: none"> • Platforms such as Modulr, Bankable, Ebankit, 10x Future Technologies Limited, Ezbop, Account store and Form 3 allow companies to move money more reliably and make it faster to process payments.⁸⁷
Operations	
Service	Transformative technology
Loan Management	<ul style="list-style-type: none"> • Loan Management systems such as those provided by Mambu, Loandisk or the Benedict Group which centralise management of customer loans and repayments.⁸⁸ • Data analytics can transform loan decisions, operations, customer demographics using software like TurnKey Lender or Credit Kudos which provides a wide range of software tailored to individual businesses.⁸⁹
Business Operations	<ul style="list-style-type: none"> • Customer-acquisition through targeted online marketing with systems such as Target Digital Marketing which collect data in order to personalise online ads.⁹⁰ • Performance analytics of staff, customer and operations collected using systems such as Servicenow which collates data in order to enhance performance.⁹¹
Customer Service	<ul style="list-style-type: none"> • Chatbots mean that general queries are dealt with more efficiently either through systems such as the Amazon Alexa or the more basic model on consumer websites which direct and advise customers before a member of staff has to get involved.⁹² • Account management such as NutShell designed to optimise companies’ performance.⁹³ • Debt collection can be streamlined through the use of software such as Lariat which offers companies centralizing web-based debt-collection software.⁹⁴

86. Moneysupermarket.com, [link](#); Flipper, [link](#) and Look After My Bills, [link](#)

87. ebankit, [link](#); Bankable, [link](#); Modulr, [link](#); 10x Future Technologies Limited, [link](#); Ezbob, [link](#)

88. Loandisk, [link](#); The Benedict Group, [link](#); Mambu, [link](#)

89. TurnKey Lender, [link](#); Credit Kudos, [link](#)

90. Target Digital Marketing, [link](#)

91. Servicenow, [link](#)

92. IBM, Chatbots, An Essential Guide, 9 May 2019, [link](#)

93. Nutshell, [link](#)

94. [Lariat](#), [link](#)

Credit Service	
	Transformative technology
Identity Verification	<ul style="list-style-type: none"> • API-enabled I&E verification and KYC (Know Your Customer) services, such as those provided by used by Yodlee, Saltedge, Truelayer, Yolt and Mint.com, can improve access and collection of customer data.⁹⁵ • Document scanning and verification services such as the “validation” software offered by ibml’s Capture Suite software, Trulioo, Onfido and Au10tux.⁹⁶
Application Processing	<ul style="list-style-type: none"> • Automated online and app-based self-service systems powered by services such as Eptica, which offers AI-powered, web-based 24/7 self-service.⁹⁷ • App-based banking integration via APIs like that developed by Starling.⁹⁸ • Automated API-based and screen-scraping transaction data services.
Risk Assessment	<ul style="list-style-type: none"> • Automated decision-making engines used by companies such as TurnKey Lender and Credit Ratings Agencies (CRAs) such as Call Credit.⁹⁹ • Social and alternative data-risk assessment algorithms such as Credit Kudos which can securely provide alternative credit scoring.¹⁰⁰ • Automated “Thin-file” credit assessment service such as Aire which aims to “thicken” the credit score of those traditionally isolated from credit scoring.¹⁰¹
Loanbook Funding	<ul style="list-style-type: none"> • Online P2P lending models such as Zopa, Ratesetter or Funding Circle which aim to use technology to redefine the loans system.¹⁰² • Online crowdfunding investment platforms like Crowdcube which allow anyone to invest in business ventures that they like.¹⁰³ • Social purpose online lending/donation models like Community Chest, Askif, Kiva or Abundance which work to crowdfund and lend money at lower tax rates in order to fund projects supported by a community of lenders and donors, often internationally.¹⁰⁴

95. Medium, “Top 10 KYC & AML Service Providers”, 17 August 2018, [link](#); The Open Banking Hub, Screen-scraping 101, [link](#); Saltedge, [link](#); True Layer, [link](#); Your Money, “Revolut is now available with Yolt”, 20 November 2019, [link](#)

96. Ibml, Document Scanning Validation Software, [link](#); Trulioo, [link](#), Au10tux, [link](#)

97. Eptica, [link](#).

98. Starling Developers, [link](#)

99. TurnKey Lender, [link](#); CallCredit, [link](#)

100. Credit Kudos, [link](#)

101. Aire, [link](#)

102. Zopa, [link](#); Ratesetter, [link](#); Funding Circle, [link](#)

103. Crowdcube, [link](#)

104. Community Chest, [link](#); Askif, [link](#); Kiva, [link](#); Abundance, [link](#)

Insurance	
Service	Transformational technology
Application Processing	<ul style="list-style-type: none"> • Cloud-based loan management system such as Mambu which helps financial institutions to digitally manage their loans systems and adapt to the newest technological advances and their consequences for finance.¹⁰⁵ • Managing repayments (rescheduling/monitoring/card payments). • Data analytics (loan decisions, operations, customer demographics etc.)
Risk Diversification	<ul style="list-style-type: none"> • Group and Social Circle insurance services where users collectively pool their premiums in order to try and save money. • Online P2P and social insurance companies which allow people to insure others.¹⁰⁶
Claims Handling & Renewals	<ul style="list-style-type: none"> • Automated online and app-based “self-service” models like So-Sure, Cuuva Urban Jungle, Homelyfe, Altus or Wrisk which aim to lower premiums for users, with everything mainly carried out via their apps.¹⁰⁷ • “On demand” insurance companies like Zego.

Conclusion

The United Kingdom has one of the largest and most innovative FinTech industries in the world. FinTech companies have the capacity to transform every aspect of financial services, both front-end and back-end. The latest wave of FinTech innovation, enabled by cloud-computing, smartphones and open data, has irreversibly transformed the market dynamics of financial services. FinTech companies can not only provide services in a more cost-efficient way than their traditional counterparts but can also become economically viable with fewer users. These changes provide a unique opportunity for policy makers to solve the problems of financial exclusion.

105. Mambu, [link](#)
 106. GoMedici, “31 P2P Insurance Startups Capitalizing on the Power of Virtual Communities”, 25 January 2017, [link](#)
 107. So-sure, [link](#); Wrisk, [link](#); Cuuva, [link](#); Urban Jungle, [link](#); Homelyfe, [link](#)

Chapter Two: A Change in Approach

Introduction

Financial exclusion in the UK remains an entrenched problem, despite London’s status as a major global financial hub.¹⁰⁸ It is also despite cross-party recognition of the problem and well-funded policy interventions over the past 20 years that to date easily exceed £2bn.¹⁰⁹

The approach that the Government has taken has been consistent for the past 20 years. In 1998, a Policy Action Team was established to assess the scale of the problem of financial exclusion and its impact on low-income households. Their work culminated in the seminal report *Access to Financial Services: The Report of Policy Action Team 14* which was published in November 1999 and made 40 recommendations. At least 23 of these were adopted by the Government and influence policy to this day, especially with regard to the successive governments’ (ongoing) support for credit unions.¹¹⁰

This chapter will:

1. **Outline the traditional approach** to financial exclusion taken by the Government
2. **Evaluate Government success** and explore its limitations
3. **Set out a new approach** to financial inclusion with FinTech at its heart

The use of FinTech has, until very recently, never been an integral part of any Government’s financial inclusion strategy or any major policy solutions. It is time to move away from the traditional approach by supporting the latest FinTech innovations.

1. The Traditional Approach

There have been three main “types” of intervention pursued by the Government. Setting aside specific funding programmes, initiatives or individual policies, these three “approaches” to Financial Inclusion have been:

- **Regulation** and price-oriented market interventions
- **Education** and money advice programmes

108. The Legatum Institute, *The Legatum Prosperity Index 2018*, [link](#); Credit Suisse, *Global Wealth Databook 2018*, October 2018, [link](#)

109. See Appendix A

110. HM Treasury, *Access to Financial Services*, November 1999, [link](#)

- **Subsidisation** of non-profit financial services

Although they had some successes, these policies have limitations and, on occasion, have had a regressive impact.

Regulation (free bank accounts, price caps)

The main method by which Government has tried to address financial exclusion is through regulation. As shall be seen, the “voluntary agreement” that led to the creation of Basic Bank Accounts (BBAs) and the legislation that created Post Office Card Accounts (POCAs) are good examples of Government taking a regulatory approach to the issue.¹¹¹

Other market regulations include the Payment Accounts Directive (PAD). This sought to increase transparency about the fees and charges applied by bank-account providers and to improve ease of switching payment accounts by establishing minimum standards.¹¹²

More recently, the Government has attempted to control the cost and availability of credit for people on low incomes. In 2016, the FCA brought in a cap on “High Cost Short Term Credit” otherwise known as HCSTC loans.¹¹³ It was intended to protect consumers from excessive charges and reduce the availability of credit from existing commercial providers.¹¹⁴

HCSTC Price Caps

Firms that offer HCSTC loans must ensure that their loans meet three criteria:

- Interest and fees charged cannot exceed 0.8 per cent of the amount borrowed per day
- A cap of £15 is placed on default fees
- Borrowers must never pay more in fees and interest than 100 per cent of their loan.¹¹⁵

Education and financial advice (in schools and from debt advice services)

Education has long been an important part of the Government’s strategy to tackle financial exclusion.

- **In 1999, the Policy Action Team first identified a lack of debt advice.** It estimated that there was a shortfall in provision that failed to meet the needs of as many as one million people.¹¹⁶
- **The Government has tried to address this shortfall.** In both the First and Second Financial Inclusion Funds, significant sums were allocated for the funding of new community-based money advice services and the training of new advisors.¹¹⁷
- **In 2013, Financial Education was included on the National Curriculum.** It has been included as part of the framework for Personal, Sex and Health Education.¹¹⁸

111. See Glossary for more information

112. FCA, 30 April 2018, [link](#)

113. FCA, 21 June 2016, [link](#)

114. FCA, 21 June 2016, [link](#)

115. FCA, 21 June 2016, [link](#)

116. HM Treasury, Access to Financial Services, November 1999, [link](#)

117. HM Treasury, Promoting Financial Inclusion, December 2004, [link](#); House of Commons Treasury Committee, 21 November 2006, [link](#); See Appendix A for a Break down of these costs

118. Money Saving Expert, 12 September 2013, [link](#)

Single Financial Guidance Body and Money Advice and Pensions Service

The Financial Guidance and Claims Act 2018 created a **Single Financial Guidance Body (SFGB)**. It brought together government-sponsored financial guidance and debt advice, previously provided by the Money Advice Service, Pension Wise and The Pensions Advisory Service.¹¹⁹

In January 2019, these three bodies were amalgamated into a single guidance body, the **Money Advice and Pensions Service (MAPS)**. It was given responsibility for delivering the national financial capability strategy as well as for coordinating the delivery of advice and education services. Funding for MAPS is raised via an FCA-administered levy on financial institutions as well as the General Levy on pensions schemes which is collected by The Pensions Regulator.¹²⁰

Subsidies to not-for-profit models such as credit unions

Credit Unions are non-profit-making money cooperatives whose members can borrow from pooled deposits at low interest rates. Support for credit unions have been a key part of successive Governments' approach to financial inclusion. In June 2008, the Government announced plans to increase the number and size of credit unions in the United Kingdom.¹²¹ In 2012, further amendments were made to the Credit Union Act of 1979, which provided them with further powers and operational flexibility with the aim of growing the sector and increasing the commercial viability of individual credit unions.¹²²

There are still further plans to apply this approach to financial inclusion. The FCA recently announced that “in the short-term at least, the capacity of credit unions to make credit available to a significant portion of high-cost credit users is limited ... We believe that, in the longer term, to facilitate the growth of larger credit unions, HM Treasury should consider if there is value in a review of credit union and society legislation.”¹²³

A Limited Role for FinTech

Technology has been recognised by Government as the key to unlocking better financial services for low-income households in the long-term.

As early as 1999, the Policy Action Team report, *Access to Financial Services*, included recommendations to use technology when addressing financial exclusion. Yet to date there have been no substantial changes in government thinking with regard to the practical applications of technology as a driver of financial-inclusion policies and initiatives.¹²⁴

Most recently, the 2018 Budget provided £2 million for an Affordable Credit Challenge Fund. Launched by HM Treasury in the summer of 2019, the fund was intended “to harness the power of the UK’s world-leading FinTech sector, inviting participants to devise technological solutions addressing the challenges faced by social and community lenders”. Applications opened at the end of July for grants of between £125,000 and £150,000 for up to six partnerships to develop ideas: three winners will receive an extra £200,000 in Spring 2020.¹²⁵ The final 5 applicants were announced earlier this autumn. Nearly all of the money was given to credit unions, thereby extending the Government’s traditional

119. Financial Guidance and Claims Act 2018, [link](#)

120. Money and Pension Services, Business Plan 2019/20, [link](#)

121. HM Treasury, Proposals for a Legislative Reform Order for Credit Unions and Industrial & Provident Societies in Great Britain, July 2008, [link](#)

122. HMRC, Company Taxation Manual, Company Taxation Manual, Company Taxation Manual, Particular Bodies: Credit Unions, [link](#)

123. The Guardian, 23 July 2019, [link](#)

124. HM Treasury, Access to Financial Services, November 1999, [link](#)

125. Thisismoney, 20 July 2019, [link](#)

approach to financial inclusion.¹²⁶

2. Measuring Government Success

The need for a new approach to financial inclusion can be justified by analysing the past 20 years of government policy. While there has been a reduction in some aspects of financial exclusion (the number of people without a bank account has fallen from 2.1 million in 1999* to 1.3 million in 2018) other indicators suggest this success has not been widespread.¹²⁷ For example, the number of households without home contents insurance has increased from 25 per cent of the population in 1999 to 40 per cent in 2017. Furthermore, 26 per cent in 2017 still had no savings or investment products.¹²⁸ While there has been some progress, the evidence suggests that large numbers of people are still denied access to essential financial services. A more detailed timeline of government interventions to tackle financial inclusion is on the following page.

- 126. NESTA, "Innovation in Affordable Credit: finalists announced", 3 Nov 2019, [link](#)
- 127. FCA, The financial lives of consumers across the UK, [link](#); HM Treasury, Access to Financial Services, 1999, [link*](#)
- 128. FCA, The financial lives of consumers across the UK, [link](#)

	BBA/POCA		Credit Unions		Education	
Year	Announcement/Action	Outcome/State of Financial Exclusion	Action/Announcement	Outcome/State of Financial Exclusion	Action/Announcement	Outcome/State of Financial Exclusion
1999	<ul style="list-style-type: none"> PAT 14 Report makes 40 Recommendations, encouraging banks and building societies to develop and promote basic bank accounts. 	<ul style="list-style-type: none"> Research published by the British Bankers Association (BBA) indicates that between 6 percent and 9 percent of individuals (about 2.5 to 3.5 million adults) do not have a bank account 	<ul style="list-style-type: none"> PAT 14's report leads to the creation of The Central Services Organization (CSO), created to encourage credit unions to serve deprived communities. 	<ul style="list-style-type: none"> There are 659 Credit Unions in Britain, serving 225,000 members. 	<ul style="list-style-type: none"> The FSA published a strategy document in May 1999, in which it defined its role within consumer education. PAT 14 recommends that DFEE promote wider access to debt counselling. 	Unclear.
2004	<ul style="list-style-type: none"> Basic bank accounts were created in 2003. Government introduces Post Office Card Accounts with £182 million from the banking industry. The Government establishes a Financial Inclusion Taskforce to monitor progress and establishes a Financial Inclusion Fund of £120 million over three years to support initiatives to tackle financial exclusion, 	<ul style="list-style-type: none"> Family Resources Survey (FRS) in 2002-03 shows that there were around 8 per cent or 1.9 million households in Great Britain without access to any kind of bank account, equating to one in twelve households or around 2.8 million adults. 1 million basic bank accounts opened and 75 per cent of benefit recipients are paid electronically. 	<ul style="list-style-type: none"> The Government set up a growth fund for third-sector lenders like credit unions within the financial Inclusion Fund to boost coverage. 	<ul style="list-style-type: none"> In 2003, there were 665 credit unions in Britain serving over 410,000 members, up from around 365,000 members in 2001. 	<ul style="list-style-type: none"> Government establishes a Financial Inclusion Fund of £120 million to reduce financial exclusion. The Government announces that it will pilot models of money advice outreach aimed at reaching those who do not present themselves to debt advisers. 	<ul style="list-style-type: none"> A shortage in the provision of money advice of at least 250,000 places a year.
2007	<ul style="list-style-type: none"> Government establishes a Second Financial Inclusion Fund. Government extends the lifespan of the taskforce. 	<ul style="list-style-type: none"> In 2005-06, the number of adults without access to a bank account fell from 2.8 million to 2 million adults, living in 1.3 million households. 	<ul style="list-style-type: none"> The Government announces that a further £6 million will be made available to credit unions and CDFIs through the DWP's Growth Fund. By 2010, this Growth Fund totalled £74 million. 	<ul style="list-style-type: none"> The Department of Work and Pensions (Department for Work and Pensions) is administering a £36 million Growth Fund for third sector lenders, allowing them to make 15,000 affordable loans. In 2006, Credit Unions begin to offer current accounts (in partnership with the Cooperative Bank), and by 2007 nine credit unions are offering the product. 	<ul style="list-style-type: none"> The Department of Trade and Industry (Department of Trade and Industry) is managing a £47.5 million fund to increase the supply of free, face-to-face money advice across England and Wales. 	<ul style="list-style-type: none"> 400 advisers are in place across England and Wales to provide one-to-one money advice. By 2007, Over 18,000 financially-excluded customers had been advised. By 2007, the charities National Debt line and the Consumer Credit Counselling Service had respectively advised nearly 100,000 and over 35,000 people.
2015	<ul style="list-style-type: none"> Financial Inclusion Taskforce disbanded in 2011. The Voluntary Agreement is signed in 2014, and the Payment Accounts Regulations updated what was required of banks when providing basic accounts and gives people in the UK a right to have a Basic Bank Account. 	<ul style="list-style-type: none"> Nearly 2 million* people still do not have a bank account. Of these 2 million people, the Financial Inclusion Taskforce found that six in ten had previously had an account and stopped using it and that only about half of people without a bank account actually wanted one. 2.5 million people have a Post Office Card Account. 	<ul style="list-style-type: none"> The £38 million Credit Union Expansion Project was announced. 	<ul style="list-style-type: none"> Although Credit Unions lent £676 million, by 2015 the demand for community finance stood at £6 billion, leaving a large credit gap. 	<ul style="list-style-type: none"> The Money Advice Service co-ordinates an evaluation on improving financial capability. Financial Education placed on the National Curriculum. 	<ul style="list-style-type: none"> Citizens Advice assisted 400,000 clients debt issues in 2014/15. Only 17% of over-indebted people access debt advice in 2015.

3. A New Approach

The Government needs to pursue a new approach by:

1. Fostering market conditions where serving low income customers well is commercially attractive
2. Focusing on ensuring that customers can access financial services they actually want and need
3. Clarifying what ‘financial inclusion’ actually means and involves
4. Ignoring myths about low income households and the accessibility of FinTech

1. Fostering market conditions where serving low income customers well is commercially attractive

For 20 years, successive Governments have followed an approach that has relieved the symptoms of financial exclusion rather than addressing its foundations. As will be seen in each of the chapters about banking, insurance and credit, the main cause of financial exclusion is that low-income customers are not always profitable. To achieve real progress the Government needs to address the underlying market dynamics that price people on low incomes out of credit, prevent them from generating enough money to set aside the “cost” of saving, and offer poor choice and service in basic banking.

FinTech firms have the power to transform the market dynamics of financial services. As highlighted in Chapter One, FinTech companies can grow faster than traditional banks, operate on a more cost-effective basis and provide better services to their customers by engaging with them through smartphones or by using data more effectively. This means that customers who would not previously have been attractive to FinTech firms are now commercially viable. The Government needs to focus on incentivising FinTech companies to serve these customers.

2. Focusing on ensuring that customers can access financial services they actually want and need

The Government should encourage the market conditions in which companies are incentivised to provide services that customers actually want and need. If people do not find financial products useful, they will not be used: historically, around 15 per cent of newly-opened accounts were closed or abandoned and customer satisfaction levels have been below 60 per cent for the four largest providers.¹²⁹

Financial products need to be useful and accessible. If customers do not understand the financial products they are being encouraged to adopt, or if they do not find them helpful, they are unlikely either to adopt them or to use them effectively - even if they are “free”. It is, therefore, important to focus on the “outcomes” that people want from financial services, instead of forcing the adoption of specific financial products that meet one-size-fits-all minimum standards.

The premise of this report is simple: if people have access to a wider

129. Financial Inclusion Commission, The Facts, accessed 2 September 2019, [link](#)

range of products designed to match their personal circumstances, then they will not just adopt financial services but also use them properly, thereby maximising their financial capability. As a result, defining the basic objectives and framework for a new FinTech-centred approach to financial inclusion is necessary.

3. Clarifying the problem

The Evolution of Government Language since 1999

- What was first termed “tackling financial exclusion” in the Policy Action Team’s 1999 government report is now referred to as “promoting financial inclusion”.¹³⁰
- The term “financial inclusion” was introduced in 2004. It was adopted quickly with the creation of the Financial Inclusion Taskforce and the £130m Financial Inclusion Fund in 2004-2005.¹³¹
- Nonetheless, it is only in the most recent 2018-19 government report on financial inclusion that the Government clarified the meaning of the term. By emphasising that it meant having “access to useful and affordable financial products and services”, their definition and approach to financial inclusion was brought into line with the World Bank.¹³²

Financial inclusion needs to be defined differently. It is important to differentiate between the problem (financial exclusion), the solution (financial inclusion) and the benefit to customers of being financially included (they have greater financial capabilities).

- **“Financial Exclusion”** specifies that a substantial minority of people do not have access to the same financial services as the majority. This also means that they have reduced financial capability and are unable to benefit from useful products and services.
- **“Financial Inclusion”** specifies the solution. Access to financial services should be an inclusive option for both the minority and the majority of people, regardless of their circumstances or financial “skills”.
- **“Financial Capability”** refers to a person’s ability to use and manage their financial resources in a way that improves their financial or personal circumstances, given the products and services available to them as well as their existing level of financial education and skills.

The terms “inclusion” and “exclusion” can sometimes obscure the underlying problem: low-income consumers struggle to access financial services because the products available are not designed for them. They need access to products and services that they find useful so that they can do more with what money they have. If products are not useful for customers there is little reason to be “included”. Shifting the focus of public policy to the “outcomes” that low-income consumers want from financial services means moving away from the terms “inclusion” and “exclusion”. Instead, the Government should talk about “maximising

130. HM Treasury, Department for Work and Pensions, Financial Inclusion Report 2018-19, March 2019, [link](#); HM Treasury, Access to Financial Services, November 1999, [link](#)

131. HM Treasury, Promoting Financial Inclusion, 2004, [link](#); Financial Inclusion Taskforce, Research Programme (2005-2011), [link](#); Financial Inclusion Commission, [link](#)

132. HM Treasury, Department for Work and Pensions, Financial Inclusion Report 2018-19, March 2019, [link](#)

financial capabilities”.

The Government has already made positive steps in this direction. Not only did they launch the financial capabilities strategy in 2015,¹³³ but their 2018-19 Financial Inclusion report opened with:

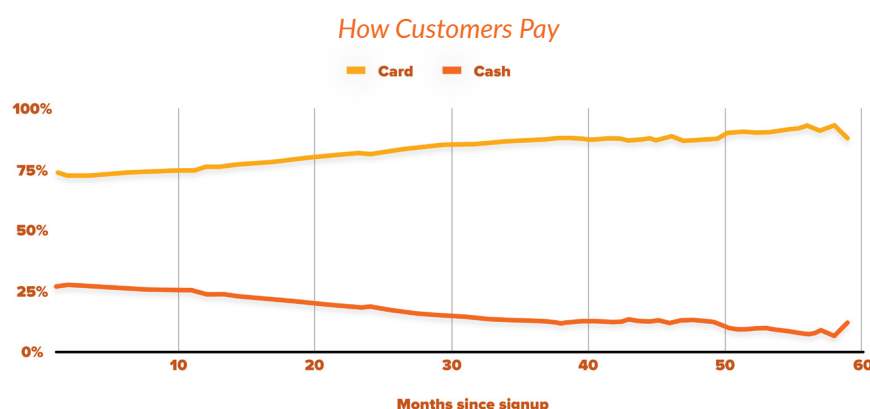
Alongside financial inclusion, the government is taking significant steps to improve people’s financial capability. We are delighted that the new Single Financial Guidance Body (SFGGB) was formally launched in January. In 2019 we will work with its new leadership to develop a long-term national strategy to improve people’s understanding of money, pensions and their ability to manage debt.¹³⁴

Nonetheless, financial capability is dependent upon choice. It is not enough for the Government simply to direct individuals towards generic financial institutions and products even if they are more advanced than they were previously. Consumers are the best judges of their personal circumstances. Policy makers and government need to facilitate the market conditions in which consumers have the incentive and capacity to choose financial services and products that are designed for them, available and allow them to do more with their money.

4. Myths that policy makers should ignore

“Low-Income people have an innate preference for cash”

Low-income customers do not have an innate preference for cash over electronic payments. Data provided by Pockit, a FinTech banking service, shows that the use of cash amongst their customers, who are usually from low incomes, gradually declines over time as they become more confident in the use of electronic payment alternatives that provide more benefits than cash.



Source: Pockit

“People on low incomes can’t benefit from FinTech innovations because they don’t own smartphones”

First, to say this is to misunderstand what the most recent wave of

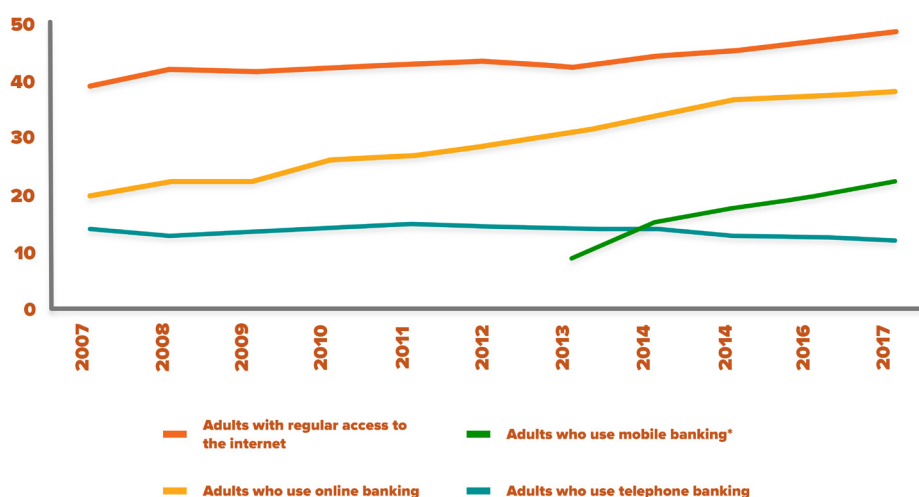
133. Financial Capabilities Strategy, accessed 12 September 2019, [link](#)

134. HM Treasury, Department for Work and Pensions, Financial Inclusion Report 2018-19, March 2019, [link](#); World Bank, The Global Findex Database 2017: Measuring Financial Inclusion and the Fintech Revolution, 2017, [link](#)

FinTech innovation has achieved and made possible. For example, the FinTech sector’s official and highly influential trade association, Innovate Finance, has a diverse membership of 250 FinTech firms across all areas of financial services. Only 9 offer an “app” to consumers.¹³⁵ What makes a FinTech company innovative is often the “backend” efficiencies that it provides. A new generation of Cloud-based and “bank-in-a-box” services offer more cost efficient solutions to providing financial services than today’s computersystems.¹³⁶ Customers can benefit from these services whether or not they own a smartphone or can access the internet. Indeed, because FinTech companies can tailor their services even to these customers who lack access to the internet.¹³⁷

Second, many already access their bank accounts via smartphones or online. According to UK Finance, 71 per cent of the adult UK population - 38 million people - accessed their bank via an online browser or a mobile banking app in 2017.¹³⁸ This represented a 12 per cent rise on the previous year.¹³⁹

Regular internet users and adults online, mobile and telephone banking (millions)



Third, while historically it was true that low-income households enjoyed limited internet access and that few owned smartphones, this is quickly changing. While smartphone ownership and internet access are still by no means universal, growth in smartphone and tablet ownership is now significant amongst the lowest socio-economic groups in the UK.¹⁴⁰ The rise in smartphone ownership, especially amongst the poorest, is due to the drastic fall in their price primarily because of the development of a vibrant second-hand market. In 2007, the original iPhone cost £405: today a basic smartphone costs £40.¹⁴¹ Indeed, ownership of smartphones far exceeds that of other financial products and services like contactless payments or credit cards to which respectively only 64 and 63 per cent of the public have access.¹⁴²

135. Innovate Finance, Membership Directory, 2019

136. See Chapter One for more detail

137. Inclusive Fintech 50, accessed 8 September 2019, [link](#)

138. UK Finance, The Way We Bank Now, 2018, [link](#)

139. UK Finance, The Way We Bank Now, 2018, [link](#)

140. Statista, accessed 12 September 2019, [link](#)

141. BBC News, 28 June 2019, [link](#), Slant, accessed 12 September 2019, [link](#); not adjusted for inflation

142. UK Finance, UK Payments Market Summary, 2018, [link](#), Access to Cash Review, December 2018, [link](#)

Digital access to financial services is much more likely to be related to age than income. Whilst 95 per cent of those aged 16-24 own a smartphone, the figure for those from 55-64 is only 51 per cent.¹⁴³ In fact, 74 per cent of “target customers” identified by the Government prior to embarking on the Credit Union Expansion Project in 2012 already used online services.¹⁴⁴ Perhaps more importantly, around half of low-income internet users said the smartphone was their most important device for internet access; this was around 20 per cent higher than those in the highest socio-economic category.¹⁴⁵

143. Statista, accessed 12 September 2019, [link](#)

144. CSJ, Future Finance, June 2015, [link](#)

145. Ofcom, 2 August 2018, [link](#)

Chapter Three: Inclusion in Banking

How FinTech can transform the market dynamics of banking

Introduction

Not only do 1.23 million people lack access to a fully functional bank account, even those who do cannot use banking products to maximise their financial capabilities. Indeed, between 60-67 per cent per cent of the 1.2 million people currently without a bank account previously had one and around 15 per cent of newly opened accounts are closed or abandoned, indicating that customers did not find the services on offer useful.¹⁴⁶

This section is divided into four sections. Each will explore:

1. The size and scale of exclusion in banking
2. Why low-income customers are commercially unattractive
3. How FinTech companies can help
4. How the Government can encourage a FinTech solution

FinTech companies have the power to address exclusion in banking once and for all. FinTech companies have the power to transform the dynamics of the banking market and better serve low-income customers. To address financial exclusion in banking, the Government needs to pursue a FinTech solution that prioritises giving customers the capacity to choose products that maximise their financial capabilities.

1. Scale of Exclusion in Banking

Low income customers affected by financial exclusion in banking fall within three groups:

- **The Unbanked:** Those without current accounts
- **The Underbanked:** Those using a Post Office Card Account (POCA) or credit union account
- **The Underserved:** Those who have access only to Basic Bank Accounts (BBAs)

146. Financial Inclusion Commission, accessed 2 September 2019, [link](#)
HM Treasury and Department
Department for Work and
Pensions, Financial Inclusion Report
2018-9, March 2019, [link](#)

These groups are often lumped together, as are individuals within the three distinct groups. Yet the reasons for using (or not using) a certain product or service can vary not only across groups, but also within them. It is worth, therefore, examining why each group is excluded from essential banking services.

Statistics on the Unbanked, the Underbanked and the Underserved

- **The Unbanked:** Over 1.2 million customers are unbanked without access to a current account in their own name: their reliance on cash means that they pay what is known as the “poverty premium”, an addition to their bills of around £485 annually.¹⁴⁷
- **The Underbanked:** 1.1 million customers, including 1 million pensioners, still rely on a Post Office Card Account (POCA) to receive state benefits.¹⁴⁸
- **The Underserved:** 7-9 million low-income customers are limited to a Basic Bank Account (BBA), unwanted and underserved by banks that lose an estimated £350 million a year hosting them under a legal obligation rather than out of commercial motivation.¹⁴⁹

The Unbanked

The 1.2 million unbanked consumers have no access to a full current account in their own name.¹⁵⁰ They not only lack an effective means to manage their own financial situation and future opportunities, but also often struggle to access such state services as a pension, out-of-work benefits and emergency financial support from their local authority or the Social Fund.¹⁵¹ Their reliance on cash leaves them often dependent on friends and family to make and receive payments on their behalf, which means that they expose themselves to a real risk of economic abuse, particularly if they are reliant on a partner.¹⁵² They also pay a ‘poverty premium’ of £485 each year on household bills and essential purchases.¹⁵³

Different Types of Formal Banking Product

- **BBA:** Basic bank accounts are provided by the largest high street banks for people with poor credit ratings who do not qualify for a current account; they provide a fee-free service with reduced facilities and no overdraft availability
- **POCA Account:** Post Office Card Accounts are a very limited type of bank account used to receive the state pension, tax credits and benefits; no other income can be paid into these accounts and the money can be withdrawn only at Post Offices
- **Current Account:** Current Accounts are used for such day-to-day financial transactions as paying bills and receiving payments
- **Packaged Accounts:** For a monthly fee, these provide the account holder with benefits such as travel insurance and preferential rate overdrafts
- **Student Accounts:** Student bank accounts are for those in higher education and provide certain benefits such as free Railcards and, usually, larger overdraft facilities

The Underbanked (Post Office and Credit Union Current Accounts)

Post Office Card Accounts

A POCA is a simple bank account which allows customers to collect

150. The Guardian, Britons without a bank account, 21 April 2019, [link](#)

151. House of Lords, Tackling Financial Exclusion, 25 March 2017, [link](#)

152. Select Committee on Financial Exclusion, Oral Evidence, 8 November 2016, [link](#)

153. Pockit, The Banking Poverty Premium, 2019, [link](#)

147. Pockit, The Banking Poverty Premium, 2019, [link](#)

148. House of Commons, Post Office Card Account: Written question - 198328, 3 December 2018, [link](#)

149. Oral Evidence from Eric Leenders, reported in House of Lords, Tackling financial exclusion: A country that works for everyone?, 25 March 2017, [link](#)

Pensions, Benefits or Tax Credit payments. They provide customers with a free, yet very limited “Payments In, Cash Out” banking service.¹⁵⁴ Around 1.1 million low-income customers - primarily older pensioners - still rely on a POCA to receive state-benefit and pension payments.¹⁵⁵

POCAs are highly limited in their functionality. Users can take out money only through a Post Office branch or a Post Office Branded ATM, and even then a few branches are unable to deal with card accounts.¹⁵⁶ With a POCA, it is not possible to purchase goods or services online, use direct debit services or make any kind of digital payment, despite the growth in the UK of “cashless” commercial transactions.¹⁵⁷

The cost to the Government of delivering these accounts is huge. Although it has indicated that it will not renew the contract in 2021,¹⁵⁸ the Government has neither reached a deal nor set a fixed timeline for how it will ensure all accounts are migrated by the end of 2021 - avoiding yet another “stop-gap” renewal of an expensive, ineffective policy.¹⁵⁹ Despite the inefficiency of POCAs, the Government is often criticised for trying to “migrate” customers away to more useful modern alternatives and even though the system was never meant to be permanent, campaigners have unfairly characterised these attempts as “hoodwinking” and “bullying” pensioners into getting a bank account.¹⁶⁰

A History of POCA Services

- The POCA system was introduced in 2003 to provide a “temporary solution” for people without a bank account during the DWP’s transition to electronic payment of benefits.¹⁶¹
- Development of the account and its continued operation are subsidised by the government via a delivery contract with the Post Office.¹⁶³
- The original £1bn contract has been renewed repeatedly, first in 2008 after a failed plan to develop a replacement banking service and then again in 2014 for another seven years.¹⁶³
- Government announced in 2019 that the POCA system will finally be shut down in 2021 after 18 years of operation that has cost over £2.25bn.¹⁶⁴
- In February 2019, the Post Office announced that it was preparing to launch a prepaid card system to replace POCA accounts and had £90 million available for the contractor that could deliver it.¹⁶⁵

154. Post Office, POCA Terms of Use, [link](#)
155. House of Commons, Post Office Card Account:Written question - 198328, 3 December 2018, [link](#)
156. Post Office, Card Account Terms and Conditions, May 2018, [link](#)
157. Independent, “A cashless society is closer than ever before, and it’s a grave threat to our civil liberties”, 9 March 2019, [link](#)
158. Which?, Two million facing new state pension payment headache, 16 October 2017, [link](#)
159. Equal Lives, Government asking people to change from Post Office Accounts to Bank Accounts to receive benefits / tax credits, 21st October 2016, [link](#)
160. Daily Mail, Thousands of pensioners fear they are being “hoodwinked”, 12 May 2019, [link](#); ThisIsMoney, Stop Bullying Us Into A Bank Account!, 9 October 2018, [link](#)
161. Gov.uk, Post Office Service for pensioners and benefit claimants to be safeguarded with new government contract, 16 December 2014, [link](#)
162. Post Office, POCA Terms of Use, [link](#)
163. Gov.uk, Post Office Service for pensioners and benefit claimants to be safeguarded with new government contract, 16 December 2014, [link](#)
164. Which?, Two million facing new state pension payment headache, 16 October 2017, [link](#)
165. CBRonline, “Post Office to Launch Prepaid Card: Unveils £90 Million Tender”, 21 February 2019, [link](#)

Credit Union Current Accounts

What is a credit union?

A credit union is a financial cooperative owned and controlled by its members. It is operated on the principle of people helping each other by providing members with credit and other financial services at competitive rates.

Many credit unions have started to open current accounts for their members. Although this is a great improvement on having no banking services, there are nonetheless a number of drawbacks.

Firstly, not all credit unions offer these services. The Credit Union Expansion Programme was intended by ABCUL (the Association of Credit Unions Limited) to provide a new platform for credit unions to offer current accounts. Of the 35 who signed up for the programme in 2012,

only three have managed to go live as of 2017. The expansion programme has since been halted.¹⁶⁶

Secondly, credit unions can charge a fee for administration of around £5-10 per month. This is true particularly if budgeting advice is also included.¹⁶⁷ For example, many offer “alternative bank accounts” through the Engage platform. Not all Engage accounts are technically current accounts¹⁶⁸ and they charge a monthly management fee which varies depending upon the credit union.¹⁶⁹

Thirdly, credit union current accounts have limited functionality. Many credit union card accounts do not allow you to pay your bills by direct debit or standing order. Engage accounts have no overdraft facility so cannot help financially-excluded people in need of affordable credit.

Case Study: Credit Union Expansion Programme

- In 2013, the Department for Work and Pensions awarded The Association of British Credit Unions £38 million to run its Credit Union Expansion Project.¹⁷⁰ The initiative aimed to provide banking services for low-income customers via a new credit union current account, facilitated by the development of a common banking platform.¹⁷¹
- Only 35 of the 290 credit unions signed up for the programme in 2012, of which only three (East London Credit Union, RetailCURE and Voyager Alliance Credit Union) functioned. The system was eventually purchased from a third-party provider (fiserv) after considerable delays.¹⁷² Two decades after the idea of credit union banking was first suggested by the Policy Action Team, the expansion of such services remains slow.¹⁷³

The Underserved (BBA Holders)

Between 7-9 million people are “underserved” by their banks and are limited to BBAs. These accounts offer no overdraft facilities or rewards schemes and sometimes do not even offer a chequebook.¹⁷⁴ Because these services are basic, low income customers are less likely to use them as is shown by the fact that around half of people with a BBA choose to manage their money in cash.¹⁷⁵ Moreover, BBAs are often not publicised by the banks that offer them.¹⁷⁶ The lack of overdraft facilities and cross-sold services mean they generate no revenue to cover the cost of administering the accounts.¹⁷⁷ This means that they have no monetary incentive to advertise to low income customers, and in so doing address financial exclusion.

Payment Accounts Regulations (2015)

- Under the 2015 Payment Accounts Regulations, the nine largest personal current account providers (Barclays, Clydesdale and Yorkshire Bank, Co-operative Bank, HSBC, Lloyds Banking Group, Nationwide, Royal Bank of Scotland, Santander, TSB) must provide fee-free BBAs which would make unintended overdrafts impossible.
- These customers must be able to use the same services, such as ATMs, that other customers of the provider are entitled to.
- The BBAs were offered under a voluntary agreement made in 2014 after negotiations with the banking sector to improve BBAs.
- The providers of these BBAs agreed to report data to the Treasury for annual publication.¹⁷⁸

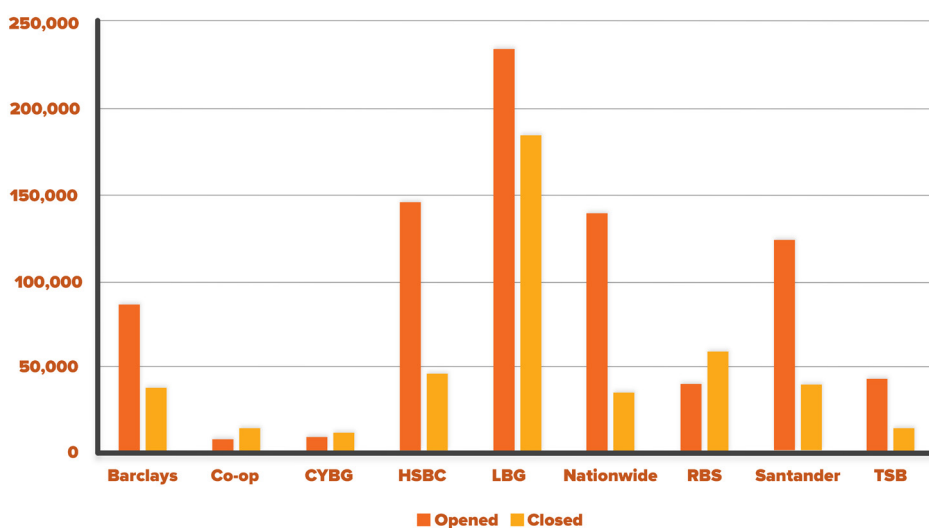
Because BBAs are unprofitable, banks do not guarantee good service.

166. FinTechFutures, ABCUL halts credit union migration to new core platform, 4 September 2017, [link](#);
167. The Money Advice Service, Credit union current accounts, [link](#)
168. Engage, Accessed 12 September 2019, [link](#)
169. Engage, Accessed 12 September 2019, [link](#)
170. Department for Work and Pension, HM Treasury, Press Release, 16 April 2013, [link](#)
171. DWP, DWP CUEP Review, 2 August 2016, [link](#). Parliamentary briefing note, evaluation of CUEP, 2018
172. FinTechFutures, 4 September 2019, [link](#)
173. HM Treasury, Access to Financial Services, November 1999, [link](#)
174. HM Treasury, 19 December 2017, [link](#)
175. Financial Inclusion Commission, The Facts, accessed 2 September 2019, [link](#)
176. Money Saving Expert, 10 September 2019, [link](#)
177. Mirror, Banks stopping people from applying for risk-free accounts, 24 May 2019, [link](#)
178. Department for International Trade, UK Fintech - State of the Nation, [link](#)

The potential limitations of BBAs were recognised in the 1999 PAT report, which claimed that, “there is a potential conflict between prescribing the core features of a basic bank account and consumer choice.”¹⁷⁹ This means not only that these customers are unlikely to maximise their financial capabilities, but also that unless they have to have an account, there is no incentive to use BBAs or for banks to advertise them or provide customers with a BBA if they are eligible for a current account.¹⁸⁰

The number of basic bank accounts that are closed each year as well as the number of people who remain unbanked, highlights, in part, that people don’t find them useful. A large number of basic bank accounts are closed each year, either because there has been no transaction on the account for more than 24 months (indicating that the people using them did not find them useful) or because it was deliberately closed by the user. Indeed, a basic bank account may only be closed without the customer’s consent in limited circumstances, such as if it was used for illegal purposes.¹⁸¹ Furthermore, even though access to a BBA is theoretically universal and guaranteed, of the 1.2 million people who remain unbanked, around two thirds previously had an account.

Number of basic bank accounts opened and closed in the reporting period



The Government needs to recognise that although BBAs provide a safety net for low income customers, they are not a solution to financial exclusion in and of themselves. Although the Treasury Select Committee has argued that BBAs should “be accessible to all customers regardless of whether they are eligible for another account or not” and recommended that the FCA should mandate bank account providers to relax their opening restrictions, it is important to remember that the 7.5 million customers who use BBAs are using a basic banking service that severely limits their financial capabilities.¹⁸² Those with BBAs are not guaranteed to receive the same services as their peers and since banks lose money by providing them, they have no real incentive to improve their functionality.

179. HM Treasury, Access to Financial Services, November 1999, [link](#)

180. Money Advice Service, Fee-free basic bank accounts, accessed 1 October 2019, [link](#)

181. HM Treasury, Basic bank accounts: July 2017 to June 2018, [link](#)

182. House of Commons Treasury Select Committee, Consumers’ access to financial services, 13 May 2019, [link](#)

2. Why people are excluded from banking

Low income customers are excluded from banking because the commercial incentives to serve them well are not as great as for customers with higher incomes under existing models. Banking is not free, but consumers in the UK typically do not pay directly for their accounts as is common in other countries. Instead, banks provide customers with a free current account in the hope of selling them products and services. Low income customers, however, are unlikely to be able to afford these products or services, or to maintain large deposits. The Government, therefore, has made it a necessity that everybody - especially UC claimants - has a bank account, and yet makes no funds available to cover the cost of these accounts.¹⁸³

Different Banking Models

There are three main ways banks make money out of customers.

- **Cross-selling other products** (loans, mortgages, insurance etc.)
- **Subscription models**
- **“Re-bundling” of banking services** from third parties (loans, mortgages, insurance etc.)

Cross-selling models work by offering customers a free bank account and paying a nominal interest rate on their deposits which are then used to make loans to other customers at a higher interest rate. Once “locked in”, customers are offered other products and services that allow banks to generate revenue at levels above what it costs to provide the account.¹⁸⁴ On average, customers of major banks have 2 products with their bank.¹⁸⁵ Banks also generate revenue from interchange on debit card transactions, fees and commissions from foreign exchange.

Subscription models are common in the EU, but in the UK are mostly associated with “premium” current account packages which also include a bundle of other products such as insurance, for which the customer pays a monthly or annual fee under a fixed-term contract.¹⁸⁶

“Re-bundling” models are the newest - pioneered by numerous FinTech firms via a mobile app-based bank account. Digital technologies have facilitated this modern variation on “cross-selling”. The core product is the digital current account, but revenue is generated from referral fees paid by selected specialist partners that provide seamlessly integrated products and services such as loans and insurance. Customers are still being cross-sold products to cover the cost of their bank account and have access to a wide range of products, but each is provided by a specialist firm.¹⁸⁷

It is possible for FinTech providers to operate multiple revenue models or a hybrid model. Such possibilities, however, are primarily limited to newer FinTech providers.¹⁸⁸

183. Money Advice Service, What do you need to know about customers on Universal Credit, [link](#)

184. FT, 9 May 2014, [link](#)

185. FCA, Strategic Review of Retail Banking Business Models, December 2018, [link](#)

186. See, for example, Revolut, Our Pricing Plans, accessed 12 September, [link](#)

187. Deloitte, Perspectives, Rebundling the Bank, [link](#); Deloitte, Could “Open Banking” solve UK banks’ ROE crisis?, [link](#)

188. See pp. 54 to see how these new business models can be more appropriate for those on low incomes.

How the traditional market dynamics of banking affect inclusion

Exclusion in banking stems from the fact that mainstream banks are not offering, or are often unable to offer any products or services that they are able to cross-sell to low-income customers. Banks are able to generate revenue from lending out a customer's deposited money and from penalty fees and charges incurred by customers.¹⁸⁹ Because low-income customers typically cannot access a mortgage and have very limited funds in their account, the only way a bank can generate revenue is from fees and charges - such as on failed direct debits or overdrafts.

With a BBA these fees and charges are no longer possible. Bank losses on basic banking services have been estimated at £300-350 million a year.¹⁹⁰ Although helpful for some customers, it is unsurprising that banks do not advertise their existence.¹⁹¹ This is reflected by the fact that of unbanked UK adults, three fifths (60%) do not know that banks have to offer everyone a basic bank account.¹⁹² In sum, banks have a reduced incentive to serve low income customers well - or at all - because they, typically, are also unable or unwilling to pay for a 'premium' packaged account under a subscription model.

Ensuring Universal Access to Banking Products

If the Government wants to ensure universal and free access to banking services, some form of direct or indirect taxation is currently necessary:

- **Direct Taxation:** the Government can subsidise commercial providers of free accounts out of revenue raised through direct taxation.
- **Indirect Taxation:** by forcing some commercial providers to ensure that their banking services are free, the Government effectively transforms the cost of serving those customers into a form of tax. This is the approach taken by the Voluntary Agreement and Payment Account Regulations.

The UK Government does both. At present, the Government has opted primarily for Indirect Taxation, which is estimated at £300-350 million per year, paid by the banks that provide basic bank accounts. Direct taxation is used to fund the provision of Post Office Card Accounts, estimated at £2.25 billion since 2003.

"Free-if-in-credit" pricing models do not necessarily work for people on low incomes

Even those people on low incomes who have access to current accounts can be poorly served. Under the "free-if-in-credit" pricing model for current accounts which is the *de facto* standard amongst UK banks, it has historically been possible for low-income customers to pay disproportionately more in terms of direct costs during ordinary use of the account. This is because, unlike with a BBA, customers have been charged penalty fees and interest charges when their account balance drops below £0, or if they have insufficient funds to cover a payment made via a card or a direct-debit agreement. Within certain limits these transactions are not rejected, but instead trigger the automatic provision of a loan to the customer via an "overdraft" facility.

189. FCA, Strategic Review of Retail Banking Models, December 2018, [link](#)

190. Gov.uk, 20 December 2018, [link](#); Oral Evidence from Eric Leenders reported in House of Lords, Tackling financial exclusion: A country that works for everyone?, 25 March 2017, [link](#)

191. Mirror, Banks stopping people from applying for risk-free accounts, 24 May 2019, [link](#)

192. FCA, Financial Lives, 2017, [link](#)

Traditionally, banks have generated significant revenue through unauthorised overdraft payments. In 2014, the FCA found that:

It is also likely that the pricing models used by PCA [Personal Current Account] providers generate significant cross-subsidies between different categories of consumers. PCAs using the “free if in credit” model do not charge fixed fees. Instead they derive a significant proportion of their income from overdraft charges, and therefore it is likely that consumers who use their overdrafts regularly cross-subsidise those who do not, which could, in itself, be distortive of competition.¹⁹³

Indeed, in 2017, banks made more than £2.4bn from overdrafts - with 30% alone coming from unarranged overdrafts.¹⁹⁴ The FCA has recently published a strategic review of retail banking business models, which once again found that the existing models of banking poorly serve low-income and vulnerable consumers.¹⁹⁵ Launched in April 2017, one of its key areas of focus is whether free-if-in-credit banking leads to cross subsidies between poorer, potentially vulnerable consumers who often use overdrafts with high associated fees and charges, and wealthier consumers who generally use these features less, and who benefit most from free personal current accounts.¹⁹⁶ Although the FCA did not find evidence of cross-subsidy, it did find that:

FIIC PCAs [Free if in Credit Personal Current Accounts] depend on banks generating funding benefit from balances, as well as earning fees on overdrafts, interchange revenues, and other fees and charges. Our analysis of account-level data shows that the majority of FIIC accounts make a positive contribution to bank profits from a combination of these sources of value. A small subset of consumers – around 10% – are responsible for 60% of the value that banks derive from PCAs. This subset of consumers mostly either hold high balances in their current accounts or are heavy overdraft users.¹⁹⁷

In light of its investigations, the FCA has recently announced huge changes to overdraft market. Its measures include:

- Stopping banks and building societies from charging higher prices for unarranged overdrafts than for arranged overdrafts
- Banning fixed fees for borrowing through an overdraft
- Requiring banks and building societies to price overdrafts by a simple annual interest rate
- Requiring banks and building societies to advertise arranged overdraft prices with an APR to help customers compare them against other products¹⁹⁹

193. CMA, Personal Current Accounts, 18 July 2014, [link](#)

194. BBC, Bank overdraft fees targeted in major shake-up, 7 June 2019, [link](#)

195. FCA, Strategic Review of Retail Banking Business Models, December 2018, [link](#)

196. Deloitte, 14 May 2019, [link](#)

197. FCA, Strategic Review of Retail Banking Business Models, December 2018, [link](#)

How are overdraft facilities priced?

Overdrafts have typically charged under two different pricing systems, depending on the amount of credit provided to cover the outgoing payment and whether this was pre-approved by the bank.

- **Authorised overdrafts:** these can be a relatively cheap form of credit for higher-income customers who meet the bank's eligibility criteria
- **Unauthorised overdrafts:** low-income borrowers with poor credit scores are much more likely than the better-off to have a payment trigger an unauthorised overdraft. Traditionally, these could be more expensive than a payday loan, especially if used on a near-continuous basis when a customer is rarely ever able to bring their account balance back into credit¹⁹⁸

According to data released by the Financial Inclusion Commission:

- 50 per cent of those who banked have incurred penalty fees, with those affected averaging five to six charges per year¹⁹⁹
- 26 per cent of the newly banked were “net losers”, incurring more penalty charges than they have gained in savings²⁰⁰

Despite these changes, customers who are seeking to avoid banking products that are inappropriate for them are forced to use basic services. The alternatives dictated by 20 years of established public policy have eliminated the costs that would typically have been incurred by low-income customers. It is very difficult to generate such costs through BBAs, POCAs and credit union accounts. Indeed, many of the customers who are poorly served by “free-if-in-credit” current accounts would benefit from moving towards BBAs. Nonetheless, an unintended consequence of these policies is that low-income customers, often eligible for Universal Credit payments, are essentially forced to use a “basic” product from reluctant providers who have no real incentive to improve their service to help customers maximise their financial capabilities.

3. A FinTech Path to Inclusion

Why is a FinTech approach necessary and what metrics should be used to assess its success?

The key to financial inclusion is the creation of helpful and easily-accessible products. Between 60-67 per cent of the 1.2 million people currently without a bank account previously had one.²⁰¹ As a result, some must have deliberately chosen to exclude themselves. The fact that low-income people still rely on cash-only, informal budgeting systems, and are prepared to pay the £485 per year “poverty premium” to do so, after being introduced to financial products, is a damning indictment on what is on offer.²⁰² Furthermore, of those who are currently unbanked but previously had a bank account, 53 per cent stated that they closed their account because they no longer wanted one and 13 per cent stated that they did not believe that there were accounts available that suited their needs. In contrast, only 5 per cent said that they got rid of their accounts because they were charged too much, indicating that customer satisfaction is just

198. Financial Times, 23 May 2018, [link](#)

199. Financial Inclusion Commission, The Facts, accessed 2 September 2019, [link](#)

200. Financial Inclusion Commission, The Facts, accessed 2 September 2019, [link](#)

201. Financial Inclusion Commission, The Facts, accessed 2 September 2019, [link](#)

202. Pockit, The Banking Poverty Premium, 2019, [link](#)

as, if not more, important that the costs of a bank account.²⁰³

The Government should try to define the objectives for a new FinTech-based approach to financial inclusion in terms of how helpful customers find financial products on offer. This is just as important as historic metrics like price, accessibility and quantified use of certain specific banking products (in this case, the number of people with a BBA). The shift towards an outcomes-based objective for financial inclusion in banking services will allow for much more robust and contextualised evaluations of government policy programmes. There is no “right” or “best” way to manage money that works for all consumers, which is reflected in how each FinTech “bank” implements a slightly different approach to their user interface and the “features” they include to best serve their target consumers.

FinTech banking can change the market dynamics of banking

Low-income customers are less undesirable to FinTech firms than to traditional banks. The business models that FinTech companies use to provide products and services can change the market dynamics by reducing costs of having a bank account. FinTech services can provide their services more efficiently and cheaply than traditional high street banks and pass cost savings on to customers in the form of lower prices. As Tom Blomfield, Monzo’s CEO, wrote in the 2019 Monzo Annual Report - “our total cost to run an account is an order of magnitude cheaper than high-street banks.”²⁰⁴ This means that low income customers who would be unattractive to banks traditionally are more attractive to the latest generation of FinTech firms.

The operating expenses of FinTech services are significantly lower. App-based banking services avoid the costs of running branches. Major banks and small retail banks have an average per branch cost of £590,000 and £420,000 respectively.²⁰⁵ As the FCA have noted, “our analysis supports the view that legacy bank IT systems can be burdensome and costly to change” and that “new digital banks don’t have these legacy structures or the associated costs.”²⁰⁶

As the FCA has identified:

*Banks have relied on current accounts as a source of lower cost and stable funding with which to fund their lending activities, as well as deriving income from transaction charges, overdraft charges, and interchange revenue. Cross-selling of savings, lending, and insurance products to current account customers has historically been a feature of business models. However, technological and regulatory changes have meant that alternative business models are beginning to emerge, taking a very different approach, and one of their key differentiators is that they seek to realise value by understanding customers’ data.*²⁰⁷

This means that FinTech banks, and the banks of the future, are less reliant upon traditional means of generating revenues from customers such as overdraft charges and can operate with business models that are more appropriate to those on low incomes and are commercially viable.

203. FCA, Financial Lives Survey, Weighted Data Table 19, 2019, [link](#)

204. Monzo, Monzo Annual Report, 28 February 2019, [link](#)

205. FCA, “Strategic Review of Retail Banking Business Models”, December 2018, [link](#)

206. FCA, “Strategic Review of Retail Banking Business Models”, December 2018, [link](#)

207. FCA, “Strategic Review of Retail Banking Business Models”, December 2018, [link](#)

FinTech products help people to maximise their financial capabilities

FinTech allows banks to provide better services. Not only is there a general distrust of mainstream banks but customer satisfaction levels have historically been below 60 per cent for the four largest providers.²⁰⁸ Although many of the challenger banks do not yet qualify for the personal banking service quality league tables, introduced by the Competition and Markets Authority (CMA) after it conducted a market investigation into the banking sector in 2016, some new FinTech companies outperform traditional banks in surveys where they are compared.²⁰⁹ Moreover, arguably the successful integration of FinTech is one of the main drivers of customer satisfaction for the larger banking providers.²¹⁰ This means that not only are customers more likely to adopt banking services that are powered by FinTech, they are also more likely to use banking products effectively, thereby allowing them to do more with their money.

The services provided by FinTech Banks can maximise the financial capabilities of low income people specifically. The reduced operating costs of FinTech banking services - both fixed and marginal - allows FinTech services to offer products and services tailored to smaller, more specific target groups. The benefits of such “niche” FinTech banking services is that when financial products are specifically tailored to one group, they can be designed and delivered in a way that best matches their consumer preferences. For example, they could prevent those with gambling additions from spending money through gambling websites, provide cashback from shops more likely to be used by low income customers and generally tailor their products to low income customers’ behaviour, financial circumstances and desired outcomes, thus maximising their financial financial capabilities.

This is simply not possible under the “one-size-fits-all” approach of BBAs. In order to make BBAs usable and useful for the largest number of people across as broad a demographic as possible, banks rely on minimum standards for functionality and features and standardised delivery channels and product design.

FinTech provides a gateway to other financial products, giving customers greater choice

The arrival of Open Banking means that transaction data can be used by FinTech firms. This data can be used to underwrite credit, to detect early warning signs of debt problems and to help people manage money more effectively, such as by increasing their savings. Alternative credit scoring via transaction data, as well as other options that are now possible via Open Banking, is known to substantially increase both access to credit as well as reduce the costs for lenders and for borrowers.²¹¹ Indeed, a survey showed that as many as eight out of ten leading global credit experts believe that Open Banking will make the market for credit more competitive.²¹²

208. Populus, Trust in Banks, accessed 8 September 2019, [link](#); Financial Inclusion Commission, The Facts, accessed 2 September 2019, [link](#)

209. Ipsos Mori, “Personal banking service quality – Great Britain”, Finder, “Finder Banking Customer Satisfaction Awards 2019, 10 October 2019, [link](#)

210. This is Money, “Best current account providers revealed: No surprises as First Direct, Starling and Monzo trounce High Street banks in customer satisfaction survey”, 30 November 2019, [link](#)

211. Responsible Finance, Inclusive Credit Scoring, 2018, [link](#)

212. Finextra, ‘Open Banking to make consumer credit more competitive’, 10 September 2019, [link](#)

What is Open Banking?

- Open Banking refers to the electronic and secure sharing of financial information, limited to conditions that customers approve of through the use of APIs which allow third-parties to access financial information efficiently.²¹³
- Open Banking requires the UK's nine biggest banks to release their data in a secure, standardised form, so that it can be shared more easily between authorised organisations online.²¹⁴
- These reforms were called for by the Competition and Markets Authority (CMA) and come alongside a regulation entitled "the Second Payment Services Directive" PSD2 (PSD2). They have been aided by the Bank of England's decision to allow the next generation of Payment Services Providers to have access to the Real Time Gross Settlement System (RTGS) system to allow them to compete on a more open playing field.²¹⁵
- The Standard is a service designed to assist European account providers to meet the specifications of PSD2 and RTGS. Customer Experience Guidelines and Operational Guidelines are included in the Standard, which extends beyond the remit of API Specifications.²¹⁶
- The Standard is designed to produce a "well-functioning, successful ecosystem" where no barriers to the provision of products or Third Party Provider (TPP) services exist. All account providers can use it, and, so far, 90 per cent of the UK payments account market have implemented it.²¹⁷

The use of APIs turn financial service providers into 'marketplaces', increasing choice and competition. Rather than launching a full suite of proprietary banking products, many FinTech companies often focus resources on making its core offering - current accounts - as good as possible and then to offer other products by using open APIs.²¹⁸ This effectively means that customers using FinTech banking platforms can choose to purchase other products and services from a range of third-party providers through the banking platform.



Whereas traditionally financial service providers may only have been able to direct customers towards other products that they offered, marketplaces allow customers to choose products that are tailored to their needs. This is particularly important to low income customers for whom not all additional products are relevant.

213. The Balance, What is Open Banking, 16 March 2019, [link](#)
214. European Commission, PSD2 - Directive (EU), 2015, [link](#)
215. Bank of England, Bank of England extends direct access to RTGS accounts to non-bank payment service providers, 19 July 2017, [link](#)
216. Open Banking Documentation, accessed 25 November 2019, [link](#)
217. Open Banking Documentation, accessed 25 November 2019, [link](#)
218. Deloitte, How to flourish in an uncertain future, [link](#)

EMIs and Current Account Switching

- The Current account switch was introduced in 2013 and has to date facilitated 5 million switches between current account providers, guaranteeing that customers will not suffer a financial loss.²²¹
- The potential to increase market competition is limited at present, since the vast majority of new FinTech providers are not enrolled or currently eligible for the scheme. This is due to both technical and regulatory requirements for participation.
- Monzo and Starling are the two exceptions due to their regulatory status as banks. The total number of customers switching to Starling and Monzo has increased significantly each quarter, up 22% in the most recent figures, however the overall combined volume is still small - just 5.01% of the total switches.²²⁰
- Competition could be greatly increased if the scheme was amended to allow 'partial switching' with fewer guarantees, lower technical requirements and that would be easier to join. The UCPD could also greatly facilitate this and lower the cost burden for small FinTech providers of offering the service to UC claimants.

219. Choose.co.uk, How to Switch Current Accounts (and why you should do it), 24 April 2019, [link](#)

220. AltFi, Monzo and Starling captured soaring numbers of account switchers last quarter, 25th July 2019, [link](#)

The advantages and disadvantages of separate banking models for those on a low income				
Type of banking service	Cross-selling Models	Subscription Models	Re-bundling FinTech Banking Models	Overall experience for those on low incomes
Traditional Financial Services	<ul style="list-style-type: none"> Those on low incomes have poor ratings and are excluded from the other services that banks can provide customers. This leaves the banks with no incentive to provide these customers with useful services. 	<ul style="list-style-type: none"> Those on a low income don't have enough money to pay subscriptions. 	N / A - these services are not available through traditional financial services	Poor. Customers do not gain access to useful products.
FinTech Banking for low-income customers	<ul style="list-style-type: none"> Costs are lower for FinTech banking providers due to a lack of legacy IT systems, regulatory compliance costs and lower overhead operational costs in the way that their services are delivered. Accessed via a smartphone app and designed from scratch, the quality and usefulness of these banking services are significantly better for somebody on a low income than a traditional personal current account provided by a high street bank. Due to their smarter use of customer data and the integration of innovative risk assessment systems, FinTech banks are able to provide credit and insurance services to more customers than high street banks and at a lower cost. This allows them to generate revenue from customers traditional banks cannot serve, thereby creating an incentive for these providers to advertise their services and for them to make sure that service is good 	<ul style="list-style-type: none"> Subscription models for FinTech banking services are possible at lower prices due to more efficient operations and delivery. They also provide more attractive benefits in terms of whatever insurance policy or 'perks' are included as part of the subscription plan. Subscription models specifically designed for low-income customers are not only more attractive to customers, but are able to make trade-offs and efficiency savings that reduce prices to levels customers are willing and able to afford. If these subscriptions were to be subsidised by the Government, then subscription models would be in reach of those on a low income. 	<ul style="list-style-type: none"> Each 'rebundled' service (loans, savings etc.) is provided by a specialist FinTech firm, prices are lower and services are better designed to match the target demographic of the banking provider. Lower costs for providing each FinTech bank account mean the level of revenue that must be generated in order for the model and FinTech banking firm to be commercially viable, are also lower and more customers can be provided with 'free' banking services. FinTech firms that are focused specifically on serving low-income customers can offer a different range of 'rebundled' services via partnership models that will be both affordable and useful for the customers they are aiming to serve. 	Better than traditional banking. Prices are reduced and the usefulness of products and services is increased. However, in most cases if subscription models, cross-sold services and rebundled partnerships are designed for higher income customers, they will not be attractive or accessible to low-income customers. This means revenue generation from low income customers is not necessarily possible. The more services are tailored to the needs of low income customers, the more likely they are to be served.

4. What Can Government do to help?

In addition to Universal Credit Banking Vouchers (outlined in the following chapter), there are a number of things that Government can do to help encourage low income customers' access to banking products.

Making it easier to transition from a POCA to a Current Account

The DWP should work with the Post Office to develop and fund a “POCA transition scheme” that would incentivise customers to switch from their Post Office Card Account. This could be done via a simple online platform or at a Post Office, and would ensure that people have access to more sophisticated banking products which can maximise their financial capabilities. Although it is possible to benefit from FinTech advances without being computer literate (because of the capacity for FinTech to transform the operational capacities of financial service providers), such a fund could be used to educate those with poor technological skills about online banking services.

Fast-Tracking “niche” FinTech products through an accelerator fund

The DWP should consider creating an accelerator fund to fast-track the development of certain “niche” FinTech banking products for demographics with a high risk of vulnerability. This could also be done where there is a public interest in the greater integration of banking with other welfare support services (e.g. back-to-work support, prisoners and ex-offenders). The specifications and delivery for any such accelerator programme should be done in partnership with key stakeholders, with initial time-limited per-account subsidies payable to providers to incentivise new entrants.

Improving current account switch services

Government should launch a consultation into how well current account switch services work for Challenger Banks and FinTech companies providing tailored services. Under current terms it is very easy to switch “like-for-like” to a similar banking service, but more difficult to switch to FinTech services that don't yet have full banking licenses. Yet if switching to a FinTech banking provider were made simpler and encouraged by government policies on financial inclusion then it would be easier for new firms to meet previously unidentified and unserved consumer demand. This would not only increase competition but would also lead to the provision by companies of “niche” accounts designed specifically for pensioners, people seeking work, disabled customers etc. Moreover, improving switching can also lead indirectly to banks improving the functionality of their products. So long as there is enough of a threat of customers switching, this can deter providers from raising prices and incentivise them to adopt innovations made by EMIs.

Chapter Four: Universal Credit

How to help people on Universal Credit access banking services

Introduction

The introduction of Universal Credit provides a unique opportunity for policy makers to introduce a new FinTech-powered policy approach to financial inclusion in banking services. Since it is a requirement that every claimant has a bank account to receive UC payments, financial inclusion is of vital importance to the roll-out of UC.²²¹ This chapter will explain:

1. **How a UC banking voucher system can deliver financial inclusion.** It can give claimants access to banking services that maximise their financial capability.
2. **How the development of a UC Payments Dashboard (UCPD) can be achieved without delaying the rollout of UC.** This Dashboard can serve as a catalyst for rapid innovation within the FinTech sector and can ultimately enable claimants to access cheaper loans and build savings through new products and services.
3. **How the Government could make it easier for banks to 'onboard' those claiming Universal Credit.** The lack of identity documents for those claiming UC increases the costs of providing them with banking services. The Government should launch an investigation into how to make this process easier.

The Government should embrace a forward-thinking FinTech-powered approach to Financial Inclusion. According to surveys from Citizens Advice, 73% of the 19 million people estimated to be likely to be eligible for UC would need help managing monthly payments, especially those likely to be financially excluded.²²² Doing so will not only drive financial inclusion by changing the market dynamics of banking for those on a low income, but will also provide an opportunity to address the concerns raised by charities about the roll-out of UC.

221. Money Advice Service, Choosing a Bank Account for your benefit payments, accessed 25 November 2019, [link](#)
222. Citizens Advice, The four advice gaps, 15 October 2015, [link](#); Financial Inclusion Commission, Financial Inclusion: Improving the Financial Health of the Nation, March 2015, [link](#)

1. UC banking vouchers

Why UC banking vouchers are necessary

The Government should aim to create a viable banking market for those on Universal Credit. The Government has an obligation, as the guarantor of the welfare safety net, to ensure that everyone has access to banking services. These services should also provide a gateway to complementary financial products like loans and savings. This universal service obligation is no different to how Government provides financial subsidies to ensure that everyone can access housing or fuel.²²³ At present, banking is one of the only essential services for which the Government fails to provide financial support through welfare payments.²²⁴ Government should explore ways to bring their approach to financial inclusion in line with financial subsidies in other areas such as energy or housing. This change is now more necessary and also more logically consistent than ever before, as millions of claimants transition to UC single payments over the next five years.

The Government should consider creating Universal Credit banking vouchers to be redeemed by users at a banking service of their choice. The basic principle of “voucher” systems is not new, with numerous examples in other countries.²²⁵ Voucher funding systems, (such as those used by schools systems in parts of the US and Sweden) give recipients a voucher, paid for by public funding, which they can redeem at a public service of their choice - i.e. parents will receive a voucher that they can put towards a school of their choice.²²⁶

- **The primary aim** of a UC Banking Voucher system would be to create a viable banking market for those on Universal Credit and ensure that they can choose from a range of banking services that improve the quality of their lives.
- **A secondary, implicit aim** is to encourage the UK FinTech sector to compete to provide a wider range and choice of financial products that are tailored to the specific circumstances of those on Universal Credit, available at a price range they can afford. By setting the subsidy for vouchers at the right level, the Government could turbo-charge this market and encourage FinTech companies to tailor their services to UC claimants.

Funding the vouchers and setting the subsidy amount for UC banking vouchers to kickstart the market

The UC vouchers should be funded out of a financial inclusion levy on the companies with the largest share of the personal current account market. This would be similar to the indirect levy that was established by the Voluntary Agreement.²²⁷ Depending upon the size of the subsidy, the authors estimate that it would cost between £92 million and £370 million a year by the time that everybody receiving state benefits had migrated onto Universal Credit. Because the cost of providing accounts varies

223. Select Committee on Treasury, Thirteenth Report, 2006, [Link](#)

224. Centre for Social Justice, Dynamic Benefits, 2009, [Link](#)

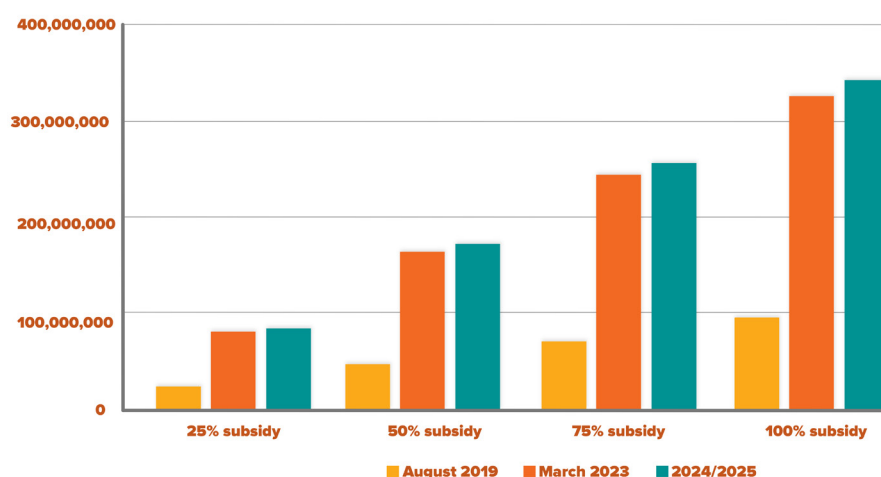
225. EdChoice, What are school vouchers, accessed 25 November 2019, [link](#); BBC News, 'What would a voucher system mean for schools?', 18 May 2017, [link](#)

226. BBC, 'What would a voucher system mean for schools?', 18 May 2017, [link](#).

227. See Glossary

depending upon how they are used and who is providing them, this cost has been roughly worked out on the basis that the subsidy would represent a proportion of the cost of a BBA. For the sake of simplicity, this figure assumes that every UC claimant would be entitled to the voucher, but the Government may wish to limit those who are eligible for the voucher. A full breakdown of these costs is available in Appendix B.

Cost of UC vouchers at different levels of subsidy over time



Such an arrangement could be fiscally neutral. The banks with the largest share of the PCA market should pay an annually cost-adjusted levy, the costs of which they could recoup if they themselves served low income customers. So long as levy contributions were calculated in such a way as to ensure that banks who provided the greatest number of bank accounts for UC claimants were not penalised, it would encourage transfers of funds either to those banks providing the greatest number of accounts to those on UC or to FinTech banks that provide better customer service, thereby encouraging innovation and increasing competition in the long-term.

Provide a financial incentive for FinTech companies that could better serve the needs of customers on UC to onboard UC claimants.

As demonstrated earlier, because they are smaller, nimbler and therefore more flexible, FinTech companies are capable of providing better banking services more cheaply. This means that if they were able to provide an account at a lower cost than the level subsidy, they would have a profit incentive to provide better banking services to those on a low income. Moreover, to ensure that banks do receive money for providing basic services that they are already obliged to provide for free, the Government should specify the minimum standards that banks should meet to receive the voucher. To do so would ensure that customers don't just have access to basic banking services, but that they have access to useful services.

The Government should begin by launching a consultation into determining the exact level of the subsidy. The costs of providing banking services are not always available in the public domain (because of commercial sensitivities) and because the costs of delivery are hard to estimate. Nonetheless, the higher the subsidy, the greater incentive

there will be for new innovative providers to offer better services for UC claimants and the more enthusiastic the traditional banks would be to recoup their costs.

UC Banking Vouchers would be easy to implement and would not require a change to UC

UC Banking Vouchers would be easy to roll out. The delivery of UC banking vouchers would be simpler to operate at scale than welfare subsidies for rental or energy costs. This is because the claimant’s bank account would both receive monthly UC payments from the DWP and pay the cost of banking services.

The operation of a voucher system could be equally straightforward from a technical perspective. The delivery of Universal Credit has been plagued by technical difficulties.²²⁸ Each UC Benefit payment is processed by the DWP and then transferred to the claimant’s bank account via the UK’s payment network accompanied by a unique transaction code.²²⁹ This is similar to the payment reference that can be attached to a bank transfer and is commonly used to identify bill payments made by customers via their unique account number, thus making the entire process fairly straightforward to automate. If vouchers are set at the same value for every eligible claimant, each payment of the voucher need use only the same standardised transaction code, rather than a unique account number or reference code. This code would be appended to the actual transaction code used to operate the payments system which is typically hidden from customers. The unique transaction code would serve as a “flag” to signal to the recipient banking provider the existence of the voucher and its monetary value, which will have been bundled in as part of the claimant’s entire monthly UC payment.

Universal Credit Banking Vouchers can help government to tackle financial abuse

What is economic/financial abuse?

The Citizens Advice Bureau defines financial abuse as “controlling someone’s ability to acquire, use and maintain economic resources” and such abuse is viewed by them as merely one element within a range of controlling behaviours used by perpetrators of domestic abuse.

Vouchers should be paid on a per claimant basis. This would involve a simple multiplier of the voucher amount based on the number of adults in the household to be included within the household’s monthly UC payment. In such cases, the automatic payment to the provider could still be taken for that increased subsidy amount, provided the adults had a joint account, or two separate accounts, with the same provider. This means that, in addition to giving UC claimants access to tailored FinTech services, UCBVs can help to tackle financial abuse. Ensuring that women, in particular, are encouraged to open their own personal bank accounts is a useful countermeasure against domestic abuse.²³⁰

228. The Guardian, “Universal credit IT system ‘broken’, whistleblowers say”, 22 July 2018, [link](#)

229. Money Advice Service, Universal Credit explained, accessed 25 November 2019, [link](#)

230. The Guardian, ‘Teaching women financial capability is the first step in fighting domestic violence’, 16 October 2018, [link](#)

It can be argued that the UC payment system where multiple benefits are paid into a single bank account creates an opportunity for financial abuse. The single-account means that many will be left at the mercy of their partners, without the ability to manage their own money and gain financial autonomy. According to a 2014 survey conducted by the Citizens Advice Bureau, 57 per cent of respondents had encountered the type of financial abuse where the perpetrator controls access to the victim's income banking or savings: 49 per cent had encountered financial abuse where the perpetrator controlled or interfered with the victim's benefits.²³¹

The UC system allows claimants to split their payments, especially if a partner has a history of abuse or addiction.²³² Nonetheless, this requires recipients to request such an arrangement, which could put the vulnerable at risk. As a spokeswoman for the organisation ROSA asked, "How would a domestic violence victim hide the fact they'd asked their Jobcentre for help if they suddenly started receiving separate payments?"²³³

Cross-party efforts to tackle financial abuse

There is cross-party consensus on the need to tackle financial abuse. The Home Affairs Select Committee, chaired by the Labour MP Yvette Cooper, urged the Government in late 2018 to scrap the "retrograde and backward" single household payments under UC and make split payments for couples standard practice.²³⁴

The Government has since attempted to tackle this:

- In early 2019, Amber Rudd MP, then Secretary of State for Work and Pensions, announced a change in the way UC benefits were paid. Under these changes, payments would be paid to the "primary carer" in each family, which, more often than not, is a woman.²³⁵ Later in the year, she also announced that, based on the recommendations of the Work and Pensions Select Committee, trained specialists would be stationed at all Jobcentres.²³⁶
- In 2019, the then Home Secretary Sajid Javid announced changes to domestic abuse law to "bolster protection for victims". He said these legal changes would reflect the findings from personal case studies of numerous women and quantitative evidence that economic abuse is a common aspect of domestic abuse.²³⁷
- Moreover, the government's proposed legal changes and extra funding such as the £100,000 promised to set up the charity "Surviving Economic Abuse" were intended to tackle the problem of economic abuse specifically and domestic abuse more broadly. However, this could be undermined by its policy of paying benefits into a single account.²³⁸

2. Universal Credit Payments Dashboard

The Government should work with the FinTech sector to develop the specifications needed to develop a new Universal Credit Payments Dashboard (UCPD) to allow those in receipt of Universal Credit to track their benefit payments. The data collected would facilitate access to a range of FinTech services that are better and cheaper and tailored for people on UC and give crucial help with the rollout of UC. A UCPD would build upon the UC online account that allows claimants to report a change in their circumstances, see their statement and apply for an advance on

231. Citizens Advice Bureau, Controlling money, controlling lives: Financial abuse in Britain, November 2014, [link](#)
232. Department for Work and Pensions, Guidance: Alternative Payment Arrangements, 6 November 2019, [link](#)
233. The Mirror, Universal Credit rules: Domestic violence victims "face further abuse", 29 February 2015, [link](#)
234. The Guardian, Universal credit is backward step in tackling domestic abuse, MPs warn, 22 October 2018, [link](#)
235. The Guardian, Universal credit to be paid to main carer in attempt to help women, 11 January 2019, [link](#)
236. DWP Press Release, Increased Jobcentre support for women experiencing domestic abuse, July 2019, [link](#)
237. BBC, Domestic abuse: Non-physical and economic abuse included in law, 21 January 2019, [link](#)
238. Home Secretary, Transforming the Response to Domestic Abuse, January 2019, [link](#)

their first payment.²³⁹ This would provide claimants with greater control over the management of their UC payments and facilitate access to their data by FinTech providers which would unlock new innovative financial services.²⁴⁰

What is a “Dashboard”

A dashboard is a website that allows you to control your account.²⁴¹ The Government has already started to build a pensions dashboard, which allows users to see all of their pension payments at the same time.²⁴²

What is a Universal Credit Payments Dashboard?

The creation of a FinTech-powered UCPD would address several key issues faced by Government. An additional layer to the UC online account, it could unlock a new wave of innovation in financial services tailored for UC claimants and could maximise the benefits of the new UC system by:

- **Improving the delivery of UC.** It would do this by reducing the IT development burden for the DWP, allowing the system to be safely rolled out faster and at a lower cost.
- **Addressing concerns about UC payments.** It would provide greater choice and control to claimants over payment frequency, housing benefits and split household payments.

The UCPD would not change UC, but act as an additional “layer” operated on a commercial basis as an efficient digital FinTech platform. It would not require “integration” with UC IT systems and would make it easier for claimants to manage their UC claim independently, reducing costs for the DWP.

The UCPD could be made up of two “modules”:

- **A web-portal (specially designed website)** for UC claimants to better manage their account;
- **A backend payments platform** that would receive and process monthly UC payments from the DWP via Open Banking and provide claimant data to unlock innovation of new specialised FinTech services.

239. Gov.UK, Sign into your Universal Credit Account, accessed 25 November 2019, [link](#)

240. Chapter Five includes more detail about how a UC payment dashboard would help to improve claimants' access to affordable credit.

241. Klipfolio, What is a data dashboard, accessed 25 November 2019, [link](#)

242. Pensions Dashboard Prototype Project, accessed 25 November 2019, [link](#)

What is a backend payments platform?

- If the UCPD's web-portal is thought of as being like "Paypal", then the backend payments platform is the part of Paypal that allows it to receive money from bank transfers and card payments.²⁴³ Paypal's backend payments platform also allows customers to send money to bank accounts, businesses and everyone who does not have an account with Paypal.
- In the case of UC, this, for example, would involve payments paid into an account by the Government and out to their housing or energy provider.

How would the Web-Portal help claimants?

A UCPD would allow them to more easily and effectively manage their single monthly payments. Although use of the UCPD would be entirely optional for claimants, at launch it would allow UC claimants to view the basic information about their claim and set:

- The division of payments to multiple bank accounts (e.g. 50-50, 40-60)
- The frequency of UC payments (e.g. monthly, bi-weekly etc.)
- A direct payment arrangement of Housing Benefit to a landlord

In the future, this basic feature set could be expanded. This expansion could be funded either by increasing the IT budget or through commercial investment within the platform depending on whether the new functionality was to meet the objectives of the DWP or the UCPD's commercial activities.

Using API-led connectivity to improve UC Service

Open Banking and API Connectivity can help UC Claimants

What is Open Banking?

- **A common API standard that allows customers to provide access to details about their bank account and share the verified data held about them by their bank with other firms.**²⁴⁴ For example, it allows a lender to access a customer's bank transaction data (after the customer provides their verified consent), which can be used to make better loan decisions.

What is API-led Connectivity?

- **API-led connectivity works by establishing a set of pre-defined technical standards and technologies that are easily added on to any IT system.** It allows different IT systems to 'talk' to each other and share data securely with any other system that has added the same API. As these communications are automated and use standardised formats; they can operate 24/7 without security risks or costly manual labour.²⁴⁵

The UCPD could unlock a new wave of innovation in financial services designed specifically for UC claimants based on Open Banking and powered by API-led connectivity.²⁴⁶ The creation of UCPD would allow specialist FinTech companies to provide innovative services to UC

243. Ecommerce platforms, What is a Payment Processor, accessed 25 November 2019, [link](#)

244. Barclays, Open Banking, accessed 25 November 2019, [link](#)

245. Big Commerce, Understanding the API Economy and its Role in Ecommerce, accessed 25 November 2019, [link](#)

246. Big Commerce, Understanding the API Economy and its Role in Ecommerce, accessed 25 November 2019, [link](#)

claimants¹. For example, if a UC claimant was able to link their Facebook account with their UC account via a third party provider, they could receive debt advice and updates over Facebook Messenger. Since many on low incomes already use services like Facebook Messenger, this increases the likelihood of them receiving updates and debt advice. Similarly, information about their UC payment amounts could be used to decrease the cost of a loan in the same way that lenders ask for verification of employment income.

How much would the UCPD cost?

The UCPD would be operated as an independent, privately-operated commercial firm, limiting the cost implications for government.

In fact, the management of UC accounts and the disbursement of monthly payments via the UCPD would be likely to be significantly cheaper than if managed by the DWP via the UC IT and payment systems. The payments platform could also make it much easier and cheaper to improve or change the practical operation of UC in the future, as its need for additional and often expensive IT projects would be reduced significantly.

The creation of a UCPD would, likewise, enable a range of FinTech-powered solutions to meet consumer demand and achieve the policy objectives of financial inclusion. This new payments platform for the allocation of benefits payments could serve as the hub of financial-inclusion policy, enabling access to a range of new digital FinTech services for all consumers, regardless of income.

The poorest and most vulnerable in society might still require a subsidy to cover the monthly cost of transactional banking services. Nonetheless, with the UCPD, the benefits for consumers would be considerably greater, and the cost of the subsidy would be significantly lower.

More detail about how a “UCPD” could help to improve UC claimants’ access to affordable credit is outlined in Chapter 5.

3. ID Documents and making it easier to onboard

Many people still struggle to access banking and other financial services, despite the universal service obligation and legal ‘right’ to open a Basic Bank Account. This is typically due to the fact that they do not have sufficient ID documents such as a passport or drivers licence. This can make it difficult to open a FinTech bank account or a Basic Bank Account. While these documents are not required, as a customer can instead provide a greater number of official government paper documents (such as a UC confirmation letter, or official court documents), there is still substantial confusion amongst both customers and providers about what can and cannot be accepted.

The government could substantially improve this situation through the Universal Credit Payments Dashboard. This would allow customers

to verify their identity with a FinTech provider via an API. This would be both secure, simple to operate in a cost effective manner and would decrease fraud as the data held by government about claimants is highly accurate. Policy Exchange is currently exploring the issue of Digital Identity and the creation of a next generation system for the United Kingdom, which will be published in 2020.

Recommendations

1: Universal Credit Banking Vouchers

Providing UC claimants with a banking voucher would ensure that every claimant could access a banking service that is useful for them and maximises their financial capability. This would create the commercial incentive for FinTech firms to provide better banking services to UC claimants. It would fundamentally change the nature of financial inclusion in banking by ensuring that every person had access to a tailored high-quality banking service.

2: Universal dashboard for UC FinTech

Funding for the next FinTech Affordable Credit Challenge Fund should be significantly increased and a large proportion of the money should be directed towards the creation of a “UC Dashboard”. This could provide increased UC-functionality and give low-income customers access to a range of financial services via open-banking APIs. The following list of design specifications is not exhaustive, but indicative of how this public policy investment could be privately run and yet have design specifications that meet key objectives:

- Able to assign transfer codes to UC payments that indicate the claimant’s eligibility for certain additional benefits/products/subsidies, such as to cover monthly account fees
- Login secured via API and SSO (single sign-on), which enables a user to log in with a single ID and password to multiple related systems - ensuring claimants can easily register for a link up to new FinTech services and can access innovate new products
- Allow people to add and detach from a household, as well as split payments of UC
- Easy integration of current account switch services for banking platforms to facilitate easier switching
- Pay.UK should work with the UC Dashboard implementation team and the winning provider to facilitate the wider availability of the current account switch service to include more FinTech providers of new banking services designed specifically for UC claimants under a banking voucher system.

3: Investigate how to improve identity verification

Government should investigate how to allow financial service providers to access data held by the DWP and other government departments, at the customer's request in order to verify their identity. They should also explore the potential of allowing customers to migrate to Universal Credit via a financial service provider that has already verified their identity as this could both decrease the costs of UC migration and improve proactive switching by claimants.

Chapter Five: Inclusion in Credit

How data-driven FinTech can reduce the cost of lending

Introduction

Credit is an integral part of a developed market economy. Loans are used by all consumers, regardless of income, to cover unexpected and emergency costs, to spread the cost of large purchases over time and to better manage their income and expenditure flows on a day-to-day basis. Although access to credit is useful for all consumers, irrespective of income, due to their lack of savings, people on low incomes often need to use credit to cover essential costs and immediate shortfalls rather than to finance the purchase of expensive luxuries. Indeed, the poorest households in the UK spend around 25 per cent of monthly income servicing borrowing costs.²⁴⁷ In order to demonstrate how the Government can improve access to cheaper forms of credit, this chapter will:

- Provide an in-depth look at the size and scale of exclusion from credit
- Explain why the Government has not been able to address this problem
- Show how FinTech companies can help bring down the cost of credit
- Outline what government can do to help

This chapter explains how to tackle the causes, and not the symptoms, of exclusion from credit. The symptoms of exclusion in consumer credit are evident: low-income households are either unable to access credit or rely on non-standard credit that is typically priced at levels that are high both in nominal terms and relative to the risk of default for millions of consumers - a fact that can cause many to default on a loan they would otherwise have repaid.²⁴⁸ Although the Government has attempted to regulate the effects of this problem through price caps on high cost short term credit (HCSTC), it is just as, if not more, important to refine the data used to work out credit scores for people on low incomes, which, in turn, will bring down the cost of credit for millions of low income customers.²⁴⁹

247. The Guardian, 'Quarter of UK's poorest households are getting deeper in debt, IFS warns', 16 Jan 2018, [link](#)

248. Financial Inclusion Commission, 'Improving the Health of the Nation', March 2015, [link](#)

249. FCA, 'High-cost credit and consumer credit', 22 July 2019, [link](#)

1. Exclusion from Credit

Different Types of Credit

- **Overdrafts** allow customers to borrow money through their current account if their bank balance drops below £0.
- **Credit Cards** allow cardholders to pay merchants for goods and services based on the cardholder's promise to repay the card issuer under agreed terms.
- **Store Cards** work in a similar way to credit cards except they usually charge higher interest rates and only work with one high street chain or group.
- **Retail/Point of Sale Finance** allows customers to apply for an instant loan that will enable them to spread the cost of their purchase over a set period of time.
- **Motor finance** is used to spread the cost of a new or used car either through hire purchase (HP) or Personal Contract Plans (PCPs).
- **HCSTC** allows customers to take out unsecured consumer loans with a duration of 12 months or less and a maximum cost of credit equal to 100 per cent of the loan value.
- **Guarantor loans** are a type of unsecured loan that requires a guarantor to co-sign the credit agreement.
- **Personal loans** are loans that a bank or other lender makes that are not secured against any asset such as your home.
- **Rent-to-own, also known as rental-purchase**, is a type of transaction under which any object (furniture, electronics, engagement rings, motor vehicles, home appliances) is leased in exchange for a regular payment, with the option to purchase at some point during the agreement.²⁵⁰

Reliance on “Non-Standard Credit” makes credit less useful and more expensive

Whereas credit maximises the financial capabilities of people on middle and high incomes, it minimises those of people on low incomes. The cost of borrowing for 10-12 million low-income customers is much higher than for middle- and higher-income borrowers and lower-income customers have fewer options in terms of the types of available credit.²⁵¹ This means that whereas higher-income borrowers can easily borrow money for up to 30 days using a credit card without paying a penny in interest charges, lower income consumers instead have to rely on non-standard credit and HCSTC (such as payday loans, home credit, rent to own). Indeed, the UK non-standard credit market comprises c.£72bn gross advances costing about 5 per cent pa on average, while 3.1 million people are dependent on HCSTC.²⁵²

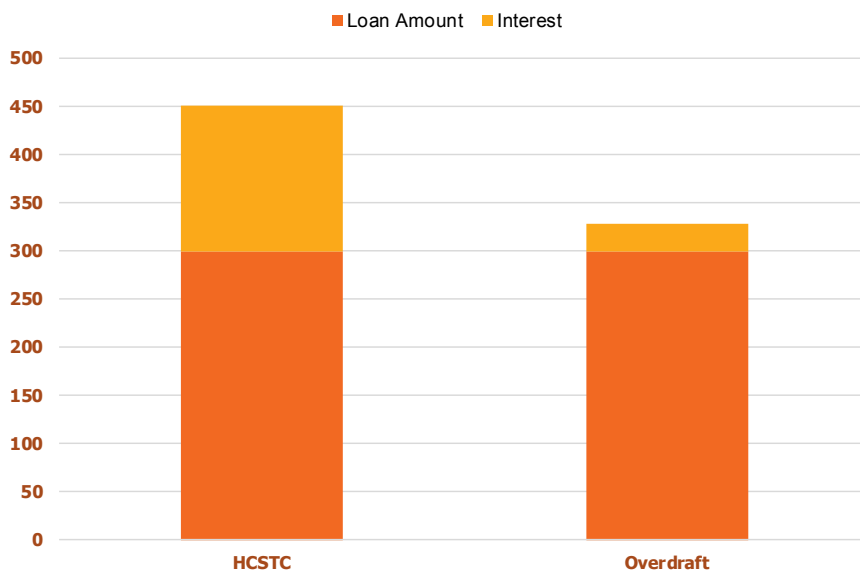
Those eligible for arranged overdrafts pay less for short-term credit than those who use HCSTC. For example, a high costs short-term loan of £300 paid back over 3 months will cost an average of £151 in interest from a payday lender and only £28.91 for an arranged overdraft.²⁵³

250. For a detailed breakdown of the proportions of customers using these different types of credit see pp. 178 of FCA, Financial Lives, 2017, [link](#)

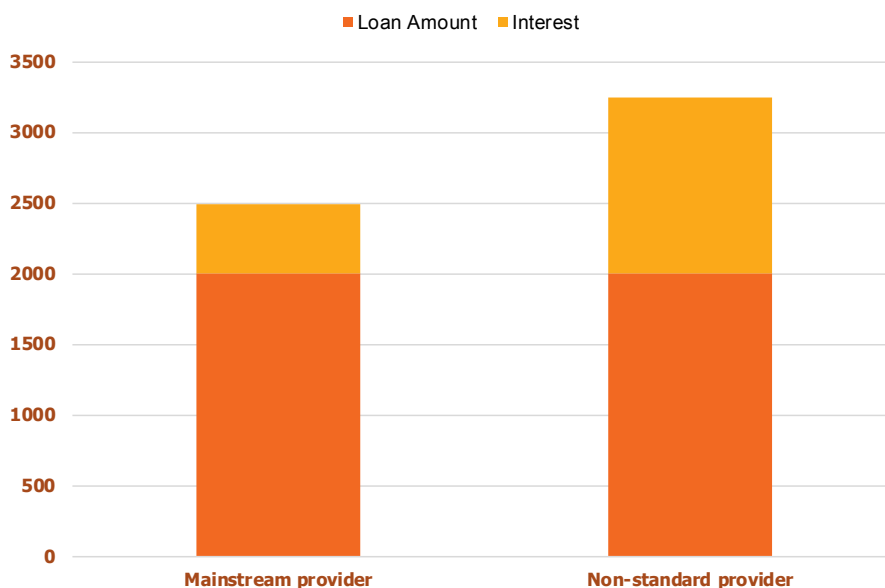
251. Policy Exchange, Why isn't the FinTech market a fin4all?, 28 March 2018, [link](#); Provident Financial, Annual Report and Financial Statement, 2016, [link](#)

252. FCA, High-cost credit: what next?, 2 May 2018, [link](#); Provident Financial, Annual Report and Financial Statements, 2016, [link](#)

253. Average calculations taken from the websites of 3 major banks and 3 HCSTC providers, accurate on 18th December 2019



The same applies to those who rely on installment loans paid back over a longer time. A loan of £2,000 paid back over 24 months would cost £2,493 from a bank and cost £3,250 from an installment provider, a difference of £757.²⁵⁴



Not everyone can access subsidised credit

Some on a low income have access to subsidised credit.

- **Around 440,000 people borrow from not-for-profit lenders.** These include credit unions and community development financial institutions (CDFIs) which are subsidised indirectly by government grants.²⁵⁵
- **Around 1.1 million accessed credit via the DWP's Social Fund in 2017-18, worth over £448 million.**²⁵⁶ The credit accessed here is subsidised directly through non-interest-bearing budgeting loans.

254. Average calculations taken from the websites of 3 major banks providing personal loans and 3 online providers of installment loans.

255. Taken from the number of outstanding Credit Union loans (GB) and the number of individual loans from CDFIs (Responsible Finance, The Industry in 2018, December 2018, [link](#); Bank of England, Credit Union Annual Statistics for 2018, July 2019, [link](#))

256. Department for Work & Pensions, Annual Report by the Secretary of State for Work and Pensions on the Social Fund 2017-18, [link](#)

DWP Social Fund

The DWP provides **Budgeting Loans and Crisis Loans**. The DWP Social Fund allows people who have been on certain benefits for the past six months to apply for a budgeting or crisis loan.

- **The loans are interest free.** Repayments are taken automatically from benefit payments. The amount paid back is based on income, including benefits, and affordability.
- **The minimum loan is £100 with a maximum of £812 if a person or their partner claims Child Benefit.** The loan is normally repaid within two years.²⁵⁷
- **A number of grants and payments are also available from the Social Fund.** These include:

The **Sure Start Maternity Grant (SSMG)**: a payment of £500 to help families with the costs of a new baby if there are no other children under 16 in the claimant's family

- **The Funeral Expenses Payment scheme:** help towards funeral costs
- **Cold Weather Payments:** help with additional costs of heating during periods of severely cold weather
- **Winter Fuel Payments:** help for older people to meet heating costs

Not everyone has access to subsidised credit. On top of the 1.1m people who were granted a budgeting loan by the Social Fund in 2017-18, there were almost 250,000 whose applications were rejected.²⁵⁸ It is also fairly reasonable to assume that there is an equally large group of consumers in similar circumstances who either did not know of the Social Fund or believed - rightly or wrongly - that they were ineligible.

National Social Fund Summary Statistics

	Regulated Social Fund			Discretionary Social Fund	
	SSMG	CWP	FEP	BL	CL
Applications received (000)	100.4	n/a	40.8	1,402.1	n/a
Initial decisions (000)	100.3	n/a	40.8	1,401.5	n/a
Awards (000)	50.5	4,571.9	25.5	1,095.8	n/a
Awards as % of initial decisions	50.3	n/a	63.0	78.2	n/a
Initial refusals (000)	56.3	n/a	15.6	249.0	n/a
Gross expenditure £m	25.6	114.3	37.1	448.3	n/a
Recoveries £m	n/a	n/a	0.1	504.3	46.1
Net expenditure £m	25.6	114.3	37.0	-56.0	-46.1
Average award £	508	25	1,461	408	n/a

Key

SSMG= Sure Start Maternity Grant FEP= Funeral Expenses Payment BL= Budgeting Loan CWP= Cold Weather Payment CL= Crisis Loan

257. Gov.uk, Budgeting Loans, accessed 5 September 2019, [link](#)

258. Department for Work & Pensions, Annual Report by the Secretary of State for Work and Pensions on the Social Fund 2017-18, [link](#)

Exclusion from Tenancy Deposit Finance

These are loans to help people in social housing and especially in the private rental sector by allowing them to spread the cost of a deposit when moving into a new home or flat. As this amount can often be equivalent to 1-3 months rent, it can create a significant barrier for low-income customers who lack sufficient savings and can restrict their ability to relocate (such as for new employment) or force them to use expensive forms of non-standard credit.²⁵⁹

Deposit payments are a particular problem for those on Universal Credit. Claimants often have to rely upon discretionary housing payments (DHPs) to get extra help with housing costs from the council. Nonetheless, DHPs are made from limited local authority budgets and not everybody gets one. If denied a DHP, it is technically possible to apply for a budgeting advance from the Social Fund. Even these are not guaranteed to cover the full cost of a deposit. Moreover, you would be considered ineligible for one if your earnings from an employer or from self employment over the last 6 months were more than £2600 (if you claimed as a single person) or more than £3600 (if you claimed with a partner).²⁶⁰

2. How to address exclusion from credit

The difficulty that those on a low income experience when accessing affordable credit is arguably the most well-recognised form of financial exclusion. This is in large part the result of the obvious consequences for low-income consumers who rely on non-standard credit (like payday loans) which have interest rates often characterised publicly in the media as “unfair” or even “exploitative”. For example, the Archbishop of Canterbury very publicly criticised pay-day lenders for their practices.²⁶¹

Tackling the root causes of high credit prices: credit risk assessments

Why credit costs what it costs

Credit is not free. The more likely you are to default, or the less sure a lender is you will repay, the more they have to charge either you or other customers to cover the potential costs of lending to you. For credit to be cheaper, whilst still avoiding “cliff-edge pricing” (see below), there needs to be better assessment of the risk of lending.

The inflated prices paid by low-income consumers for credit are not always attributable to rampant profiteering by lenders. To tackle exclusion in credit, it is also necessary to tackle the exclusion that arises from the pricing models used by financial services to evaluate risk. This fundamental problem has not been addressed due to a lack of recognition of the importance of pricing models in the provision of credit.

Changing the ownership model of the companies providing credit does not necessarily mean that loans will be cheaper. Indeed, the problems that culminated with the highly publicised demise of Wonga and

259. Citizens Advice, Get help with renting costs, accessed 25 November 2019, [link](#)

260. Shelter, Rent deposit, bond and guarantee schemes, [link](#)

261. Independent, ‘War on Wonga: We’re putting you out of business, Archbishop of Canterbury Justin Welby tells payday loans company’, 25 July 2019, [link](#)

other payday lenders can in some ways be understood as a case study of market failure, since these firms initially set out to meet consumer demand for credit amongst low-income households ill-served by mainstream banks.²⁶² Setting aside its poor practices, what Wonga did correctly identify at the outset of 2008 (yet failed to deliver) is something that still remains true today: the existing models of providing mainstream credit, typified by banks and other mainstream lenders, mean that millions have no easy access to a form of credit that is affordable relative to their income and useful for people on low incomes.

Case Study: Wonga

- After enjoying a period as a FinTech “unicorn” and the darling of London’s investors, Wonga and others were rightly criticised by the media, politicians and campaigners for driving over-indebtedness amongst low-income consumers and charging “exploitative” interest rates.²⁶³
- Despite the fact that they initially intended to gather data from thousands of alternative data points, Wonga’s inability to assess the risk of default, the high cost of capital needed to fund loans and the cost of acquiring new customers once the market was saturated, had highly negative outcomes for consumers.²⁶⁴
- Wonga’s “unfair and misleading” debt-collection practices led them to being fined £2.6m in June 2014, following an investigation launched by the Office of Fair Trading and taken up by the FCA.²⁶⁵ As FCA Director of Supervision Clive Adamson commented at the time, “Wonga’s misconduct was very serious because it had the effect of exacerbating an already difficult situation for customers in arrears.”²⁶⁶

Methods of credit scoring lead to “cliff-edge” pricing

Credit scores do not, and will not ever, determine the risk of lending to customers perfectly. This is because the credit-scoring systems often look at wrong or incomplete data about a customer. It is estimated that current credit scoring approaches could be costing households £1,770 extra per year and 57 per cent of people are at risk of their credit application being rejected.²⁶⁷

If a customer’s credit rating is calculated incorrectly, then they run the risk of suffering from the result of “cliff-edge” pricing models. ‘Cliff Edge’ pricing refers to an imperfect method of risk-based pricing for credit where there are only a relatively small number of “risk categories” to which borrowers can be assigned.

There are two problems with this form of credit pricing:

1. **There is a greater variation of customers within each risk group.** This means that those likely to repay loans are lumped together with those less likely to repay loans, thereby increasing the cost of credit for all involved. Since all borrowers within one category are priced at the same level, there will also be a larger average variation between each borrower’s actual risk level and the risk-pricing level, with some paying a discount and others a premium.
2. **The difference in credit pricing between these risk categories**

262. The Guardian, ‘Where did it all go wrong for Wonga?’, 7 August 2018, [link](#)

263. Forbes, ‘Names You Need to Know: Wonga’, May 3 2011, [link](#)

264. Forbes, ‘The Algorithm that beats your bank manager’, 15 March 2011, [link](#); Bovill, ‘Wonga – a cautionary tale for private equity and venture capital investors’, 29 November 2018, [link](#)

265. MoneyMarketing, ‘Wonga - a recent history of the payday lender’, 14 January 2018, [link](#)

266. BBC News, ‘Wonga chased debt using fake law firm, says FCA’, 25 June 2014, [link](#)

267. Responsible Finance, ‘Responsible Finance calls for credit reference agencies to do more to support financial inclusion’, 28 February 2018, [link](#)

increases in size. If a borrower moves up or down by one price category, the amount they pay will rise or fall by a relatively large amount - the “cliff edge” - compared to a market with more risk categories and pricing levels.

This “cliff edge” can be seen in the differences between the interest paid on loans given to those who use a basic credit card. Their next available loan option charges significantly higher interest. This type of pricing can sometimes be attributed to a lack of information held by the lenders about borrowers and/or their inability to use what data they do have to accurately predict the risk of default for a borrower prior to granting a loan.²⁶⁸



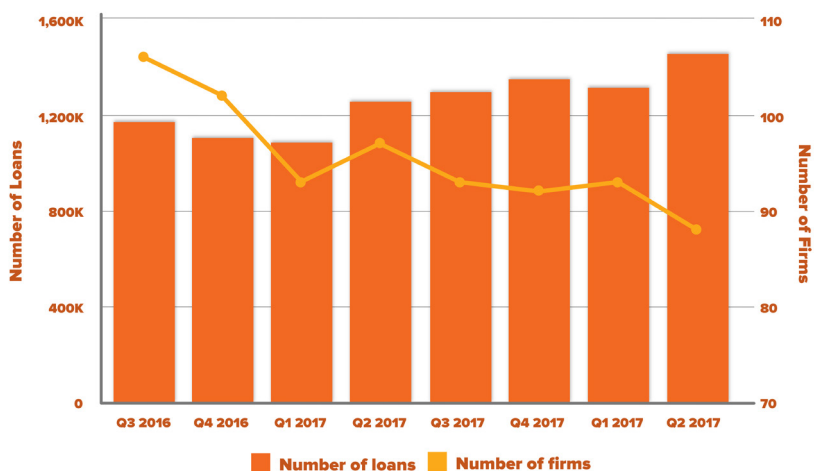
The limitations to regulatory price caps

One of the key ways in which the Government has tried to tackle the cost of lending is through a HCSTC price cap. The regulatory price cap was set at 100 per cent on the total cost of credit and was brought in as a reaction to the growth of payday loans and associated problems of over-indebtedness, which peaked in 2012-2013 when the market served around two million customers and provided 10 million loans.²⁶⁹ The FCA’s own analysis on the impact of the regulatory price shows that it has been effective in capping the total cost of loans that a customer might have to repay.²⁷⁰ Moreover, the cap also led to a decrease in the number of payday loans since the peak in 2012 and the number of companies providing them.

268. This data is taken from an average of 3 representative examples for each of the products listed in this graph and the cost of borrowing £150 over 6 months with those providers.

269. CMA, Payday Lending Market Investigation, 2012, [link](#)

270. FCA, TEN-16-075. PRICE CAP RESEARCH, 16 June 2017, [link](#); FCA, Consumer Credit - high cost short-term lending data, 15 May 2019, [link](#)



However, there are a number of potential limitations to the cap. These relate to whether the price cap has achieved the technical objective of addressing the root cause of the inflated prices paid by low-income consumers when accessing credit, rather than whether such a cap was the “wrong” thing to do from a social policy perspective. Although governments are unlikely to want to remove the cap, it is important to note three limitations in particular.

First, the market has shifted towards longer-term loans. Loans for under 30 days are now less common because it is difficult to make money under the cap. Longer-term loans can have a total cost of credit that exceeds the cap. For example, a loan of £5,000 over 60 months has a total cost of credit that exceeds the cap at £11,857, despite a politically palatable APR of 49.99 per cent.²⁷¹ Customers now may be forced to borrow a higher amount over a longer period.

Secondly, the price cap has become a price floor. Lenders have altered their products to maximise profits under the rules of the cap, leading to decreased price transparency for customers. Sometimes, it is possible to take out a loan over a longer period, from the same lender, and pay lower monthly installments and a total cost of the same amounts.²⁷² There are almost no conceivable circumstances where a consumer would be better off taking the shorter-term loan, given the higher monthly repayments, but the lack of price transparency means that many will opt to do so due to an intrinsic belief that a shorter loan offers better terms, and may consequently end up in financial hardship.

Thirdly, the absence of lenders and HCSTC loans is not inherently a good thing. Unless those borrowing did not actually “need” this credit, or it is replaced by a better alternative, the problem of credit exclusion still exists. Indeed, research undertaken by Coventry University and Toynbee Hall, on behalf of the Carnegie UK Trust and Barrow Cadbury, and the FCA’s HCSTC review, both provide stark views of the problems faced by those who are denied access to credit.²⁷³ Indeed, it is likely that those unable to gain access to a HCSTC loan now rely on alternative forms of

271. This represents the average of three guarantor loans provided by Amigo, TrustTwo and talk loans, as of 18 December 2019.

272. Policy Exchange conducted an extensive review of the market leaders providing HCSTC during the course of this research, capturing pricing information from the calculators provided on their websites for various loan sizes and durations between 7 and 12 months

273. Carnegie Trust, Payday Denied: Exploring the lived experience of declined payday loan applicants, 2018, [link](#)

credit, or simply “go without”, which is a worrying outcome considering the high proportion of loans that are used to pay for essentials such as food, rent or bills.²⁷⁴

The limitations to credit unions

Credit unions have long been hailed as a solution to financial exclusion when it comes to credit. Their most vocal advocate is the Archbishop of Canterbury, Justin Welby, who said they are “essential”.²⁷⁵

Changing the ownership models of firms providing credit is not the most effective way to bring down its cost. Focusing on the ownership models of the companies providing credit will fail to address this more fundamental problem because such an approach is based on a flawed assumption that the primary component of price inflation for credit is rampant profiteering by lenders within an uncompetitive market.

This applies not just for credit but also for access to banking services. As of 2018, membership of credit unions surpassed two million, with many able to register for a credit-union current account.²⁷⁶ This was the result of the £38m Credit Union Expansion Project, run by ABCUL from 2013-2018, that was tasked with growing the sector via a common centralised credit-union banking platform²⁷⁷- an idea first planned in response to the Policy Action Team report.²⁷⁸ Nonetheless, only three out of 290 credit unions currently offer this service.²⁷⁹

Credit unions have faced a number of problems which have limited their effectiveness in tackling financial exclusion. In particular, they suffer from four constraints:

1. **Interest rates cannot be charged above a maximum level.** This has meant that they generally struggle to raise enough money to cover their operating costs, and certainly cannot invest in developing their own technology to improve their efficiency. There have been 54 failed credit unions over the last ten years with at least 73,500 people affected and a minimum of £60.8m jeopardised.²⁸⁰
2. **The requirement to have a “common bond” between the members (such as by geography, profession, or employer).** This often means that there is not enough of a socio-economic mix of high-income and low-income members to make the credit union viable.²⁸¹
3. **Credit unions might not always be a stepping stone to mainstream credit.** It is not immediately clear whether smaller credit unions report data on successful repayment of loans to the three major credit reference agencies.²⁸² This means that the use of credit union loans and a demonstrated ability to repay reliably will not necessarily help responsible borrowers access products such as a mortgage, car loan, or low-cost credit card.

274. FCA, High-cost credit and review of the high-cost short-term credit price cap, 2017, [link](#)
275. Archbishop of Canterbury, Archbishop hails ‘major step’ of flagship church credit union, 11 February 2015, [link](#)
276. The Guardian, ‘Credit unions on the rise as membership surpasses 2 million’, 31 August 2018, [link](#)
277. Co-op News, Credit Unions go digital - slowly, 2 March 2018, [link](#)
278. HM Treasury, Access to Financial Services, November 1999, [link](#)
279. FinTechFutures, 4 September 2019, [link](#)
280. Based upon Policy Exchange Analysis of information provided by the FSCS ([link](#))
281. Credit Unions of Wales, “What is a Common Bond?”, accessed 6 September 2019, [link](#); see pp. 3 to 10 of Credit Union Expansion Project, Demographic Profiling May 2012, May 2012, [link](#)
282. Pp. 47 of the successful ABCUL bid document for the Credit Union Expansion Project tender stated that “a data batching process is being developed to allow credit unions to submit payment information on their loan accounts into the Experian CAIS system, thus creating credit history for their members and a growing repository of credit union lending data.” This indicates that this was probably not possible at that time for all credit unions (ABCUL, Annex W, Response to ITT Part 10, 2012, no longer available online).

Credit Unions can have an important role to play in the future. Governments need to be careful, however, if they think that credit unions alone are going to solve this problem without substantial further reforms.

Recognition of the limitations to subsidising credit unions

Credit unions have been at the heart of governments' financial-inclusion strategy since 1999. The Treasury's Policy Action Team report of 1999 was the first comprehensive investigation for government on the issues of financial inclusion, but the team were not given an entirely free mandate. Several guidelines were set by the Government, highlighting how the project tied in with its broader legislative plans, including: "the scope for development of credit unions, building on planned legislative change."²⁸³ The very first line of the conclusion of the report was: "Credit unions can make a contribution to the wider strategy of access to financial services for people in deprived neighbourhoods."²⁸⁴ However, the report did actually express significant reservations about the policy of deregulating and expanding credit unions. In particular these were concerns about growth, professionalization and market penetration.²⁸⁵

The limitations of the credit union movement have been recognised by Lord Freud, Minister of State for Welfare Reform from 2010-16. After leaving office, he spoke of how the DWP had come to recognise their limitations:

DWP has been a traditional supporter, with very heavy sums of money, of the credit union movement. We did a study, run by Deanna Oppenheimer for us, which showed that it was not a viable industry as it is presently constituted. It loses a lot of money on every loan it makes. That was why we have taken those two steps: to allow them to charge a bit more, up from 2% to 3% per month, on their loans.

That is getting the return base up but the cost base is much too high. That is with the introduction of the new banking platform for them, which we have been supporting with £38 million...Until you have got to that base, it is very hard. It was losing money on every loan it made up until recently, as an industry.²⁸⁶

A Welsh assessment expressed similar concern:

We also came to the view that the expectations placed upon credit unions were very high and arguably unrealistic. We concluded that there appeared to be a disconnect between the capacity of the credit union movement in Wales and the aspirations for it to deliver the expected high level policy objectives spanning social justice, economic development and even education.²⁸⁷

The Good Credit Index, produced by think tank Demos, a traditional supporter of credit unions, summed up the problems faced by credit unions neatly:

The credit union sector faces significant challenges in its capacity to offer

283. HM Treasury, Access to Financial Services, November 1999, p.1. [link](#)

284. HM Treasury, Access to Financial Services, November 1999, p.10. [link](#)

285. HM Treasury, Access to Financial Services, November 1999, p.18. [link](#)

286. Parliament, Oral answers to evidence in House of Lords, Q241, [link](#)

287. Nia Bryer, An Evaluation of the Access to Financial Services through Credit Unions Project, 31 March 2018, [link](#)

affordable credit at scale. Each union is distinct, and not all desire to reach out to disadvantaged and vulnerable groups, with many opting to focus not on the highest-risk households but rather on those who are ‘just about managing.’ In addition, credit unions sometimes struggle in an increasingly digital lending environment.²⁸⁸

3. A FinTech Path to Inclusion

There is clearly an opportunity for FinTech providers to better serve the 10-12 million customers that rely on non-standard credit. FinTech solutions can help with:

- Poor visibility of credit risk amongst low-income consumers
- High cost of capital for lenders providing non-standard credit
- Poor commercial viability for loans made to vulnerable consumers

What credit inclusion means

- In line with the new approach to financial inclusion outlined in Chapter Two, public policy seeking to encourage new FinTech solutions to increase financial inclusion should start by clearly defining the desired credit outcomes for consumers.
- These are simply the ability to cover unexpected costs and income shortfalls, or defer the costs of large irregular purchases. This is no different than how consumers on higher incomes use credit on a regular basis without much cause for concern. Public policy interventions in this area have thus far focussed on the price or profit motivations of the provider, rather than on what those who use credit want.
- The desired outcome for policy makers must be that all consumers, regardless of their income, have access to some form of helpful and useful credit which is affordable but does not lead to over-indebtedness.

How FinTech can improve credit risk assessments and build credit history

FinTech solutions can unlock new ways of assessing credit risk for low income borrowers. This, in turn, enables firms to lend to greater numbers, at lower prices whilst still maintaining a profit. For example, Aire - who are authorised and regulated by the FCA - are trying to “thicken” the thin credit scores of applicants who are not being served by traditional credit-scoring models.

About Aire

Aire has scored over £4billion of credit and has seen its credit approval ratings growing by an average of 14 per cent without risk exposure increasing.²⁸⁹ Recently closing a Series B (venture capital) funding round where they raised almost £9 billion earlier this year, Aire uses Artificial Intelligence (AI) to give users customised credit scores using their credit history, lifestyle, career and financial maturity.²⁹⁰ The service offers virtual interviews and its API can integrate into existing technologies and platforms, ensuring streamlined and efficient service.²⁹¹ Using such technology enables more accurate and simple credit scores, improving widespread access to credit.

288. Demos, The Good Credit Index, July 2019, [link](#)

289. Responsible Finance, Responsible Finance calls for credit reference agencies to do more to support financial inclusion, 28 February 2018, [link](#)

290. TechCrunch, 'Aire raises \$11M Series B to give credit scoring an "upgrade"', February 4 2019, [link](#)

291. SiliconCanals, 'Aire: British startup that uses AI to help people with credit checks just scored €9.6M funding', 4 February 2019, [link](#)

There are approximately two million consumers who fluctuate in terms of their ability to access standard credit.²⁹² As a result, they rely on non-standard credit with the associated price inflation for those loans. It is well established that for this segment of financially-excluded customers, there are additional types of data that could help improve their access to credit and reduce the cost of borrowing. For example, while mortgage payments are well reflected in traditional credit scores provided by credit-rating agencies (CRAs), good repayment of rent to a social or private landlord is not. Experian estimates that inclusion of this single additional data point in these customers credit scores could allow 70 per cent of renters to access cheaper forms of credit or even a mortgage.²⁹³

Adding rental payment data alone is not enough. That information represents just one additional data point on customers' credit scores, which could even increase financial exclusion for many low-income customers who are late in making rent payments. It is possible to add many more payments currently not considered by credit-rating agencies in their algorithms. These would provide further opportunities for low-income customers to demonstrate their creditworthiness, as well as enable greater differentiation of risk between similar customers that would smooth the gradation of loan pricing and reduce the impact of the cliff-edge pricing that exists today.²⁹⁴

FinTech companies can help credit-ratings agencies to integrate new data points. Given how long it has taken to make progress on including rental data in consumer credit scores, FinTech solutions that give customers the tools to demonstrate their own creditworthiness should be welcomed. There are already examples of this in the market. Both Loqbox and Credit Kudos (amongst many others) provide examples of what can be achieved when FinTech firms work to design services specifically for low-income customers, based on integration with an account delivered by a FinTech banking provider.

293. Hansard, House of Commons debate on "Mortgages: Eligibility", 23 October 2017, [link](#)

292. Provident Financial, Annual Report

294. See Experian's statements, 2016, [link](#)

About Loqbox

LOQBOX is a multi-award-winning financial-inclusion FinTech that addresses financial exclusion by providing everyone with the opportunity to build a credit history while they save and learn about money. By tackling the three elements of financial exclusion head-on, LOQBOX enables any consumer to simply and quickly build their digital identity, enabling more people to access financial products and build their credit history and increasing opportunities for those who would typically be excluded from financial products that many take for granted. Building a savings habit and a pot of savings creates real financial resilience and also improves financial education by providing guidance and insight across the entire spectrum including banking, savings, credit and overall financial health. LOQBOX is able to do this for free thanks to innovative partnerships with other financial-services providers.

Tom Eyre, CEO and co-founder of LOQBOX, says: “At LOQBOX, we have a clear understanding of the drivers behind financial exclusion which has enabled us to create a solution that works harmoniously with other elements of the financial services sector to provide our service at exactly the right time to exactly the right people. This collaborative approach is enabling us to end financial exclusion for the many millions of UK consumers currently unfairly excluded from the financial system. By leveraging collaboration between incumbent institutions, third party organisations and FinTech providers, innovative businesses like ours are able to serve a broad range of consumer needs in a way that would previously have been impossible.”

About Credit Kudos

Credit Kudos uses Open Banking data on a person’s transaction history to create an alternative credit score that is based on verifying their actual average monthly income and expenditure, as well as advanced algorithms that look for patterns and abnormalities in spending that indicate risk of default. These are similar to the checks conducted during the manual loan-assessment process employed by staff in a community development finance institution (CDFI) or a credit union.

How FinTech can create new methods of providing loans

The application of FinTech to almost any traditional financial product may change it only slightly. However, it almost invariably reduces the cost of providing it on a much larger scale, generating savings which can, in turn, be passed on to customers. Small innovations to payroll systems have paved the way for salary-backed loans, which can prevent customers from needing to resort to HCSTC.

What is a salary backed loan

Salary Backed, or a salary advance, loans are granted with the permission of an employer using their own funds for the loan. The employee provides a signed guarantee that repayment can be deducted from their future wages, according to the agreed terms. These loans can be provided for free or at marginal cost by employers, because there is a very low risk of default and few administration costs.

Salary-backed loans can bring down the cost of borrowing dramatically.

If those providing people with funds are guaranteed repayment then the cost of providing these funds can be reduced. The idea of providing low-cost loans to employees is not new, with strong roots in the USA where it has often been provided by the employer themselves as a ‘salary advance’ on a semi-informal basis, as a gesture of goodwill.²⁹⁵

FinTech startups have “modernised” the “salary advance” concept.

295. CreditCards.com, How employee salary advances work, 17 July 2013, link

They use an automated online platform (with a 2-pronged web portal) to allow employers easily to connect their payroll system so they can make loans directly to their employees. Managing the process via a third party FinTech loan platform is more secure, more cost efficient and provides anonymity for employees.

About WageStream

- Companies like WageStream work with employers to give workers access to their accrued earnings within a pay-cycle period
- They do this without credit or interest by giving workers access to their own money in return for a small fee (currently £1.75)²⁹⁶
- They can do this because they receive payment automatically from employers when the relevant employees are paid at the end of the month

4. What Government can do to help?

How the Government should approach FinTech credit solutions

The recommendations presented here do not attempt to endorse a specific type of credit product or delivery model that government should promote through a public-policy initiative. The following innovative policy solutions were developed from an examination of existing FinTech models of providing credit, with the aim of using the welfare state's existing function and financial resources to expand access to credit at prices affordable for low-income consumers. The necessary precursor to these policies is the implementation of a FinTech-powered UC Dashboard.

The primary mechanisms explored here revolve around several common themes. These include:

- Increasing information about low-income consumers needed to assess credit risk
- Enabling low-income consumers to decrease the overall risk of lending to them by providing a proof of income or other guarantee based on their benefit entitlement
- Increasing the availability of subsidised loans through policy changes

1: "Real-time" transaction-based credit scoring

The UC Dashboard needs to be specified in such a way as to create an Open Banking compliant API. This would allow the platform to facilitate easier access to real-time transaction data from FinTech current-account providers. Access to a customer's transaction data is the key to making more accurate risk assessments and therefore reducing the price of credit and ending the cliff-edge pricing phenomenon. This would essentially be a digital version of the successful loan-assessment process currently carried out by the best community development institutions, which is

296. Gov.UK, Wagestream, accessed 25 November 2019, [link](#)

what allows them to lend on a small scale to people on low incomes in a sustainable way.

2: Voluntary priority payments

The Government should utilise the creation of the proposed UCPD as a mechanism to provide access to credit from private-sector providers.

People in employment are able to access cheaper credit on the basis that their future earnings will allow them to repay that loan. Since not every UC claimant is eligible for loans from the DWP social fund, mirroring this principle within UC via the UCPD would enable claimants to access affordable credit as well as better prepare them for the future.

To achieve this, the specifications for the UCPD should include the creation of a simple mechanism for claimants to make “voluntary priority payments” (VPP). These payments could be deducted automatically each month from their UC payment and paid directly to the providers of credit. This would operate in a similar way to loans from the Social Fund, except that the funds to which UC claimants would have access would come from private companies and not from government, ensuring that those who are unable to access social funds are still able to gain access to cheaper forms of credit.

Safeguards would be needed to ensure that voluntary priority payments did not allow claimants to borrow more than they could pay back. Moreover, the fee for providing these short-term loans would need to be capped at an appropriate level. Nonetheless, the ability to leverage their monthly UC payments as a guaranteed source of repayment would enable claimants to access significantly cheaper sources of credit as the risk of loan defaults would essentially be eliminated.

Three different examples of how this could work are provided below:

- **More flexible benefits**
- **UC-backed loans**
- **Deposit guarantee loans**

More flexible benefits

The UCPD would enable private companies to give UC claimants a proportion of their income before their DWP monthly payment. This would allow people on UC to access their benefits in the same way that the employed can access their accrued earnings before payday through companies like WageStream. When their benefit payments were made, the amount that UC claimants had withdrawn would then be deducted from their UC payment and repaid. The amount that benefits claimants should be allowed to access would need to be regulated carefully, as would the fees that private companies would be allowed to charge them for this service. Nonetheless, this would prevent UC claimants from having to resort to expensive emergency loans because their benefits had not yet come through.

To help achieve this, the Government should create an Open Banking compliant API specification as part of the UCPD. This would help to facilitate access to, and verification of, the benefit payments and monthly entitlements for each welfare recipient over the previous 12-24 months, and ideally in real-time. This should include whether those payments were being split via the platform into multiple current accounts or being made as one single household payment.

UC-backed loans

The UCPD could also help claimants to provide a verified source of income that would allow them to access credit. Typically lenders require proof of income in order to determine the affordability of a loan and ensure that the borrower will be able to repay. As Universal Credit is designed to mirror life in work, information about a claimant's monthly Universal Credit payments should be made available to lenders. Lenders could then make an affordable loan on the basis of the fact that they would be guaranteed to receive a monthly Voluntary Priority Payment and the amount of total income a claimant had from both employment and Universal Credit.

Deposit guarantee loans

Voluntary Priority Payments through the UCPD could improve access to deposit guarantee loans. UCPD service specifications should require the provision of a simple mechanism (web client and API) for the mutual verification of a new tenancy agreement. This could then trigger the creation of a new provisional or pre-approved voluntary priority payment related to a tenancy deposit and/or a loan taken to finance it. It could also include a simple mutual-approval system to confirm and “lock” (with safeguards) automatic rent deductions paid to landlords for the duration of a tenancy, or for another fixed period related to the financing or waiver of a deposit.

3: Social Fund loans

Loans made via the Social Fund are some of the most secure on the market. The limitation of these loans is not the risk of default, but the cost of administering the applications and its operation. This is because the supply is limited by the funding government is willing to set aside as loan capital. The DWP should explore how the administration of the system, whether by the department or via a third party, could be covered through minimal interest-rate charges on loans by those borrowers who applied for a loan but were deemed to not meet the criteria for social assistance.

Alongside the interest-free Social Fund loans, new interest-charging loans should be made available for those whose financial circumstances are slightly stronger. The DWP should explore how to best offer claimants with sufficient means to access Social Fund loans who still have some disposable income remaining and available to save through repayments. Loan repayments would be secured using voluntary priority payments at

a level sufficient to cover the minimal interest rate charges, repayment of loan capital and a marginal round-up amount placed in a savings account. This savings fund would be unlocked at the end of the loan repayments.

4: Maximising the power of credit unions

This report has sought to highlight how the current construction of credit unions means that they are not realistically able to improve financial inclusion policy on their own. However, it would be short-sighted to throw away the achievements of 20 years of public policy and subsidies that have increased the number of people saving with local credit unions.

HM Treasury in partnership with the DWP should reform the regulation of credit unions to allow unions with surplus funds to invest in a collective pool. This would allow other lenders to access a low cost form of capital and make loans to the type of customers credit unions want to serve, but without the limitations that make credit union loans unsustainable. These collective pools of capital could be administered directly by the DWP or HMT, potentially with a guarantee to protect members deposits, and would be made available only to qualified and selectively screened responsible lenders (e.g. CDFIs). These collective pools could also be made only available to larger and more professional credit unions.

Chapter Six: Savings and Insurance

How FinTech can increase access to Savings and Insurance

Introduction

People on low incomes are excluded from insurance and savings services. The traditional business models for savings are weighted against those who cannot afford to make larger deposits and who need instant access to their savings. Similarly, the traditional risk-pooling model for insurance means that the cost of insurance is higher than low-income customers can afford.

This chapter will explore:

1. The extent, scale and effects of financial exclusion in savings and insurance
2. The reasons for this exclusion in savings and insurance
3. How FinTech innovations can address these problems
4. How the Government can help to give people on low-incomes access to better savings and insurance

The Government, through schemes like Help to Save, has attempted to create the incentives that might convince low-income households to save. Nonetheless, less attention has been paid to how customers want to use insurance and savings services and why the existing market fails to meet this demand. Academic research has consistently showed that different people, from different income brackets, use savings in different ways.²⁹⁷ The type of services that government prioritises do not necessarily match the outcomes that low-income consumers find most helpful from insurance and savings.

1. Exclusion in Savings and Insurance

Consumers use savings and insurance products to protect themselves from income shocks. These might include unemployment or repairs following a car accident. Such unforeseen expenses are an unfortunate fact of life, with nearly three-quarters (71 per cent) experiencing at least one

297. Money Advice Service, Savings Evidence Review, [link](#)

such incident each year.²⁹⁸ Despite this, 24 per cent of the UK public do not have any savings to fall back on.²⁹⁹

Customers lacking sufficient financial resilience in the form of savings or insurance are more likely to face hardship following a financial shock.³⁰⁰ This problem is exacerbated because many of those excluded from insurance and savings will often also have limited access to useful forms of affordable credit.³⁰¹

The lack of savings in the UK

Levels of financial resilience

- 25 per cent of UK adults have no savings, either formal or informal³⁰²
- 34 per cent of UK adults say they would not be able to recover quickly from an unexpected financial shock or loss of income³⁰³
- 19 per cent of UK adults worry that their money will not last until next payday³⁰⁴
- 6 million homes in the UK do not have any form of home insurance³⁰⁵

There are 3.1 million low-income consumers with no savings at all.³⁰⁶

Four in ten working-age people in the UK (equivalent to 16.8 million) lack a savings buffer (less than £100 in savings available to them at any time).³⁰⁷ Nonetheless, according to the Family Resource Survey, over 50 per cent of those in the bottom three income deciles have no savings at all. This means that the number of people without savings could be as high as 3.65 million.³⁰⁸

Amount of savings and investment	Total weekly household income per week											
	All households	Less than £100	£100 - £200	£200 - £300	£300 - £400	£400 - £500	£500 - £600	£600 - £700	£700 - £800	£800 - £900	£900 - £1,000	More than £1,000
No savings (%)	35	50	53	50	47	43	39	37	32	27	27	20
Less than £1,500 (%)	11	8	10	11	10	12	12	13	13	14	13	10
£1,500 but less than £3,000 (%)	7	5	5	6	6	6	6	8	7	10	9	7
£3,000 but less than £8,000 (%)	13	12	10	11	11	11	12	12	15	14	16	15
£8,000 but less than £10,000 (%)	3	1	3	3	3	2	3	2	3	5	4	4
£10,000 but less than £16,000 (%)	6	5	4	6	6	4	6	5	7	6	6	8
£16,000 but less than £20,000 (%)	3	2	2	2	2	2	3	2	3	4	4	4
£20,000 or more (%)	21	16	11	12	14	19	19	21	21	20	21	33
Total sample size	19,110	370	1,114	2,248	2,459	2,137	1,726	1,420	1,263	1,038	864	4,471

The lack of access to insurance products in the UK

Half of households in the bottom half of the income distribution lack home contents insurance. By comparison, that is true of only one in five households on average incomes.³⁰⁹ This is particularly troubling considering that households with no home contents insurance are more than three times as likely to be burgled than those with insurance.³¹⁰

Defining the outcome: why people save money

Attitudes towards savings are linked to income level. While people from all financial backgrounds have the same overall motivations and attitudes towards savings (risk avoidance and financial planning), their

298. Money Advice Service, Press Release, 29 September 2019, [link](#)
299. Moneywise, 'One in three Brits worried about sudden financial shock', 16 August 2018, [link](#)
300. Stepchange, Held Back by Debt, [link](#)
301. FCA, The Financial Lives of Consumers across the UK, 20 June 2018, [link](#)
302. Independent, 'A quarter of British adults have no savings, study reveals', 20 March 2018, [link](#)
303. Zurich, 17.6 million would struggle to recover from a financial shock or loss of income, 15 August 2018, [link](#)
304. Zurich, 17.6 million would struggle to recover from a financial shock or loss of income, 15 August 2018, [link](#)
305. Finder, Home Insurance Statistics, 15 July 2019, [link](#)
306. Money Advice Service, Press Release, 29 September 2016, [link](#)
307. Money Advice Service, Press Release, 29 September 2016, [link](#)
308. Family Resource Survey, Savings and Investments Data Tables 2017-18, Table 7.12, [link](#)
309. Financial Inclusion Commission, The Facts, Accessed 11 September 2019, [link](#)
310. Financial Inclusion Commission, The Facts, Accessed 11 September 2019, [link](#)

income impacts the way in which they save, what they can save for and what products they want and find useful. In order to make savings work for the poorest, it is important to understand what type of insurance and savings products they want.

The most common type of saving amongst low-income households is saving for a short-term goal like Christmas. Saving for a mortgage or for a luxury car is simply not relevant or realistic for these customers, and their immediate concern is much more likely to be making ends meet rather than maximising the return on their savings through longer-term investment opportunities.³¹¹

2. Why are low income people excluded from insurance and savings?

The need to provide savings and insurance products for people on low incomes is often overlooked. While exclusion in consumer credit has attracted media and political attention, exclusion in the area of savings and insurance is equally widespread. It is driven by poor product design and inappropriate business models which are unable to meet the demand for low-cost insurance.

Traditional savings

Traditional savings products pay customers a low interest rate to attract deposits. These funds are then used to fund loans for other customers at much higher rates, with the bank generating a profit from the difference. In order to make this traditional banking model work, banks incentivise customers to save larger amounts, over longer fixed-term periods, by offering higher interest rates for long-term savings.

People on a low income cannot often afford to make larger deposits and need instant access to their savings. Due to the nature of their income cycles, instant-access savings accounts are more useful for low-income consumers. This means that multi-year ISA type products, differentiated by fractions of a percentage point in their interest rate, are likely to be of little interest to low-income customers. In many cases these products are simply unavailable due to minimum savings thresholds, yet they are marketed heavily by mainstream banks and are ultimately promoted by government tax policies.

Choosing not to save is sometimes a rational choice for people on low incomes. The financial incentives offered on traditional savings products - normally expressed as an annual interest rate - would be only a few pennies a year on small sums, and such requirements as minimum amounts and fixed duration would be off-putting. For most low-income households savings products are not to grow their financial net worth, but as an emergency rainy-day fund.

311. https://masassets.blob.core.windows.net/cms/files/000/000/795/original/Savings_review_FINAL.pdf
<https://www.moneyadvice.service.org.uk/en/corporate/research>

Risk pooling in insurance

Traditional insurance products are based on risk pooling. Risk is pooled over as large a group as possible to lower the average risk: the lower the risk, the lower the cost. It is a model designed more out of necessity than to maximise customer benefit and ultimately reflects insurance firms' inability to use new data sources to accurately predict risk. This is similar to the problems of lenders in assessing risks of default. The same end result is that low-income customers have limited access at inflated prices. Nonetheless, due to the obvious economic incentives, some of the most significant FinTech innovations in insurance are being led by some of the biggest companies in the UK market.

Saving on Universal Credit

Low-income consumers cannot afford to pay the cost of saving. In order to make savings one has to forgo spending elsewhere, which for people on a low income is often on essentials. This sacrifice could be considered to be a 'cost' of saving. The reason why so many people are excluded from insurance services is because they cannot afford to make this 'cost' of saving: if you lack disposable income this can mean forgoing spending on essentials that one needs to live.

There is still an active debate about how much truly disposable income people have if they are out of work or in receipt of any UC payments at all. At one extreme, JRF research suggests that "in order to reach a minimum acceptable living standard in 2019, a single person needs to earn £18,800 a year and a couple with two children need to earn £20,600 per parent."³¹² This is in excess of standard UC payments, and while it is beyond the scope of this research to make a judgement about what people should be paid on UC, it is clearly arguable that saving is not feasible at present.

Help to Save

- The Help to Save scheme is a government-backed savings account designed to help people on low incomes boost their savings by 50p for every £1 saved up to £1,200.³¹³
- Those entitled to Working Tax Credit or Universal Credit could be eligible to open a Help to Save account.
- Over 132,000 people have signed up to the government-backed savings account Help to Save – depositing more than £31.4 million.³¹⁴
- However, it was originally envisaged that 3.5 million people would use the service.³¹⁵

Low-income consumers cannot afford to take maximum advantage of Help to Save. To take maximum advantage of the scheme, a household must save £50 a month or £12.50 a week. The households in the lowest two income brackets (equivalent to around 2.5 million households) would have to reduce their weekly spending on food by 36 per cent to afford this.³¹⁶

Help to Save is designed as a multi-year, fixed-term savings product that offers low-income consumers little flexibility. This key design flaw

312. Joseph Rowntree Foundation, A Minimum Income Standard for the United Kingdom in 2019, [link](#)

313. Gov.uk, Help to Save, [link](#)

314. HM Revenue & Customs, HM Treasury, Press Release, 30 August 2019, [link](#)

315. Traviss & Co., "HMRC states around 3.5 million individuals 'yet to benefit from Help to Save' Spending in the 2019, [link](#)

316. [link](#)

makes it unsurprising that uptake of the scheme has been very low. Even with 50 per cent matching funding of savings, it is unattractive to low-income consumers because they do not find the product useful. A saving product based on a more short-term basis would be more helpful, and attractive product to low income savers.

3. A FinTech Path to Inclusion

FinTech companies can improve on traditional models to provide cheaper forms of insurance and savings services that are better suited to the needs of their customers. In particular, FinTech companies:

- Have innovative, and more nuanced services to encourage saving
- Can offer “smarter” savings tools to their customers
- Use data to bring down the cost of insurance
- End over-insurance

Innovative business models

New FinTech savings and insurance products operate under different business models to those developed by mainstream banking and insurance. These business models allow firms to address the major deterrents to saving and insurance that affect the low-paid.

1. **In savings, Fintech firms are incentivised to grow the total amount amongst all customers.** Since they typically are not lenders, they have less regard to the amount or duration saved by each individual, as increased deposits does not so directly impact their revenue or ability to make loans.
2. **In insurance, FinTech firms analyse more detailed data.** This allows them to create smaller and more accurately defined risk pools. Customers are covered by more bespoke insurance policies, meaning that they are offered at lower prices and in a way that is easier to access.

The cumulative result of FinTech innovation is that firms are well placed to offer products and services that are more useful for low-income customers than the traditional forms of saving and insurance and help them improve their financial resilience and withstand income shocks.

“Smarter” products that are more useful

Round-up and sweep savings

FinTech companies can offer “smarter” savings products. These focus on making saving easier or more affordable and build on well-established methods to make it easier for consumers to save small amounts on a regular basis. These small savings can gradually accumulate over a month or year into a fund that proves useful in the event of a financial shock. Specifically,

they encourage round-up transaction-based savings and regular sweep savings:

- **“Round-up” savings:** each financial transaction is rounded up and the “rounded-up” figure is set aside as a saving
- **“Sweep” savings:** a regular amount is “swept” into a savings account periodically and automatically, depending upon how much a customer can afford

Both require no direct action by consumers, or a change in behavior.

With their consent, these two processes could be done automatically in the background and integrated with other financial transactions and as a part of their existing behaviour.

FinTech firms have improved on both of these concepts using advanced algorithms to analyse data made available through “Open Banking”. These allow companies to analyse a consumer’s current and past financial behaviour as well as to predict their future financial commitments, such as bill payments. These app-based products can accurately predict the level of savings that are affordable for a consumer based on their past and future expenditures on bills, necessities and other regular expenses.³¹⁷ Because no consumer trade-off or active decision-making is needed once a FinTech savings app of this type is set-up, it reduces the likelihood that funds which could potentially be set aside as savings are instead used for other discretionary spending.

“Gamification” of incentives

Some FinTech services use gentle nudge incentives. These built-in incentives enable consumers to easily recognise areas of their spending where they may want to voluntarily reduce spending, which is done in a way that minimises the “trade-off” or “sacrifice” of doing so.³¹⁸ For example, Onedox makes it easy to cancel unused subscriptions for things such as a music or video streaming service that is rarely used or even forgotten about.³¹⁹ Similarly, Emma - a powerful AI-based financial assistant - makes it easy and engaging for customers to learn more about how they spend their money over time and how they could achieve their goals.³²⁰ Funds saved in this way either through savings or reallocation can then be potentially allocated towards building financial resilience for the future.

Other FinTech services have developed products that use challenges and competition to reward positive behavior. Building upon a practice common amongst credit unions and community development financial institutions, these firms reward those with good savings habits. Rather than rewarding through a financial pay off in the form of interest payments, these firms give these customers access to credit services that were previously unavailable to them. Credit unions typically do this by allowing members to borrow a total amount equal to three or four times what they have saved. Similarly, Moneyline, which provides small personal loans to

317. For example, MoneyBox, accessed 25 November, [link](#) and Oval Money, accessed 25 November 2019, [link](#)

318. See Toucan, accessed 25 November 2019, [link](#)

319. Onedox, accessed 25 November 2019, [link](#)

320. Yolt, accessed 25 November 2019, [link](#), Emma, accessed 25 November 2019, [link](#), Cleo, accessed 25 November 2019, [link](#) and Elfnity, accessed 25 November 2019, [link](#)

people excluded from mainstream credit, allows borrowers to round up their regular loan repayments by a small affordable amount which is set aside as savings and can then be withdrawn as a lump sum.³²¹

Using data to level the playing field in insurance

Cloud computing, machine-learning algorithms and smart devices have been unique catalysts for FinTech innovation in insurance services. They allow for more accurate assessments of risk, made on an individual basis, rather than a broad category-based approach based on basic information about a consumer (such as their post code, age, sex and the average risk for people in those categories).

Category-based risk pricing increases the cost for those who are often safe to insure. The two areas where this has been the most developed and is most relevant is in car and home contents insurance:

1. **Under a category-based approach, young drivers are forced to pay high prices for car insurance because accidents are higher for this demographic than any other.** However, clearly there are skilled responsible drivers within this broad group of consumers who are unfairly penalised.
2. **Similarly, low-income households pay inflated prices for car insurance and home contents insurance.** While geographic “red-lining” for insurance has been made illegal, it has not stopped prices from rising to prohibitive levels for low-income households living in high crime areas.³²² Yet simply because average claims rates are higher, this does not mean that risk is equally distributed across all low-income consumers or even all consumers in an area with above average crime and insurance claims related to, for instance, theft, arson and vandalism.

Smarter insurance services offered by FinTech firms can greatly reduce the cost of insurance for many low-income consumers. They provide a mechanism to better link behaviour with insurance prices, as opposed to simplistic demographic analytics:

1. **Car Insurance:** The best example of this is the “black box” that can lower the cost of car insurance. An electronic device that monitors how safely a person drives and then adjusts the cost of the insurance premium accordingly, a black box can see drivers aged 17 to 24 save £151.25 a year.³²³
2. **Home Contents Insurance:** Smart devices used by FinTech firms like Neos not only help consumers actively take steps to protect their home from both crime and accidental damage, but also help them pay less by reducing their risk.³²⁴ The benefits of smart device-enabled home content insurance are magnified if offered by a firm like My Urban Jungle, which specialises in decreasing all barriers to access and providing a highly flexible, pay-as-you-go

321. Moneyline, accessed 25 November 2019, [link](#)

322. CRA Insights, Redlining Risk - Walking a Fine Line, July 2016, [link](#)

323. MoneySuperMarket, Telematics Insurance, March 2019, [link](#)

324. Neos, accessed 25 November 2019, [link](#)

form of insurance tailored for renters and costing as little as £5 per month.³²⁵

Ending “Over-Insurance”

Many FinTech companies now offer insurance products together with their bank accounts. This not only makes insurance claims cheaper and easier because the claims are integrated with the bank account, but also makes uptake easier. Moreover, they can also tailor the insurance services to take account of the transaction data used by the bank accounts.

These “bundled” insurance packages can help to end the problem of overinsurance. For example, the FinTech banking firm Starling Bank announced, in late 2018, a partnership with the social insurance firm SoSure which provides mobile phone insurance.³²⁶ SoSure provides an appealing insurance service for people on low incomes because they allow you to insure individual products instead of paying for expensive bundle deals for additional products like laptops and tablets which many people on a lower income do not possess: a Nokia 3 smartphone can be insured from only £5.49 a month.³²⁷ In addition their social insurance policy allows people to re-coup up to 80 per cent of their insurance premium each year by encouraging others to sign up.³²⁸ In contrast, the average high street bank typically sells a bundled insurance package, as part of their higher tier current accounts (and is often not available to basic bank account customers). They often provide coverage levels that exceed the needs of most low-income households and have a higher average price point of £15.50.³²⁹

P2P (peer-to-peer) insurance models and direct no-claims rebates can make insurance more accessible and cheaper. They can also allow communities to assess and price-risk amongst themselves.³³⁰ Firms like Laka, which specialises in people-centered bicycle insurance, allow lower-income customers to insure at an affordable price since their self-regulating community will not cross-subsidise insurance policies for those owning much more expensive bicycles.³³¹

FinTech is also able to deliver more useful and attractive forms of insurance. Firms like Trove, Cuvva and Brolly are providing much more flexible forms of on-demand insurance for renters, borrowed cars and single items.³³² This not only decreases costs but, more importantly, on-demand insurance helps to remove the barriers to access faced by low-income consumers whose financial circumstances make fixed term policies requiring large up-front payments or credit-based financing options unsuitable.

Firms like Wrisk and Homelyfe focus entirely on making the selection of insurance, claims process and account management as simple and accessible as possible.³³³ By removing complicated terms and insurance jargon as well as elements of price inflation related to price comparison, and massively simplifying and speeding up the claims-handling process, such app-based insurance services can make accessing insurance much more attractive to low-income households.

- 325. MyUrbanJungle, accessed 25 November 2019, [link](#)
- 326. Starling, Starling Bank and so-sure team up, 9 October 2018, [link](#)
- 327. SoSure, accessed 25 November 2019, [link](#)
- 328. SoSure, accessed 25 November 2019, [link](#)
- 329. Policy Exchange conducted extensive research of the available current account packages and mobile phone insurance policies offered by high street banks. It found an average cost of three representative examples to be £15.50 per month
- 330. Deemly, accessed 25 November 2019, [link](#)
- 331. Laka, accessed 25 November 2019, [link](#)
- 332. Trove, accessed 25 November 2019, [link](#), Cuvva, accessed 25 November 2019, [link](#), Brolly, accessed 25 November, [link](#)
- 333. Wrisk, accessed 25 November 2019, [link](#) and Homelyfe, accessed 25 November, [link](#)

4. What Can Government Do to Help?

The purpose of this research is not to recommend any one FinTech firm, product or service. In fact, few of the firms listed here are truly designed exclusively for low-income consumers. The point of the examples presented here is to show the direction of FinTech innovation. It shows how FinTech can help to address the underlying product designs and business models that lead to low levels of savings and insurance amongst low-income households.

Access to these products can be facilitated by integration and partnerships with FinTech banking services designed and operated for the benefit of low-income consumers. To enable low-income consumers to improve their financial resilience through the use of savings and insurance products, the Government must adopt policies that utilise FinTech innovations rather than pursuing policies that simply try to educate and persuade low-income consumers to use products that do not match their circumstances.

The Government should focus on giving people on a low-income products that help them to build up a financial safety net. As set out in Chapter Five of this report, the Government should change its approach and start with the outcomes that people want from insurance and saving products. They should promote policies that enable low-income consumers to combine the limited resources available to them (whether from their income or provided by the welfare state) into the most effective type of financial buffer possible.

1: Improving the Help to Save scheme

To achieve the targets the Government hoped to achieve with Help to Save, policymakers should change certain aspects of the scheme. Specifically HMT should consider:

- 1. Allowing “catch-up” deposits up to a maximum of £50 for the preceding two-month period.** This means that if a claimant missed one monthly saving target, they would be able to top it up the following month. For example, if somebody was only able to afford to save £30 one month, they could pay £70 the following month to catch-up on their deposits.
- 2. Paying out top-up bonuses every 6 or 12 months rather every 24.** This would create a more short-term incentive to save, and one more appropriate for low income households.
- 3. Working with the Behavioural Insights Team to introduce basic elements of gamification and nudge theory into the UCPD.** This could include displaying the maximum bonus as a pending bonus, a visually interactive countdown of “you’re-on-track-to-earn-your-bonus-of-£x-in-xx-days/months” and positive text/email deposit reminders. This would build upon the Help to Save tools included in the HMRC App.

2: Expanding Help to Save

Changing the methods of measuring success

To achieve the Government’s policy objective of enabling 3.5 million low-income consumers to achieve the financial resilience of £1,000 in savings, the Government must expand Help to Save in a way that is more useful and appealing to them. However, it must do this in a way that is more fiscally sustainable, as providing the current level of matching-funding at the targeted numbers would cost £2.1bn over two years. As the Government’s stated policy objective is to enable low-income consumers to build greater financial resilience, the success of Help to Save should be evaluated on how effective it is at increasing average savings over time, for as many of the target demographic as possible. The type of account, or how people actually save, is irrelevant.

Moving towards a “multi-provider” model which includes FinTech

The Government needs to change the metrics by which it judges the success of Help to Save by amending the existing policy design and opening up the provision of new Help to Save to innovative FinTech providers. HMT originally considered a multi-provider model for Help to Save, but during the consultation phase reached the conclusion that having the state-owned bank National Savings and Investments (NS&I) as the sole delivery partner would be more efficient. It was also felt that it would have positive branding benefits.³³⁴ The unquestionably low uptake for the new match-fund savings scheme indicates this was not the case.

Opening up Help to Save to FinTech providers will help to increase uptake. The HMRC App already makes it easier to save through Help to Save. The ways in which FinTech firms could better serve low-income customers, as well as help them find new sources of disposable income for discretionary savings, has been covered previously in this chapter. The primary reason for the success of new FinTech savings products is their ease of use and the mechanisms by which they enable savings, rather than the financial rewards they pay to savers.

Getting the incentives right

Opening up Help to Save to new FinTech providers represents an opportunity to improve the fiscal viability of Help to Save at the scale desired by government. Removing the financial incentive as the sole mechanism for promoting increased savings means that matching-funding levels could be lowered for Help to Save accounts operated via FinTech firms, while still achieving increased levels of financial resilience. For example, a 25 per cent matching-fund bonus would still represent a financial incentive that vastly exceeded any other savings product available on the market and would further increase the attractiveness and benefits of FinTech savings products that currently pay relatively low interest rates - if any.

Government should explore dividing matching-funding between

334. HM Treasury, Help to Save: response to the consultation on implementation, October 2016, [link](#)

the saver and the provider. If the government wished to further kickstart the development of bespoke products for UC claimants by FinTech firms, they could further divide this matching-funding so that 20 per cent was paid to savers as a financial incentive and 5 per cent was paid to the providers. This would instantly create a huge commercial reward for offering these accounts, while also linking the success of those firms in increasing average savings levels to their commercial profitability, which is the key to driving innovation.

The new generation of small interconnected FinTech firms are perfectly placed to deliver Help-to-Save cooperatively, in partnership with NS&I as their licenced deposit holder. Enabling FinTech firms to offer more innovative types of savings products, but under the umbrella of the Help-to-Save scheme, could greatly increase levels of financial resilience amongst the poor. Without offering a better and more diverse range of savings products as the entry point to the scheme, there is no reason to believe the uptake rate of Help to Save will improve.

Allowing claimants to save and borrow through a loan-to-value ratio

DWP should amend the Help to Save specifications and delivery partner to allow claimants not only to save, but also to borrow during the two year duration of the savings account scheme. These loans could be provided with a maximum LTV value determined by the length and amount of savings and government matching-funding committed thus far, with those funds being blocked and unavailable for withdrawal to secure the loan. In other words, this would allow people to use the amount that they have saved a collateral to borrow a greater amount. For example, somebody who had saved £100 through help to save may only be able to borrow up to £300, but somebody who had saved up £300 may be able to borrow up to £900.

LTV ratios

- The loan-to-value (LTV) ratio is a term used by lenders to express the ratio of a loan to the value of an asset purchased.
- Loans with high LTV ratios carry with them lower rates for lower-risk borrowers and allow lenders to consider higher-risk borrowers, such as those with low credit scores, previous late payments in their mortgage history, high debt-to-income ratios, high loan amounts or cash-out requirements, insufficient reserves and/or no income.
- For example, in the case of a mortgage it ensures the bank won't lose out if the value of the house drops and a borrower defaults, since they didn't make a loan for the whole amount.

This would have a number of benefits:

- 1. It would provide an additional incentive (other than match funding) to save.** Rather than save simply to receive matched funding over the long-term, those eligible for help to save would be encouraged to save to “unlock” potential loans.
- 2. It would bring down the cost of lending.** It becomes less risky to lend if loans are calculated through an LTV ratio. For example, if somebody saved £100, was eligible for a loan of £300, their initial saving would already be paid, meaning that the maximum loss to the lender would be £200. This means that they can charge lower rates of interest and spread out repayments over longer periods.

Chapter Seven: Financial Education

Making advice and education available and scalable

Introduction

A key pillar of the government’s traditional approach to financial inclusion has been the subsidisation, coordination and expansion of free money-advice services. As discussed in Chapter Two, this includes both debt advice and financial education. The extent of the financial-capability deficit, which extends across the entire population, has been well established in a series of government commissioned research projects. These date back to the work of the Financial Standards Agency and its “baseline survey” on financial capability in 2006.³³⁵ Equally well established are the benefits of ensuring people of all ages, income and education levels have access to money-advice services to help them navigate their financial life, as well as the confidence and skills they need to do so.³³⁶ At present, one in ten consumers admit to being “terrible with money” and that they struggled with debt problems as a result.” These low levels of financial capability are estimated to cost the UK economy around £3.4 billion annually.³³⁷

This chapter will show how government can use FinTech solutions to improve financial education. It outlines:

1. The scale of exclusion in financial education and debt advice,
2. The limitations to the Government’s approach to financial exclusion,
3. How FinTech can improve debt advice and financial education,
4. How the Government can provide education, advice and skills training in a consistent manner throughout life

FinTech can help to address the problems that the Government has identified but failed to address. Despite considerable Government efforts, recent research found that around five out of ten people still do not feel confident about their own skills and capability when it comes to making financial decisions.³³⁸ This is only a marginal improvement when compared to similar research done in 2005-6 by the Financial Standards Authority

335. FSA, Levels of Financial Capability in the UK: Results of a baseline survey, March 2006, [link](#); MAS, Financial Capability of the UK, 2013, [link](#)

336. MAPS, Right Place, Right Time, [link](#)

337. Money Saving Expert, ‘Lack of financial education costs UK £3.4 billion a year’, 13 December 2012, [link](#)

338. MAPS, Press Release, 8 April 2019, [link](#)

which revealed six out of ten lacked financial confidence.³³⁹

1. The Scale of Exclusion from Financial Education and Debt Advice

Demand for debt advice far outpaces supply

In 2015, Citizens Advice conducted some research around the advice gap. It identified four different types:

- **The affordable advice gap** affects consumers who are willing to pay for advice but think it is too expensive.
- **The free advice gap** affects people who want advice but are unable to pay for it and are unaware of, or unable to access, free services.
- **The awareness and referral gap** affects people who do not know where to get advice.
- **The preventative advice gap** affects those for whom non-money issues can impact their financial position.³⁴⁰

The Government has, to date, been unable to fill these gaps and ensure that services, advice and education are available on the scale demanded and needed by consumers. According to the Money Advice Service, “demand continues to exceed the supply of debt advice, with 1.7m people likely to seek debt advice and only 1.1m receiving it in 2016/17. The levels of unmet demand are particularly high in Scotland and London.”³⁴¹ Indeed, demand for debt services has since reached a five-year high.³⁴² The number of callers falling behind on council tax doubled from 2008 to 2018 and those struggling with rent arrears rose from six per cent in 2008 to 30 per cent in 2018.³⁴³

Supply and demand in the UK across all channels

Region / country	Demand	Supply	Unmet Demand	Unmet Demand as % of Supply
Scotland	143,553	76,175	67,378	88%
London	242,206	136,012	109,194	80%
Northern Ireland	46,436	27,470	18,966	69%
South East	194,793	120,373	74,420	62%
East of England	142,239	88,033	54,207	62%
South West	131,529	82,149	49,381	60%
North West	197,943	125,189	72,754	58%
Yorkshire and The Humber	148,624	96,004	52,620	55%
East Midlands	125,445	81,624	43,821	54%
Wales	90,155	59,522	30,633	51%

339. FSA, Levels of Financial Capability in the UK: Results of a baseline survey, March 2006, [link](#)

340. Citizens Advice, The four advice gaps, 15 October 2015, [link](#)

341. Money Advice Service, Mapping the unmet demand for debt advice in the UK, July 2018, [link](#)

342. Independent, 'Demand for debt help reaches five-year high as more people struggle to pay for basic expenses', 3 September 2018, [link](#)

343. Independent, 'Demand for debt help reaches five-year high as more people struggle to pay for basic expenses', 3 September 2018, [link](#)

West Midlands	155,060	108,833	46,227	42%
North East	76,663	58,225	18,437	32%
UK Total	1,697,646	1,059,609	638,037	60.21%

The Limitations to Financial Education in Schools

Financial education was finally included as a mandatory subject in the statutory national curriculum for secondary schools in September 2014.³⁴⁴ Having no dedicated funding, it is offered by most state secondary schools in the UK either through general classes on Personal, Social and Health Education or during other lessons, such as mathematics or business studies. Nonetheless, there are a number of problems to this:

- 1. Standards of teaching vary hugely.** Of those schools who claimed to offer financial education, 92 per cent taught financial numeracy and calculations, yet only 40 per cent claimed to give students experience in planning and budgeting. More often than not, specific financial education (i.e. teaching skills for day-to-day money management) is reportedly carried out only once or twice a year, with only a fifth of schools and colleges saying they offer financial education in some form at least once a week.³⁴⁵
- 2. Financial education carried out in state schools is neither standardised nor taught by specialists.** In 88 per cent of cases, responsibility for its administration falls upon teaching staff with no training or relevant qualifications.³⁴⁶ Moreover, financial education is most likely to be integrated into mathematics, putting those who opt out of studying it after the age of 16 at a distinct disadvantage.³⁴⁷
- 3. The curriculum has not been adapted in light of the rise of new FinTech developments.** This means that even if students do receive financial education, they are likely still to be inadequately equipped for managing their finances in the digital age.

There are, however, a range of charitable organisations working to deliver financial education programmes and initiatives. These are typically funded, operated and delivered on a small scale at the local level. While there is no unified coordination of these efforts, or standardisation with regard to measuring quality and content delivery, they make a serious contribution. For example, in 2017/18, MyBnk worked directly with 33,458 young people across the youth sector to deliver 6,108 hours of one-to-one training through 287 hosts in 62 local authorities nationwide.³⁴⁸ In 2018, The Money Charity delivered 1,027 hours of Money Workshops to 20,911 young people across England, Northern Ireland and Wales.³⁴⁹

344. Money Saving Expert, 'Financial education to be added to the national curriculum', 7 February 2013, [link](#)

345. The Money Advice Service, Financial education in secondary schools in England, November 2018, [link](#)

346. The Money Advice Service, Financial education in secondary schools in England, November 2018, [link](#)

347. The Money Advice Service, Financial education in secondary schools in England, November 2018, [link](#)

348. Mybnk, accessed 25 November 2019, [link](#)

349. The Money Charity, Annual Report 2018, [link](#)

2. The limitations to the Government's approach

Financial Education does not change the market dynamics of financial services

Financial education on its own is not enough. It is important to remember that financial education and money help only to mitigate the symptoms of financial exclusion, not to address the underlying root causes of exclusion that have been shown throughout this report to be the primary driving factors behind the financial troubles of low-income consumers. Without first addressing the underlying market dynamics that exclude low-income consumers, education and advice can only ever help them make better use of the limited range of unsuitable financial products and services available. Similarly, for those customers struggling with over-indebtedness or poor financial decisions, advice services can only ever help them to limit the damage of problem debt.

The present system for debt advice is difficult to scale to fill demand

Meeting the demand for conventional debt advice has been a long-term difficulty for governments, and will become impossible in the future.

The Money Advice Service estimated that the unit cost of debt advice was £138 in 2015.³⁵⁰ If the Government were to satisfy the unmet demand in the UK (638,037 people), it would cost just over £88m. However, it is predicted that by 2022, over 2m people a year will need debt advice, double the current number. Supplying that to an additional 1m is predicted to cost an extra £138m. Furthermore, this excludes the 8.2m estimated to be suffering with problem debt who have not actively sought advice.³⁵¹ Including them in future cost projections would add a staggering £1.1bn to the current cost. The debt advisor PayPlan has in fact warned the Treasury against encouraging those with problem debt to seek advice, as funding is so inadequate. The current model is clearly unaffordable and unworkable.

Debt education is extremely important but cannot be provided at scale in its current form. Recent research on over-indebtedness in the UK shows that average levels of consumer debt have continued to rise steadily over the past two decades.³⁵² So while the use and provision of debt advice services has increased, the major relevant charities report that the problem is still getting worse.

350. HM Treasury, Review of the Money Advice Service, 2015, [link](#)

351. Financial Times, 'Providers of debt advice warn of funding crisis', August 2018, [link](#)

352. House of Commons Library, Briefing Paper Number 7584, 21 December 2018, [link](#)

3. A FinTech Path to Inclusion

“You shouldn’t need to educate someone to use your product. That means you’ve designed your product wrong”³⁵³

Making things simpler and more intuitive

If financial products were designed to be more intuitive, there would be less of a need for financial education. This was one of the key premises behind the findings of the *Sergeant Review of Simple Financial Products*, which observed that “when consumers arrive at the financial services marketplace, there should be simple processes and products available that will allow them to make a straightforward purchasing decision.” It went on to say:

“Financial Products should be easy to understand, easy to compare, easy to buy, easy to manage, and provide a fair deal for customers – there should be no risk of surprises. In order for them to be both commercially viable and affordable to consumers, they need to be designed as “non-advice” products.”³⁵⁴

The latest wave of FinTech firms have produced a wide variety of mobile, features and user interfaces. These are each designed from top-to-bottom for a specific use case, or customer type. They offer customers advanced features, but accessed via a simple and highly intuitive user interface, meaning that managing and tracking finances is something customers do not have to learn, but can just do (or in many cases let the app do it for them through tagging and categorisation services).

How Open Banking can improve debt advice

As alluded to throughout this report, the regulatory reforms known collectively as ‘Open Banking’ have made it easier for customers to share their financial data. This means that customers can access debt advice, tailored to their personal circumstances, meaning that those unable to access face-to-face debt advice can still receive support. Moreover, it also makes the income and expenditure (I&E) process more accurate. Whereas previously many debt advisors relied on self-certifying methods of establishing the expenditure of those seeking advice, apps like Tully have utilised the data made available through ‘Open Banking’ to allow customers to generate an instant and complete analysis of their financial behaviour.³⁵⁵

353. Ben Brabyn, Twitter, 18 December 2018, [link](#)

354. Sergeant Review of Simple Financial Products, March 2013, [link](#)

355. Open Banking, Money Advice, accessed November 2019, [link](#)

About Cleo

- Cleo is an AI who helps users to save money. Originally built on top of Facebook Messenger platform, it has since developed into a stand-alone app - helping over 2 million people to access insight and practical information about their financial situation since 2016.
- The natural language algorithms used by Cleo make it much easier for people to get information about their financial situation and how they use particular tools such as how they can budget or save money. Cleo uses gifs and emojis in order to provide its advice, with adjustable settings for how harsh users want their updates to be. The features that draw this audience in and make the product accessible, range from an inclusive and engaging tone of voice, with 92% of users choosing to 'get roasted' and confront their biggest weekly spends; and forecasting to predict unsustainable spending before it happens with its 'Daily Fortune Teller' mode.
- 62% of Cleo users have a weekly check-in and the average Cleo user engages with her 14 days a month. Insight driven via the familiar and already popularised Facebook messenger platform, and directly through pro-active notifications means Cleo is accessible to almost everyone without needing to make appointments, have enough data to download an app, removing the need to pay unaffordable fees just to get high quality advice and information at different stages of a user's life.
- On average Cleo users earn £24,000 per year. After using Cleo for 1 month, regular users have on average managed to improve their financial situation, seeing a 20% reduction in overdraft fees.
- CEO Barney Hussey-Yeo told Policy Exchange that Cleo "is an AI assistant that builds direct engaged relationship with consumer, she helps them save, she helps them spend, she helps them get the right financial products. Financial advice is missing from retail banking, from Government and from education. Cleo is bringing that to everyone globally. Our aim is a financial advisor in your pocket - for the mass market."

Building on what works in education

One area of recent FinTech innovations that is particularly relevant is aimed at teaching children the basics about money. With the aim of improving both digital literacy and financial skills from a young age, many companies have developed "digital piggy-banks". These have accompanying prepaid cash cards and have been launched by several firms.

Switzerland-based Credit Suisse launched the "Viva Kids" package in 2017. This was launched in response to research which found that parents are keen for their children to learn how to responsibly handle money. The package includes a "Digipigi" money box, an app which allows control over both a private and a savings account and a Maestro card. The app allows children to make saving goals, make payments and check their balance whilst allowing parents to monitor their child's financial transactions via a connected parent app.³⁵⁶

Similarly, Gohenry is a UK-based pocket money app which launched in 2012. It offers a prepaid cash card and extensive parental control. Parents can set up automatic pocket-money transfers, choose where the card can be used and receive real-time notifications of what their child is spending and where they are spending it as well as set up task lists within the app to encourage completion of chores in exchange for pocket money. The app also boasts an educational purpose, arguing that its service allows children to learn about budgeting, saving and responsible spending, forming

356. FinTechNews, 'Digital Piggy Banks Teaching Kids to Save Money', November 29 2017, [link](#)

healthy financial habits to last a lifetime. Gohenry is funded via a monthly membership fee which breaks down to 75p/week per customer, as it does not make money through interest or debt.³⁵⁷

Upskilling: Using technology to increase income, not just manage debt

Advice on debt is only one aspect of financial education. It is just as important to give people on low incomes access to educational services aimed at developing their skills to help them not just to manage their budgets but to earn more.

Companies like Lambda, which have been successful in the US, have started to expand into the UK. Lambda teach people how to code either on a full or part-time basis: they are not required to pay their fees until they have a job, thereby applying the same principles as the student loan system to life-long education. Although based in the US, they have recently started to expand and offer their services to UK and EU customers. To date in the US, they have raised over US\$50bn from investors, recently closing a US\$30bn fundraising round.³⁵⁸ Their statistics show that once people have been taught to code, their earnings increase: 86 per cent of students reported being hired within 180 days of completing the course, with an average yearly salary of US\$60,000.³⁵⁹

Massive open online courses (MOOCs) can achieve similar results. For example, Coursera offer free sign-up for specialisation courses and degrees to over 40 million customers, with many of them free of charge.³⁶⁰ Those courses that do charge are comparatively cheaper than those offered by traditional higher-education institutions.³⁶¹ Recently closing a Series E funding round where they raised £83million, the company is now valued at over £80million.³⁶² They aim to tap into a neglected market to enable wider access to education.³⁶³

There are also companies that target their services at specific groups that could benefit most from “up-skilling”. For example, both Code First: Girls and CodeYourFuture aim to increase digital skills through courses provided free of charge for marginalised groups (in these cases, women and refugees). Code First: Girls is a not-for-profit social enterprise which, since 2013, has delivered £6 million worth of free education to young girls in the UK, aiming to reduce the disproportionate gap between men and women working in technology.³⁶⁴ CodeYourFuture runs an intensive (and free) coding course for refugees, aiming to give them the skills required to get an entry-level job as a web-developer.³⁶⁵ Both of these ventures are charitable attempts to provide the public with more employable skills, aimed at creating more candidates for the UK tech sector, which by 2020, according to research by TechCityUK, will need one million more workers.³⁶⁶

357. Gohenry, accessed 25 November 2019, [link](#)

358. Forbes, 'Lambda School Is Paying Students To Learn The Highest-Paying Skills In The World', April 2 2019, [link](#)

359. Forbes, 'Lambda School Is Paying Students To Learn The Highest-Paying Skills In The World', April 2 2019, [link](#)

360. Forbes, 'This Company Could Be Your Next Teacher', October 16 2018, [link](#)

361. Forbes, 'This Company Could Be Your Next Teacher', October 16 2018, [link](#)

362. Coursera, Coursera raises \$103 million in Series E Funding Round, April 25 2019, [link](#); Forbes, 'Online Education Provider Coursera is Now Worth More than \$1billion', April 25 2019, [link](#)

363. Forbes, 'This Company Could Be Your Next Teacher', October 16 2018, [link](#)

364. Code First: Girls, Why we do what we do, [link](#)

365. Wired, 'CodeYourFuture is the UK's first and only Refugee Coding School', December 26 2016, [link](#)

366. Code First: Girls, Why we do what we do, [link](#)

4. What can Government do to help?

The Government needs to take a new approach to financial education.

Debt advice is effective for those who can gain access to it but it is expensive and difficult to “scale” to meet demand. Moreover, financial education in schools is, despite the best efforts of charities, still incredibly varied in quality depending upon which schools offer it. FinTech firms, by designing their products in a user-friendly way, can help to eliminate the necessity of financial education. Moreover, other FinTech firms are already developing products to help children learn about financial prudence. Nonetheless, government must adapt its approach by focusing not just on financial education but on allowing people to gain access to educational services.

1: Fund “scalable” solutions that achieve results

The Government should explore how fair share contribution models for debt advice can supplement its current approach.

The fair share contribution model provides an alternative model for “scalable” financial advice. Completely funded by donations, they aim to provide free debt advice to those struggling with money management. Their debt-management plans are free for clients and are modeled on a US model which they have now introduced to the UK.³⁶⁷ This model has been endorsed by Peter Wyman in a review of the funding of debt advice in the UK.³⁶⁸

Fair Share Contribution (FSC)

- The fair share contribution method is based on trusting creditors to make donations to the Stepchange charity since they should understand that free debt management advice benefits their customers and, by extension, themselves.³⁶⁹
- Creditors who receive payments from customers on a Stepchange debt management plan pay a percentage-based contribution for the Stepchange service.³⁷⁰

Government should also ensure the Money Advice and Pensions Service has the legal capacity, mandate and direction to invest directly in FinTech services.

By investing in such services, it can support products that help people develop their financial capability in a scalable and financially viable manner throughout their life. It should also set a plan for delivering any grant-funded debt advice and financial skills-training in a way that is both capable of growth and makes the best use of innovative FinTech services.

2: Give every student the skills to succeed

Government must also make sure that financial education is made available to all students, regardless of their subject specialisation, throughout their primary and secondary education.

Such education should be embedded as part of the curriculum rather than taught as specific separate modules. Delivery of these programmes must have specific funding to allow schools to train specialist teachers to design their

367. Stepchange, How our Free Debt Advice is Funded, [link](#).

368. Peter Wyman, Independent Review of the Funding of Debt Advice in England, Wales, Scotland and Northern Ireland, 25 January, 2018, [link](#).

369. Peter Wyman, Independent Review of the Funding of Debt Advice in England, Wales, Scotland and Northern Ireland, 25 January, 2018, [link](#).

370. Peter Wyman, Independent Review of the Funding of Debt Advice in England, Wales, Scotland and Northern Ireland, 25 January, 2018, [link](#).

programmes and coordinate delivery, or to bring in external technology-based education services and to work in partnership with FinTech services targeted at helping young people to develop financial skills.

Afterword

Rt Hon Lord Darling of Roulanish

For most people, banking is now an essential service – as essential as water or electricity. If you're employed, housed, or if you get benefits, particularly Universal Credit, you need a bank account. More than that, if you want to pay without cash, whether online or 'contactless', a bank account is essential. To get credit or to take advantage of many other services and sales discounts, you often need an account. Cash won't ever disappear completely but you can see the way things are going.

Yet, in the UK, after 20 years of research and successive Government interventions, as many as 12 million people, primarily on low incomes still can't get access to basic financial services such as a bank account or affordable credit. As a result they are denied choices open to others and often pay more or end up with unsuitable products. Can new technology help?

We are recognised as the major FinTech capital of Europe. This report suggests a number of thought-provoking ideas as to how we could use the latest innovations in financial services to help people who are denied the services most take for granted. The Government should look closely at its recommendations. Today there's much talk about how we need to achieve a fairer society and provide opportunity for everyone. We could help to achieve that ambition by ensuring that we have an effective, efficient and inclusive banking system that works for everyone.

Glossary

Term	Definition
Affordable Credit Challenge Fund	A £2 million fund provided by the government to encourage the FinTech sector to devise technical solutions to the challenges faced by social and community lenders
ABCUL	Association of British Credit Unions Limited
API	An Application Programme Interface allows two sets of software to interact
Authorised Overdrafts	An organised overdraft is one that is agreed in advance with a set borrowing limit and agreed interest and fees
BBA	A Basic Bank Account is a fee-free account lacking such facilities as overdraft or chequebook
Cash ISA	A cash ISA is a savings account that pays tax-free interest up to a limit of £20,000
CASS	The Current Account Switch Service allows you to transfer all the details of your existing current account, like direct debits, to another account provider
Challenger Banks	These are recently formed banks in the UK which compete with the traditional high-street banks
Chat-Bot	A piece of software that simulates conversation through speech or text
Citizens Advice Bureaux	A network of charities that provide free advice on subjects like money and consumer protection
Cliff-edge pricing	A model of risk-based pricing for credit, in which there are only a relatively small number of risk categories for borrowers to be assigned
Cloud Computing	A network of remote servers hosted on the internet to store data
Common Bond	Shared identities such an occupation or a trade union that all members of the credit union have in common

CDFI	A Community Development Financial Institution is provides credit and other financial services to underserved markets
CMA	The Competition and Markets Authority is a government department responsible for strengthening business competition and reducing anti-competitive activities
Credit Risk Assessment	A process whereby a financial institution assesses the risk associated with providing credit services to a particular customer
Credit Union	Not-for-profit and member-owned financial institutions whose members are connected by a common bond (see above)
Cross-selling	The act of selling related or complementary products to an existing customer
Current Account	A bank account used for day-to-day management of income and expenditure
Dashboard	A website that allows you to control your account
Direct tax	A tax levied on the income or profits of the person who pays it, rather than on goods or services
Ecosystem	A complex network or interconnected system
E-Wallet	A type of electronic card linked with an individual's bank account that is used for transactions made online through a computer or a smartphone
Fair Share Contribution	A model employed by the charity StepChange whereby creditors who receive a payment from a customer on a StepChange debt management plan pay a percentage-based contribution for their service
Financial Capability	The combination of attitude, knowledge, skills, and confidence needed to look after one's finances
FCA	The Financial Conduct Authority is the conduct regulator for 58000 financial services firms and financial markets in the UK
Financial Exclusion	Financial exclusion is a difficulty in accessing financial service that is often a result of poverty and social exclusion and imposes significant costs on individuals for making such basic financial transactions as cashing cheques

Financial Inclusion	Financial inclusion is where individuals and businesses have easy access to useful and affordable financial products and services that meet their needs
Financial Inclusion Fund	£120 million over three years provided by the government to support initiatives to tackle financial inclusion
Financial Inclusion Taskforce	A taskforce set up to monitor the government's progress on achieving financial inclusion
FinTech	A combination of the words 'financial technology' that refer to the new specialised software and algorithms that improve and automate the provision and use of financial services
Front/backend services	In software engineering, the terms front end and back end refer to the difference between the presentation layer (e.g. the client) and the data access layer (e.g. the server) of a piece of software
Help to Save	A government-backed savings account that helps people on low incomes save by boosting their savings by 50p for every £1 saved
HCSTC	High Cost Short Term Credit refers to loans scheduled to be paid over a short period
Indirect tax	A tax levied on goods and services rather than on income or profits
Market Failure	An inefficient distribution of goods and services in the free market, that is a bad outcome for a group
Money and Pensions Service (MAPS)	The successor to the government's Single Financial Guidance body that amalgamated the government's Money Advice Service, Pensions Advisory Service and Pension Wise
Money Advice Service (MAS)	That part of MPAS that offers impartial, free financial advice
On-Board	The process of signing people up to a financial service provider and getting them a bank account
Open Banking	The electronic and secure sharing of financial information subject to the consent of the owners of the data
Open Data	Data that is available for everyone to access, use and share
Open source code	Any program whose source code is made available for use or modification as users or other developers see fit

Overdraft	A deficit in a bank account caused by drawing out more money than is in the account. There are heavy penalties should it be unauthorised
Packaged Account	An account that, for a monthly fee, provides the account holder with benefits such as travel insurance and preferential rate overdrafts
Payment Accounts Directive	The EU Payment Accounts Directive was adopted in July 2014 with the main aim of helping the EU internal market for payment accounts become more transparent and create minimum standards for the switching of payment accounts
Policy Action Team	The Treasury team brought together in 1999 to write a report looking into how to achieve financial inclusion
Post Office Card Account (POCA)	A very limited type of bank account used to receive benefits of state pension, tax credits and benefits
Poverty premium	A surcharge paid on everyday goods and services that penalises the poor by, for instance, charging a fee to non-account holders for cashing a cheque and preventing access to advantageous tariffs.
Re-Bundling	Generating revenue from referral fees paid by selected partners that provide integrated products and services such as loans
Real Time Gross Settlement system	The continuous process of settling payments on an individual order basis without netting debits with credits across the books of a central bank
Real Time Payments	Electronic retail payment solutions that are available 24 hours a day, 7 days a week, 365 days of the year
Regulatory Price Caps	A legal cap on the amount that providers can charge for their services
Risk based credit pricing	Offering different interest rates and loan terms to different consumers based on their creditworthiness
Round-up	Where each financial transaction is rounded up and the excess is put into a savings account
Salary Backed Loan	Loans granted with the permission of an employer using their own funds for the loan
Scaling	Scaling a business means creating the circumstances to enable and support growth in that company

SDK	A software development kit that brings together a group of tools that enable the programming of mobile applications
Second Payment Services Directive	A directive that aims to drive increased competition, innovation and transparency across the European Union and the European Economic Area payments market, while also enhancing the security of internet payments and account access
Single Financial Guidance Body	The predecessor of the government's Money and Pensions Service that amalgamated the government's Money Advice Service, Pensions Advisory Service and Pension Wise.
Smartphones	A mobile phone that performs many of the functions of a computer, typically having a touchscreen interface, internet access, and an operating system capable of running downloaded apps
Social Fund	A fund that allows people who are on certain benefits to apply for a budgeting loan or for help with exceptional needs like funeral expenses
SSO	A single sign-on is a session and user authentication service that permits a user to use one set of login credentials (e.g., name and password) to access multiple applications
Student Account	Bank accounts for those in higher education that provide certain benefits such as free railcards
Subscription models	A business model that charges customers a recurring fee – typically monthly or yearly – to access a product or service
Upskilling	The process of improving skills which often increases income
Unauthorised overdrafts	Overdrafts that happen when you spend more than you have in your bank account without agreeing it in advance
Unbanked	Those who do not have access to the services of a bank or similar financial organization
Underbanked	Those who have an account but insufficient access to mainstream financial services and products typically offered by retail banks
Underserved	Those who have access only to BBAs

Universal Credit (UC)	A social security payment replacing 6 other benefits with a single monthly payment if you're out of work or on a low income
Universal Credit Banking Vouchers (UCBV)	A proposed government voucher to help ever Universal Credit claimant to access but a high quality banking service that is both tailored to their needs and maximises their financial capabilities

Appendix A

Policy Exchange analysis of government spending on financial inclusion from 2003-2019

The Government has spent at least £2.4 billion on Financial Inclusion Strategies since 2003.

£2.25bn on POCAs

- The cost of the original POCA contract was at least £1 billion between 2003 and 2010.³⁷¹
- In January 2006, it was announced that the Government would suspend the contract with the Post Office Limited, but after a search for a successor to POCA (the costs of which are unclear), in 2008 the Government decided to award a new contract to run from April 2010 and March 2015.³⁷²
- At the time, the cost was announced as £1bn, and DWP Minister James Purnell it was praised for saving 3,000 Post Office Branches from closure.³⁷³
- In 2014, Steve Webb, Pensions Minister, announced that the Government awarded a new £250 million seven-year contract to continue the POCA service until 2021.³⁷⁴

Financial Inclusion Funds

- The Financial Inclusion Fund from 2005 to 2008 totalled £120 million.³⁷⁵
- The Financial Inclusion Fund for 2008–11 totalled £130 million.³⁷⁶

371. Parliament UK, May 16 2011, [link](#)

372. Parliament UK, May 16 2011, [link](#)

373. The Guardian, 13 December 2008, [link](#)

374. The Guardian, 16 December 2014, [link](#); Hansard, 16 December 2014, [link](#)

375. House of Commons Treasury Committee, 21 November 2006, [link](#)

376. House of Commons Treasury Committee, Financial inclusion follow-up, 11 December 2007, [link](#)

377. DWP, Press release, 16 April 2013, [link](#)

ABCUL

- The ABCUL Credit Union Expansion Project had a subsidy of £38m in 2012³⁷⁷

FCA Levy

Year	Funding Levy for MAPs/MAS
2019/20	£84m ³⁷⁸
2018/19*	£83.5m ³⁷⁹
2017/18*	£75m ³⁸⁰
2016/17*	£75m ³⁸¹
2015/16	£79.1m ³⁸²
2014/15	£81.1m ³⁸³
2013/14	£78.3m ³⁸⁴

*Reported underspend on the budget according to the FCA

- For the 2019/20 budget, the FCA has split the funding for MAPS into two streams - debt advice and pensions advice
- The debt advice levy is £53.3m while the pensions guidance levy is £30.7, bringing the total to £84m³⁸⁵
- This increased from the 2018/19 budget of £83.5m and the 2017/18 budget of £75.0m.

385. FCA, FCA regulated fees and levies 2019/20, [link](#)

378. FCA, FCA regulated fees and levies [2019/20](#), [link](#)

379. FCA, FCA regulated fees and levies [2018/19](#), [link](#)

380. FCA, FCA regulated fees and levies 2017/18, [link](#)

381. FCA, FCA regulated fees and levies 2016/17, [link](#)

382. FCA, FCA regulated fees and levies 2015/16, [link](#)

383. FCA, FCA regulated fees and levies 2014/15, [link](#)

384. FCA, FCA regulated fees and levies 2013/14, [link](#)

Appendix B

Potential Cost of a Universal Credit Banking Voucher

The authors here have attempted to provide an estimate of the costs involved in providing Universal Credit Banking Vouchers. As outlined, these costs are fiscally neutral and could be funded through a levy on the largest banks providing personal current accounts, who could then redeem their costs by serving those on UC. Depending upon the size of the subsidy, the authors estimate that it would cost between £86 million and £345 million a year by the time that everybody receiving state benefits had migrated onto Universal Credit. This has been worked out on the basis that the subsidy would represent a proportion of the cost of a BBA. These figures are designed to give no more than an illustration of the potential size of a levy.

Cost of providing BBAs (2016)			
	Low bound	High bound	Median/Final
Estimated cost of providing BBAs (2016)	£300,000,000.00	£350,000,000.00	£325,000,000.00
Number of active BBAs			7,455,960
Average cost per BBA (as provided by traditional banks)			£ 43.58928964
Numbers of Universal Credit Claimants			
Number of UC claimants (most recent numbers (August 2019))			2,369,887.00
Number of UC claimants expected on completion of rollout in March 2023			8,150,000.00
Number of UC claimants forecasted for 2024-25			8,500,000.00
Cost at August 2019 (most recent figures)			
Cost at 100% subsidy			£103,301,690.9
Cost at 75% subsidy			£77,476,268.15
Cost at 50% subsidy			£51,650,845.43
Cost at 25% subsidy			£25,825,422.72
Cost at March 2023 (all legacy benefit claimants fully migrated)			
Cost at 100% subsidy			£355,252,710.60
Cost at 75% subsidy			£266,439,532.90
Cost at 50% subsidy			£177,626,355.30
Cost at 25% subsidy			£88,813,177.65

Cost at 2024-25 (forecasted number of UC claimants 10 years from full rollout)	
Cost at 100% subsidy	£370,508,962.00
Cost at 75% subsidy	£277,881,721.50
Cost at 50% subsidy	£185,254,481.00
Cost at 25% subsidy	£92,627,240.49

Notes:

The cost of providing a bank account are not uniform. For example, overdrawn accounts cost bank providers more than accounts that aren't overdrawn. Similarly, depending upon the features available to banking customers and the number of transactions they complete, the cost of providing an account changes. Because of this, the figures below use as a basis for the subsidy the amount that the banks are estimated to lose from BBAs.

It is unclear not only how many Universal Credit Claimants there will be if/when the plan is finally rolled out but also which UC claimants should be awarded a voucher. These figures assume that the roll out of UC Banking Vouchers follow the rollout of Universal Credit, that all UC Claimants will get an equal subsidy and that all UC Claimants are eligible. Nonetheless, the Government may wish to restrict the cost to certain groups.



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