

# Executive Summary

**This Government have begun to tackle financial exclusion and loan sharks, however, their activities amount to little more than tinkering with the edges of the problem. This report takes a broad approach to the problem of debt amongst people living on a low income. The content of the report is formulated through discussions involving a broad range of stakeholders in the issues, most importantly involving those living with debt and poverty, reviewing current initiatives and evaluating other proposals and recommendations. The report presents a central directive to coordinating a currently fragmentary approach to tackling the problem of debt, focusing specifically on the situation facing those in persistent debt and poverty.**

The report concentrates on exploring two dominant themes:

1. Tackling the distinction between the alternative credit market and mainstream financial inclusion.
2. Tackling the injustice that means that people living on a low income pay more for their credit, and promoting affordable alternatives.

## Introduction

Church Action on Poverty's (CAP's) interest in debt arose through the experiences of people living on low incomes in the North East of England. This led CAP to help launch the Debt on the Doorstep network in 1999. As a contribution to the wider campaign, CAP has sought to give voice to the experiences and understanding of those living with debt and poverty, and to bring these contributions to the table alongside those of policy influencers and policy makers. This process resulted in five National Policy Forums hosted by Church Action on Poverty, which helped to give shape to the ambitions of those living in poverty and debt to tackle these issues, producing policy grounded in the invested interests of stakeholder groups. The recommendations included in this report are those that can be delivered.

The faith reflection given at the close of our fifth National Policy Forum focused on the words Jesus taught us which may be translated as, '*forgive us our debts, as we forgive those who debt against us*'. This

couplet was used to call for interdependence and partnership as the basis for financial inclusion. 'Interdependence' can be found between a lender and a borrower who form an effective relationship involving the provision of suitable financial services and effective debt repayment. 'Partnership' between rich and poor customers who together are able to support local financial services such as the growth of their local credit union. Whilst Church Action on Poverty strives to engage in the lives of people living in poverty without discrimination, where appropriate we also encourage the involvement of the experience and understanding of the Christian tradition as we highlight the existence and affects of poverty in this country. With this in mind we remember the specific context in which good use of credit, and therefore debt, should be used in the promotion of life in all its fullness – this aspect is highlighted in the words '*give us our daily bread*', that precede the title of this report.

## A participatory approach to policy development

At each policy forum, a different theme was explored, although through the involvement of those experiencing each issue the context of poverty and debt was maintained. The themes were treated holistically and this led to a shift in emphasis in several of the themes. Taken together, the themes of the Social Fund, high cost credit, banking initiatives, debt recovery and advice, and community finance initiatives form a holistic approach to the debt of people on a low income.

Each Policy Forum was attended by a broad range of stakeholders and allowed wide involvement in developing both understanding of the problems and policy recommendations for addressing them. In bringing varied perspectives together a degree of objectivity was nurtured and where confrontation had been expected it was possible to take some small steps together. Each Policy Forum concluded with a report. To draw together the process, a small number of grassroots participants met with CAP staff to reflect on the findings and the recommendations made during the individual Forums.

It is the contributions of all the participants of the Forums, but particularly those experiencing debt and poverty first hand, that have directed this report and the policy positions taken within it.

### This report

This report maps out the perspective of those living in poverty and debt - caught between low income and high cost credit. They are in poverty primarily because they don't have enough money. A lack of money forces many into debt, into the hands of extortionate moneylenders and further reduces their income. This is a situation that is rapidly gaining wide recognition. In this report, those who experience this situation present their analysis of that experience, the lessons they have learnt and their recommendations for transforming the problems they face. This report is in three parts, the first part being a general introduction.

The second part of the report presents the situation facing those in poverty, caught in a cycle of low income and high cost. This cycle moves through five stages, examining the squeeze between receiving a low income and paying a high cost for credit. The process involves the experience of a wide variety of stakeholders shared through the five National Policy Forums, breaking the individual contributions down and reflecting on them in the context of debt and poverty, analysing the shared understanding across all five initial themes (Social Fund, high cost credit, banking initiatives, debt recovery and communities finance initiatives) and offering routes of transformation through the recommendations. We now offer it to you, returning the involvement of those who took part in the National Policy Forums with interest and added value, and inviting you to implement the recommendations, particularly the 'big ideas'.

### Low income

The situation facing those on a low income is the most appropriate context in which to formulate joined-up policy solutions. Policy development is best based both in the context of limited opportunity and relating to those for whom many policies are intended, this may be achieved through the involvement of those living in poverty. It is precisely because of their low income, that any strategy to tackle debt or financial exclusion should begin with those on a low income. This report focuses on what may be done to increase the financial citizenship of those in receipt of a low income.

#### Big idea 1: flexible benefits

A number of recommendations are given in each section. The key recommendation in the first section, which concentrates on the context of debt in low-income households, focuses on developing a flexible benefit system. The Government are supportive of the provision of

opportunity for work as the best route out of poverty. In many cases employment will lead directly to an increase in income. However, the benefits system can be obstructive in enabling people to move into work. A flexible benefits system will enable people to shift easily from benefits to work.

### Hidden agenda – tackling grey areas of the law

The debt of those living in poverty is an issue that is given little mainstream attention precisely because it affects those who are financially excluded, those who find most of their financial 'support' offered by an 'alternative credit market'. There is little attention or regulation given to the activities of the alternative credit market, and this has resulted in the promotion of misinformation and misunderstandings. The rights of low-income consumers of financial services are not sufficiently supported or enforced and little is done to promote consumer power and confidence. This report highlights the problems, issues and arguments that surround the provision of financial services to those living in poverty. In particular this report calls on others to dispel the ignorance surrounding credit lending to low-income customers and provide transparent information and customer empowerment.

#### Big idea 2: increased advice services

The provision of available and personal financial advice is needed to enable those considering taking out a loan to seek advice before accepting a loan contract. We welcome the recommendation in the Performance and Innovation Unit's report on the Government's Use of Loans for a cross-cutting review of financial advice, however, a cross-cutting review must be conducted within broader parameters demonstrated in this report.

### Flexible finance – financial services that help people on low incomes

Many of those living on a low income are financially adept precisely because of their circumstances and limited resources. However, their methods of financial management may be unorthodox and dated by the standards of mainstream financial services provided in the high street. This report calls for financial strategies that are accessible and affordable for those on a low income, enabling them to adapt to meet their varied

needs and circumstances, and tackle financial exclusion.

**Big idea 3: multiple and complementary financial services**

There is no one dominant provider of affordable credit. The Universal Bank, due to be introduced in April 2003, and basic bank accounts are a welcome and important part of developing multiple financial services. The potential of the Universal Bank will fail to be realised if it is not linked to other financial initiatives that involve the provision of credit. The Government need to promote joined-up solutions in the provision of financial services.

**Protecting vulnerable consumers**

Without sufficient consumer protection, customers are vulnerable to inappropriate practices of lending companies and debt recovery companies, in addition to costs that exceed what is normal for those with access to mainstream financial services. This report calls for protection to be given to vulnerable consumers so that they may not be unfairly discriminated against in terms of both practice and price.

**Big idea 4: abolish bailiffs and regulate relationships**

The use of domestic bailiffs should be abolished. Their use is ineffective, inefficient and draconian. However, if the use of bailiffs is to continue they should be subject, alongside credit lenders, to increased regulation to identify and protect vulnerable consumers. The Government needs to act to promote effective financial partnerships and interdependence between the lender and borrower.

**High cost credit**

Without tackling the high cost demanded for credit of those on a low income those living in poverty will continue to pay more to adapt to their financial circumstances. Without promoting affordable credit solutions customers on a low income will continue to be financially excluded. How long can this continue?

**Big idea 5: tackling extortionate credit**

The legal definition of extortionate credit needs to be redefined in order to provide effective protection against creditors who charge extortionate prices or operate oppressive practices or terms. Importantly with the progression towards electronic transactions, repayments to credit lenders should be made through bank accounts as part of the choice of service given to low income customers.

**A coordinated approach to debt and financial exclusion**

The Government, since the work of Policy Action Team 14, have not pursued these recommendations with sufficient urgency to meet the demands of the situation currently facing those in poverty and debt. Neither has the additional work in various departments given sufficient attention to the opportunities to further the Government's priorities of eradicating child poverty and promoting neighbourhood regeneration in a society in which people will not be penalised due to where they live. A coordinated anti-poverty strategy must tackle the problem of debt and financial exclusion.

The third part of this report looks specifically at the involvement of the Government in tackling poverty and debt. The report considers the responses given so far by the Government and gives recommendations for cross-departmental cooperation and further delivery of solutions that will alleviate the burden of debt specifically for the poorest.

This report focuses on the problem of debt through the situation of those who live with poverty. It places debt at the heart of financial exclusion. It targets the areas most in need of action and presents a strategy to enable effective reduction of poverty through tackling the problem of debt. It also provides a platform of joined-up solutions upon which a coalition may be built to deliver fair finance for all.

**Big idea 6: a debt and financial inclusion unit**

At present, responsibility for tackling the various aspects of debt and financial exclusion are scattered throughout government. The Social Exclusion Unit needs to undertake a thorough cross-cutting review of Government anti-debt policy, and develop proposals for coordinating policy across government.

# The future of debt and financial exclusion

***“Ironically, concern about financial exclusion has arisen not because more people cannot gain access to financial services but because use has increased, leaving a minority of people on low incomes behind.”***

Elaine Kempson.<sup>1</sup>

In the last 30 years there has been a move away from managing a cash budget towards financial services and electronic money management, making dealing in cash increasingly difficult. Where jam jars were once the best available tool for managing a budget, financial services now offer bill payment methods including direct debit, overdrafts, credit cards and loans to the extent that it is possible to juggle debts by moving them between credit sources. However, there are three and a half million people in the UK without a bank account of any sort, and over seven million people who don't have a current account. This group generally has a low income and continues to budget with jam jars where they can watch their savings for Christmas, or school uniforms grow. Many people on a low, or varied income, do not have a bank account, or access to suitable alternatives. Their financial exclusion doesn't enable them to 'juggle their debt'<sup>2</sup> between overdrafts, credit cards and loans.

## What is a 'personal flexible finance system'?

The means by which people manage their own finances is a personal finance system. Personal finance systems are varied and on the one hand may involve often switching bank accounts to make the most of introductory offers and interest rates. Another person's system may be based upon several jam jars on the kitchen shelf and the awareness of where every penny is being spent. This report argues that crucial to an effective personal finance system the element of flexibility is necessary to manage in varying circumstances. Those on low incomes require a successful personal finance system as much as those who are more affluent.

***“From September to Christmas you try to pay off as much as you can in those few months, otherwise you can't get them anything for Christmas.”***

National Policy Forum participant – 9 July 2001

Key elements required for a personal flexible finance system are:

### Threats to personal financial viability

Key barriers to financial exclusion are<sup>3</sup>:

- ◆ Unemployment and lack of income.
- ◆ Unacceptable proof of identity.
- ◆ A lack of access to financial services (mainly caused by the reduction of bank and Post Office branches).
- ◆ Postcode stigma – higher than normal prices, particularly of insurance, due to where people live.
- ◆ Charging for financial services.
- ◆ Strict payment deadlines.
- ◆ Money management – the absence of cash or control.
- ◆ A lack of credit worthiness.

Key barriers to financial literacy are<sup>4</sup>:

- ◆ Low skills levels.
- ◆ A lack of knowledge.
- ◆ Mistrust of suppliers.
- ◆ Psychological barriers including confidence.
- ◆ A feeling of loss of control over money.

♦ **Accessible Credit**

Most people on low income need credit to supplement their income in times of additional demand. The demand may have arisen gradually, and credit is required to tackle accumulated debts (e.g. the rent, utility bills and the milkman). Or the demand may be sudden, and credit is needed for an immediate purchase (new cooker, funeral expenses). Or the demand may be additional, although not altogether unexpected (such as a new baby or new school uniforms), or it may be that it is too difficult just to make ends meet. The ability to access credit in such times is of particular assistance in developing a system that has the flexibility to adapt to these various situations.

**“Home credit provides a human element...there can be a long-term relationship with an agent (and constant flow of debt)...Home credit is on your doorstep.”**

National Policy Forum participant – 9 July 2001

♦ **Affordable Credit**

Credit needs to be affordable so people already living on a low income are able to continue to meet their basic day-to-day living expenses and afford to repay the loan. Even if credit is not provided at a discount, (Social Fund, Student Loans) it should be provided at mainstream prices, (Banks, Building Societies) rather than at extortionate prices, (home credit lenders, Crazy George’s). Savings provide another source of affordable ‘credit’, however the provision to save depends on the level of income that remains once the expenses required for day-to-day sustainability are made. Without affordability credit is either beyond the reach of those on a low income, or, a necessary and unfortunate financial burden demanded of the borrower to allow them to meet their present need.

♦ **Informed Choice**

Consumers should be able to make an informed choice about financial products they may wish to use. It is important that customers are able to choose financial products that meet their needs, rather than choose a product that does not, or fail to choose any product at all when there is a product available which meets their needs. The ability to make informed choices precludes some degree of social inclusion without which information, advice and relationships either aren’t available, or aren’t maintainable.

**Current position of financial services**

**“Poverty is not only about shortage of**

**money. It is about the rights and relationships; about how people are treated and how they regard themselves; about powerless, exclusion and a loss of dignity. Yet the lack of an adequate income is at its heart.”<sup>5</sup>**

In the last 30 years the use of financial services has escalated, as has access to credit. The levels of consumer credit borrowed are being constantly exceeded<sup>6</sup>. The shape of our economy is changing through the profligate use of credit and ensuing context of debt faced by many individuals. Students face increasing debts<sup>7</sup> on graduating into the job market. Whilst students are able to borrow student loans from the Government, and repay at a minimal APR (approximately 1.3%) they are only required to do so once they earn above a percentage of average income.

However, 8.3 million people aged between 18 and 65 in the UK (23 per cent), would have been refused credit by high-street banks and building societies if they had applied in 1999 (Datamonitor, 2000). For them the options are either not so readily available, or affordable, and are without the security of non-repayment below a defined income level. The Government, through the Social Fund, do supply grants to meet particular needs, although their preference is to loan money repaid directly through benefits. However, the availability of the Social Fund is restricted. Licensed money lenders, operating in the ‘alternative credit market’, serving households on low incomes, likely to be renting their home and who tend to be families with dependent children<sup>8</sup>, supply credit in a variety of forms that is both more accessible and at a much higher cost. Much hope lies with credit unions to provide affordable credit to households, often in deprived communities. However, the credit union movement in the UK remains small.

The alternative credit market is at a point of crisis. The warning signs, such as that espoused by this report, are there to be heard. The ‘alternative credit market’ is dominated by ‘weekly-collected’ credit companies, the biggest of which is Provident Financial. Other credit providers are store based credit suppliers including Cash Converters (a franchise operation offering purchase and sell back) and pawnbrokers and Crazy George’s, which sells goods on a rental purchase agreement. Both Cash Converters and Crazy George’s provide relatively new forms of credit. With the failure of the Social Fund to meet the demand of applicants and the absence of high street retail and mainstream financial services the alternative credit market is allowed to exist unchallenged by all but a handful of credit unions.

Employment remains the best route out of poverty championed by the Government, but sometimes escaping from poverty is the best route to employment.

Key aspects of the Government's ambition to tackle poverty are delivered through some form of income support direct to families with children, and through neighbourhood regeneration. The burden of debt interacts with all three routes favoured by the Government to tackle poverty.

### **Tacking the crisis requires new ways of thinking.**

***“The Bible recognises the need for lending and credit, but its purpose is to lead to dignity and to liberate people.”***

National Policy Forum participant – 9 July 2001

We are connected more closely and in more ways than we had previously realised. As the power of technology grows so our communication infrastructure expands. People and communities are empowered through information and technology and are increasingly able to take greater control of their situation and 'borrow' local solutions. Our economic systems are also becoming more globally interdependent. Just as unemployment affects our economy, so the poverty of one person affects us all. In this country the work of churches and non-governmental organisations have led Britain to be a big player in tackling international debt and global poverty. Similarly, domestic poverty is gaining recognition both in this country and abroad as expressions and approaches are learnt from the experience of overseas aid agencies.

The extent of our interconnections has changed the speed with which knowledge is transferred and problems are perceived – but not the speed with which these problems are solved. Social decisions are mediated by institutions that were designed for a slower and more methodical approach to solving problems. Now our problems seem bafflingly multi-faceted. The slow insufficient responses of our institutions leaves many people frustrated and disillusioned. The Government is now not the only provider of welfare, yet even in the provision of financial services it remains a big player<sup>9</sup>. The Government face the challenge of re-establishing the relevance of government and politics in the lives of an increasingly disillusioned, and non-voting public.

### **Our Challenge**

The challenge is to ensure that all citizens have the opportunity to manage their personal finances with flexibility, self-reliance and independence. We must learn from the financial precariousness of those living in poverty. We need to develop a holistic and coordinated approach to tackling debt as part of a wider anti-poverty strategy. Close cooperation is needed in order to deliver the financial services that are required by diverse consumer groups. Specific attention and tailored financial solutions will support government intervention to shift the financial market towards equity, if not outright bias to the poor.

***“You are socially excluded in the most minute ways. You're different, you can't join in and you just do without. I went without a TV for two years and wasn't part of what goes on, children are excluded from every conversation about it. This happens in every area of your life.”***

National Policy Forum participant – 31 January 2002

# The Debt Trap – from low income to high cost credit

Debt is both a symptom and a cause of poverty – a downward spiral, a vicious cycle, a trap. Debt is a close companion for many people living on a low income. Many national policy forum participants regarded it to be inevitable. Debt can be a useful means of adapting to situations with additional financial expenditure, but the experience of the national policy forums showed that this is seldom the case. Without effective regulation and policing there will always be someone who will offer the credit needed, but at a price.

**“Once you start borrowing you are in a cycle, you just keep going.”**

National Policy Forum participant – 9 July 2001

Paul Jones, at the National Policy Forum on 31 January 2002, shared conclusions from his research that echoed what we were hearing in the Forum from those experiencing poverty and debt first hand:

*“Although previous research has shown that financially excluded households do not prioritise ‘credit’ as a financial product to which they would like to access, it is clear from my study<sup>10</sup> that in fact obtaining credit is an essential part of everyday life for people on low incomes. Ninety per cent of participants said they needed to borrow money not only to buy essential items, but also to make ends meet. People regularly borrowed to pay bills, to buy clothes and school uniforms, and for birthdays, holidays and Christmas – often out of sheer desperation.”*

Those participants in the Policy Forums who live in poverty often referred to low income as the primary cause of their debt problems. A clear understanding of the financial situation facing those in poverty is still required of others in order that developments in the provision of financial services actually contribute to the task of lifting people out of poverty. This agenda should be explicit.

Not only should the situation of debt faced by many people in poverty be made transparent, so should the conduct of the financial services operating and often playing a role in the perpetuation of poverty for their customers. These aspects are attested to in the second section of this part of the report, in discussing the ‘hidden agenda’.

Managing finances on a low income for most people prohibits opportunities for effective saving because this would reduce income still further, particularly when it already is not enough. Not even the best financial manager can make too little into enough. Those on a low income often have fewer resources (although often greater resourcefulness), and less means of adapting to changes in circumstances. Hard choices need to be made about what can be afforded. Poverty is costly, both financially and through stress and ill health. The resources and opportunities to manage a flexible system of personal finance whilst on a low income is explored in the third and central section of this part of the report, entitled ‘Flexible Finance’.

The effect of debt on people living in poverty is disproportionately greater than its effect on those with access to mainstream financial services. If we want to understand the strategies used for money management by people on a low income, we have to view the methods of money management used by those in a wider context. Otherwise we are in danger of seeing those living in poverty as somehow separate from the rest of society, and thereby perpetuating the effects of financial exclusion. However, financial exclusion is a reality, and this is the context within which people on a low income manage their finances. Whilst easy and immediate access to credit has produced record levels of debt in Britain, store cards, credit cards, overdrafts and loans are not available to low-income customers. The position of those on a low income features prominently in the fourth section, ‘protection for vulnerable consumers’.

The final section of this part of the report concludes the cycle, returning to more monetary matters as the high cost of credit is addressed. The cost of extortionate credit is often more than the price, the charge, the sales practice and the unfavourable terms, it is the never ending cycle of borrowing, debt and poverty.

Each section sets out the key issues, principles for policy formulation and recommendations. Alongside the recommendations is ‘a big idea’ to provide a direction for the development of any strategy intending to tackle the problem of debt as it affects those on a low income.

## Low Income

**Low income is a key reason why people in poverty get into debt. The Government needs to take steps to ensure that everyone has an adequate income, whether in work or not. This will involve increasing the National Minimum Wage and further reform of the benefits system.**

### Key Issues

Two out of every five people in debt are dependent on means tested benefits<sup>11</sup>. Those on low incomes are particularly affected by debt precisely because they live on a restricted income.

Low income is not only a cause of poverty it is also a significant barrier to effective financial inclusion. Low income, for many, is the beginning of the debt trap - a fact repeatedly attested to by participants in the National Policy Forums. It is because income is insufficient that people living in poverty turn to credit lenders<sup>12</sup>. Additional income would provide those on low income an opportunity to save beyond the urgency to fulfil present needs.

The Policy Forum of 9 July 2001 heard stories from those who have experienced debt as a result of borrowing from high cost credit lenders. Two mothers had had to make hard choices to fulfil their responsibilities as parents in a situation in which they could not meet all the financial needs placed on them:

*“At the moment I’m on income support and child benefit. I’ve used the Provi [Provident Financial] and Shopcheck and I’ve been unable to keep paying them so I don’t do that no more. Now I have to buy from shoplifters so I have money to look after myself.”*

*“I have a fifteen year old daughter and she needs clothes so I have to get a Provi loan or vouchers. It’s hard. At the end of my benefit I’ve nothing left to pay back the loan and vouchers. I can’t spend money on shopping and bills.”*

Debt affects choices and often imposes a moral pain and difficult compromises. In both cases the message is blunt - there is not enough money. If the problem of debt amongst the poorest is to be tackled at source - by addressing the problem of low income - there are several aspects to consider.

***“Fundamentally, the main problem with the Social Fund is that it attempts to compensate for the present levels of weekly benefit which are so low as to make it difficult – and impossible for many.”***

National Policy Forum participant – 12 March 2001

### Policy principles:

#### ♦ Raising income

One route out of the debt trap is through receiving a higher level of income. There are three main income sources for those on low income: benefits (e.g. council tax benefit, housing benefit and income support), tax credits (e.g. child tax credit or working tax credit) and wages. However, the Government are reluctant to raise benefit levels significantly for fear of undermining the ‘benefit’ of employment. The Government’s focus on ‘making work pay’ means that any income increases are more likely to be delivered through the minimum wage and the tax system. By introducing the National Minimum Wage the Government have raised the income floor of those in employment. Yet at just over £4 an hour<sup>13</sup>, the Minimum Wage rarely delivers sufficient income to live beyond covering day-to-day needs. The Government has been more supportive of families with children in line with their ambition to end child poverty and this has led to some significant increases in income for those with children through tax credits and child benefit. It would be a shame if the increases that are provided end up paying the high costs of debt, and bolstering the profits of debt lending companies.

#### ♦ Income adequacy and entitlement

***“Sufficient income is being able to save up for things, like repaying your debts, and having a little to spare – not asking for a great deal, but at the moment basic necessities cost too much.”***

National Policy Forum participant – 31 January 2001

The need to establish a suitable level of income is an issue that featured prominently in the policy forum discussions. There is mounting pressure on the Government to declare what level of income the law states that a person needs in order to live, and how that decision is made<sup>14</sup>. The Government, however, are inclined to concentrate more on ensuring that people get the income that they are entitled to through an increased take-up of benefits. The Government’s preference for means-tested benefits has also led to a gap between entitlement and receipt of income, because people either aren’t aware of their entitlement or require persuasion to accept their entitled ‘hand outs’<sup>15</sup>. Transparency is required to promote understanding of the level of income by which people are expected to live. In addition, the Government also

need to act to ensure that information on entitlement is provided and a positive culture of benefits take-up is nurtured.

♦ **Tackling income reduction**

Debt is a cause of poverty because it leads to income reduction<sup>16</sup>. For example, if you have to pay your gas and electricity bills by prepayment meter, it costs on average £80 a year more than paying by direct debit<sup>17</sup>.

Repayments on interest free loans (e.g. crisis or budgeting loans) reduce weekly income, but the effect is worse when interest and additional costs are also required. The Social Fund loans effectively provide advance payment of benefits. However, repayments then have the effect of placing the borrower in a situation in which it is significantly harder to ‘make ends meet’. Repayments to moneylenders charging a high cost for the provision of credit have a more dramatic impact on income. Protection should be given to ensure that the income of those living in poverty is not reduced beyond their means.

**Recommendations**

- ♦ The state should be required to ensure all citizens have access to an income adequate to meet their needs, whether in work or not. An increase in benefit levels is needed to provide more security for those who cannot work and have few other assets.
- ♦ Those who are seeking to support themselves through work, should be able to expect a wage which enables them to live with decency. The

Minimum Wage should be increased to a level that would, for someone in full-time employment, enable them to do so.

- ♦ The Government should introduce Minimum Income Standards to help protect those living on low income from falling to a level of income which is destructive.
- ♦ Reform or greater investment in the Social Fund is required in order to tackle the high refusal rate whilst maintaining the Social Fund’s role for those on the lowest incomes.
- ♦ The level of Social Fund repayments and the repayment period should be much more flexible.<sup>18</sup>

**Big Idea 1: flexible benefits**

A flexible labour market needs a flexible benefits system. A flexible benefits system will enable people to shift easily from benefits to work, particularly in situations of short term or variable work, and back onto the support of benefits without lengthy delays or administrative procedures when work is not available. A flexible benefits system tailored to meet the needs of the labour market would complement the Governments ‘welfare to work’ focus, would reduce the demands for crisis loans due to delayed benefits and would increase the uptake of benefit entitlements, thereby effecting a more efficient income provision.

*“People need enough to live on and to get satisfaction from making it last. If they haven’t got enough that is when the trouble starts.”*

National Policy Forum participant – 9 July 2001

### **Unified Credits: A proposal for an integrated system of tax and benefits**

What is given below is not a system worked out in every detail. It does, however, demonstrate that with a sufficiently open mind a system of tax and benefits, which is both fair and which avoids creating personal and financial hardship through unemployment and poverty traps, can be developed.

#### **2.1 A Single Unified Credit**

This integrated system would be based on a single assessment of household need to replace the current range of different benefits, regulations and assessments. This assessment would identify a minimum household income which would be met by paying a Single Unified Credit to all low income households, whether in work or not. In effect the Single Unified Credit would integrate Jobseeker's Allowance, Income Support and the new Working Tax Credit.

#### **2.2 Personal Income Allowances (or Earnings Disregards)**

In the same way that all benefits are amalgamated in this system so too are all benefit disregards and tax allowances. Thus each individual would be given a fixed (annual) Personal Income Allowance instead. Earnings up to this level within a given period (month, six month, quarter or year?) would have no impact on the Unified Credit.

#### **2.3 A single and unified taper rate**

All earnings above the Personal Income Allowance would lead to benefits being withdrawn or tax paid at a single rate. This would replace the seemingly arbitrary, confusing and illogical mix of rates within the current system. Initial earnings above the Income Allowance level would result in a reduction in the Unified Credit payment with effect from the following payment period (e.g. month, 6 months etc).

#### **2.4 A smooth transition from receiving benefit to paying tax**

At a certain earnings level, the Unified Credit would be reduced to nil and individuals within the household would become net taxpayers via the PAYE system. The transition from "welfare to work" or between out-of-work and in-work benefits would therefore be smooth and many of the barriers to work would have been broken down.

#### **2.5 A development of the Working Tax Credit?**

For people in work, this system could be delivered through the pay packet as is currently proposed for the Working Tax Credit.

#### **2.6 A fully integrated tax and benefit system.**

This scheme would allow for the full integration of the tax and benefits systems. It would also allow for variations in earned income in a way that the current system does not. As things currently stand, people who are offered casual or short-term work may be unwilling to declare it to the Benefits Agency for fear of losing their benefits immediately. Similarly, people may be forced to refuse offers of work. This will be the case if the additional costs associated with working (e.g. travel) added to the amount of benefit lost is greater than their take-home pay.

#### **2.7 Overcoming the barriers to taking work**

Under the proposed system, however, any income earned in any given period (week, month or quarter) can be set against the Personal Income Allowance. Thus, individuals would be able to take-up casual work when it was on offer and to see the immediate benefit of their labour. This system has an in-built incentive to work (it avoids the unemployment trap) and does not penalise people for being honest.

## The Hidden Agenda – tackling the ‘grey areas’ of the law

**The growing alternative credit market - lending money to people on low incomes - largely operates out of the public eye and away from public scrutiny. Without effective championing of consumer rights the lending market will continue to benefit the lender at the expense of the borrower. Much more needs to be done by Government both to ensure consumers have access to adequate information and advice and to prevent lenders exploiting ‘grey areas’ of the law.**

### Key Issues

At a time when credit provision has increased dramatically and is enjoyed by many consumers<sup>19</sup> the situation facing those in poverty and debt often remains hidden from mainstream perception of financial services. The issue is not just the obscurity of the alternative credit market, but the pain that persists because it is so often obscured, and the lack of resources and protection given to those who are already vulnerable suffering on low income and often already in debt. If the situation of those on low income and debt is not highlighted then the myth that debt can be avoided will persist, the crisis that already affects many people on a personal level will continue to be ignored, and the Government’s anti-poverty strategies will flounder.

In a climate in which credit lending licenses are easy to obtain, sales are made in private behind the front door, and there is little perception by the general public of financial services operating beyond the high street, transparency of information and consumer awareness is likely to suffer. Furthermore, in situations where the customers are vulnerable, and have few other choices, the need for robust scrutiny of lending practices is vital.

The DTI, during the National Policy Forum on 9 July 2001, described activities at the edges of the Consumer Credit Act, as operating in grey areas of the law. Those who operate close to the legal definition of extortionate credit, operate in what is commonly called the ‘alternative credit market’. It is unacceptable for unscrupulous lenders to be able to use such ‘grey areas’ to exploit vulnerable customers, or those with no ready access to alternative sources of credit.

The ‘ease’ of gaining credit can lead to the assumption that credit is beneficial. Often there is insufficient information to make a fair choice of the suitability of loans and financial services on offer. Most particularly there is little awareness of what happens when things go wrong and circumstances change. Credit can swiftly turn into debt - an emphasis that is given

less focus. The pervading culture of finance as private, confidential and above all personal, also acts to exacerbate the hidden nature of many aspects of credit and debt, often leading to neglect on the part of consumers and exploitation on behalf of credit lenders.

*“The information offered by, for example the Provident, is difficult to understand and contains too much small print.”*

National Policy Forum participant - 31 January 2002

### Policy principles:

#### ◆ Financial Education

It is essential that people have the information, knowledge and skills to make effective choices about what financial services are right for them. Pilot programmes are currently being developed to provide financial literacy through existing community based organisations such as the Citizens Advice Bureaux, Credit Unions and Housing Associations<sup>20</sup>. The efforts of financial education will struggle to overturn the pervading culture in which credit is good, and isn’t able to tackle the vulnerability implicit in living on a low income. The market can limit the available choice despite the best financial awareness of the consumer. There are several aspects that require changes to the pervading societal attitudes:

- ◆ The pervading perception of credit needs to be tempered with a greater realisation of the affects of debt, which can be both beneficial and harmful.
- ◆ We welcome the Community Finance Learning Initiative pilots, alongside which we call for respect and recognition to be given to the personal economics and financial skills of those living on low incomes.
- ◆ The culture of private finance, which mitigates against greater transparency should be tempered with mutual concern akin to the ethos of community credit unions, of people helping people.
- ◆ The perception that ‘bank’s aren’t for the likes of us’<sup>21</sup>, and mistrust of suppliers should be built upon informed (and respected) choices.
- ◆ The negative association of a ‘poor man’s bank’.

#### ◆ Transparency

Wise financial choices require transparency of detail. People do not need to become financial experts but they need access to appropriate financial information

and the basic skills to use it. Too often in the policy forums we heard that the information consumers sought about financial services wasn't clear, or worse, wasn't available. The small print on financial products, such as loans, isn't easily understood, and there is little opportunity given to the prospective borrower to take time to check the details or receive independent advice before accepting a loan.

**“What are the main decisions that maybe you make when looking to take out a loan? Are there particular things you look for in terms of information..? Or are you really in the position that there isn't a lot of choice and you're left to go to someone who does offer you money?”**

National Policy Forum participant – 9 July 2001

### Case point: comparing credit costs

It is extremely difficult to compare the costs of credit loans. In the National Policy Forum of July 9 2001, we benefited from some clear comparisons made between credit borrowed from Provident Financial (a licensed moneylender), and two catalogue companies, each of whom advertised their prices differently, but all charged similar overall costs. Provident Financial pride themselves in being up-front about their costs, whilst there are other companies that will add extra costs such as penalty charges for late repayment, or unauthorised borrowing. Distortion of annual percentage rates (APR) is caused by short term loans, and additional costs are not covered by APR, so even this highly complicated system<sup>22</sup> designed to make interest rates easily comparable does not help consumers understand costs.

### Case point: enforcement

The Lord Chancellors' Department have recently acted to promote greater awareness of the legal limits of bailiff practices through publication of the *National Standards for Enforcement Agents*<sup>23</sup> and the promotion of self-regulation, there are other areas of enforcement that remain in need of increased transparency. Many of those on low income who take their cases to the court appreciate the opportunity to receive help sorting out their repayment problems, however, for many others the courts are considered to be the last place to go with their financial problems. The law regarding debt recovery is complex and dated with multiple options given to the creditor to enforce debt, and an accompanying array of costs to be charged to the debtor. There is a general lack of transparency regarding repayment procedures and options, in particular the role of the court.

### Case point: Social Fund

The National Policy Forum also witnessed evidence that the Social Fund fails to make transparent its operations. Applications are made to the part of the Fund most likely to deliver a payment, even though that may not be the most suited to the needs of the applicant. Staff administering the Social Fund would even encourage the applicant to make these choices regarding which category would be most likely to deliver. We also heard how the process of applying to the Social Fund for a crisis loan was made additionally complicated as few staff were made aware of the resources accessible to them to assist the applicant in making an application in the appropriate manner<sup>24</sup>. The transparency of the Social Fund is further obscured by its cash limited nature, which leads to wide variations in success rates for applications, dependent on when and where they are made. The appeals and complaints processes are also unclear. That few appeals are made to the Independent Review Service for the Social Fund is an indication of how inaccessible the appeals process is.

### Recommendations

- ♦ Awareness raising campaigns aimed at promoting the affects of credit and debt, to highlight the issues and promote consumer interest should involve stories of bad debt.
- ♦ The provision of financial literacy programmes currently being piloted should be extended in financial institutions (e.g. credit unions and banks); advice centres (e.g. Citizens Advice Bureaux) and education establishments (e.g. schools, further and higher education).
- ♦ Investment is needed to provide more independent advice. In addition to increased funding provided by mainstream financial institutions, additional funding could be raised either by directly placing a levy on licensed moneylenders or through fines for lenders who contravene the law or guidance relating to 'extortionate credit'.
- ♦ The Office of Fair Trading (or Financial Services Authority) should enforce guidance on the availability and transparency of information about financial products. Regulation is required to ensure that the cost of credit is comparable between products.
- ♦ Staff in financial institutions (e.g. Jobcentre plus personal advisors and those administering the Social Fund) should be trained to provide some basic advice and a referral service.

**Big idea 2: increased advice services**

The provision of available and personal financial advice is needed to enable those considering taking out a loan to seek advice before accepting a loan contract. The ‘sale’ of this loan, commonly provided by door-to-door sales, and the opportunity to seek independent advice should be protected by a general duty of fair-trading. Furthermore, the availability of advice is also important when repayment difficulties are encountered. There should be a duty on both parties (creditor and debtor) to involve advice services when repayment is defaulted. The duty on creditors should therefore involve identifying vulnerable customers, without then excluding them as a lending risk. There should be a duty placed on creditors to accept repayment plans developed in consultation with independent advice services or courts. In cases where there

are multiple outstanding debts this would prevent the default of payments to some creditors because others take priority by stubbornly refusing to accept other repayment options. If the provision of advice is in the form of a ‘one stop shop’ of advice alongside financial services, effective regulation will be needed to ensure that the advice is independent from the financial services. This form of help may be most suitable in credit unions which provide one generic financial advice service. It is important that advice is available, accessible and encouraged for those encountering problems with their debt, before these problems become established and more difficult to manage. We welcome the recommendation in the Performance and Innovation Unit’s report on the Government’s Use of Loans for a cross-cutting review of financial advice, however, a cross-cutting review must be conducted within broader parameters demonstrated in this report.

**Case study: money advice and budgeting service**

The Irish Government has played a major role in developing a national Money Advice and Budgeting Service: From an initial pilot scheme in 5 areas a decade ago, the Irish Government now funds 50 Money Advice and Budgeting Service centres across the republic, which are currently assisting 40,000 households with debt and money advice, bill payments via a Special Budget Account and access to Credit Union loan services.

**The Money Advice and Budgeting Service**

The Money Advice and Budgeting Service (MABS) is a free and confidential service for people with debt problems and money management problems. There are 53 MABS offices in Ireland with trained Money Advisers and they are there to:

- ◆ Help deal with debts and make out a budget.
- ◆ Examine individuals’ income to make sure they are not missing out on any of their entitlements.
- ◆ Contact creditors with offers of payment if people are not able to do it themselves.
- ◆ Help people decide on the best way to make the payments.

**People usually go to MABS because they:**

- ◆ Have extra bills to pay because something has happened to them, e.g., illness in the family, separation, bereavement, accident, etc.
- ◆ Can’t pay their everyday bills because they are unable to manage their money.
- ◆ Have less money than they used to and can’t keep up with loan repayments.
- ◆ Have been living on a low income for a long time and are getting further and further behind because of the cost of education, clothing and footwear, travel, childcare, rent, etc.
- ◆ Took out more loans than they are able to repay.
- ◆ Sometimes people go from welfare to work and find they haven’t as much money as they thought they would have and need help with a new budget.

## Flexible Finance – financial services that help people on low incomes

**Most people on low incomes are extremely good at managing their personal finances, but lack access to appropriate financial services, including most importantly, affordable credit. The Government must act to support the development of such services, including bill payments schemes, credit unions and other savings and loans facilities. Where possible these should be provided through integrated local ‘one stop shops.’**

### Key Issues

Rumours of the ability of people living on low incomes to escape poverty merely through improved management of their finances are, at best, ill founded. At the worst these rumours are deeply patronising and perpetuate the myth that poverty is purely an individual concern, caused by wastefulness. We understand that poverty is multifaceted - it is difficult to escape from poverty merely through improved financial management. Mitigating factors include time, self-esteem, the opportunity for reflection and financial planning, the lack of imposing crisis, and the smoothing of structural resistance imposed on those with limited resources such as the imposed inflexibility of payment deadlines, and debt recovery procedures all act against the development of a pathway out of poverty. Improving the scope for financial management involves developing a flexible system that will accommodate all these mitigating factors.

People who live on low incomes with limited resources are required to be amongst the best money managers<sup>25</sup>, making a pound stretch along way; cooking a stew which lasts through the week simply with the addition of extra potatoes. They rarely have the assistance of financial services that will manage their money for them (e.g. through automated payments). Faced with complex benefits claims forms that few can understand<sup>26</sup>, low income, no savings, no overdraft, no affordable credit, those living in poverty manage their money superbly.

Changes in circumstances, particularly detrimental changes, require a certain degree of flexibility to accommodate extra financial demands. However, those living on a low income have few extra resources to fall back on, and are required to make what is available work best for them in varying circumstances. When this fails they look to friends and family for loans, to financial institutions and moneylenders, and to intervention from the state in the form of Social Fund loans<sup>27</sup>. The extent to which people on low incomes are dependent on

credit lenders places an unfair burden on those who would prefer financial flexibility and a sufficient degree of self-sufficiency and independence.

**“Provident says ‘yes’ to people when so many others are shut out.”**

National Policy Forum participant – 9 July 2001

### Policy principles:

#### ♦ Credit

The provision of credit is key to managing flexible personal finance, yet the supply of credit is generally either limited or expensive for those on a low income. Many banks are now offering, through basic bank accounts, a minimal buffer zone, but they are reluctant to offer an overdraft and are discouraged by the Government from doing so for fear of their customers falling into debt. Credit unions are promoted as offering affordable credit, yet they will often only grant a loan of relative value to the amount saved, and will rarely allow loans to be given before thirteen weeks. Social Fund budgeting loans are restricted initially by a qualifying period of twenty-six weeks on income support or job seekers allowance, and the discretion of the fund administrator. The Social Fund is further restricted by the combination of a fixed budget and the lottery of time and place at which the application is made, which, although the applicant may qualify, means they are refused.

#### ♦ Choice

There may appear to be many providers of credit but not all credit is accessible for those on a low income<sup>28</sup>. In the alternative credit market, which specialises in serving those on a low income, there appears to be a multitude of credit providers, however the choice between them remains slim. The requested securities made against loans may vary; Crazy Georges will reposed goods, Provident Financial rely on charging for home collection, catalogues will call for goods to be returned, and Pawn shops will take possessions for security. However, the prices of credit vary little, and there is little opportunity to compare prices<sup>29</sup>. Credit Unions, whilst offering an alternative price, do not provide a sufficient alternative whilst their movement remains small.

Savings may provide an additional resource to aid financial flexibility, and the Government have acted to promote savings through Individual Savings Accounts (ISAs), and are seeking to provide products tailored

towards those on low income, such as Savings Gateway. However, saving is rarely an option for those on low income, particularly those concerned with paying off their debt first. Credit unions are foremost a savings option, and without sufficient income to save, they will be struggling for sufficient numbers of customers.

♦ **Access**

***“I have used the Social Fund and found it impractical – having to wait days for an appointment for a crisis loan, grant or budgeting loan only to be told you don’t qualify.”***

National Policy Forum participant – 12 March 2001

Personal financial assistance is best provided in a face-to-face context, because this increases the adaptability of the relationship to meet more holistic consumer needs. However, mainstream financial services are increasing their provision of personal financial services through the Internet and over the telephone, a context unfamiliar to those on low income. This change in the provision of financial services is exacerbated through the withdrawal of banks from deprived communities and rural areas. Post Offices are also under pressure to cut back the number of branches they operate and limit the hours of opening where they maintain the only financial presence in an area. Access to credit unions is also restrictive, because the movement is small; many are run on a voluntary basis with limited opening hours. Furthermore their provision is based on rules of the common bond and a geographical remit.

There is a role for expanding the diversity of financial services, particularly in order to maintain the physical presence necessary to provide access to those who prefer personal face-to-face service, predominately those on low income and the elderly. Those who do have the option of access to financial services by other means (Internet and telephone) are able to maintain access for those who do not have the same options, by using that which is otherwise threatened (e.g. bank branches and Post Offices). Similarly, the credit union ‘network’ requires the investment of a diverse range of members, accompanied by financial investment to expand the ‘network’, geographically and numerically. Credit union services need to be locally focused and deliver personal financial services, building on the emphasis of their motto “people helping people”. Access to mainstream financial services, can be further enhanced through the universal bank and shared banking services.

♦ **Budget management**

There are services, such as direct debit and hire purchase, which promote themselves as tools of flexible

money management, yet impose strict payment deadlines, which if defaulted result in high cost for the customer. What does often help is the provision of credit that can be repaid with flexibility. The opportunity to both reschedule loan repayments and occasionally default a payment without jeopardising the repayment schedule or incurring significant additional penalty charges would comprise a relevant financial service for those on low income. There is some recognition of the additional expense of payment methods predominantly used by those on low income (e.g. payment meters), typically for utilities, and this has been highlighted by the Government’s commitment to tackle fuel poverty. One key difference between a budget managed by someone on a low income and that managed by financial services is one is based on a weekly income and the other is based on a monthly basis. In addition to providing financial services that are operable on a weekly basis, skills training should focus on adapting to a monthly budget, building self-esteem, confidence and competency, empowering the consumer to negotiate repayment schedules, payment options and make informed decisions about credit agreements.

**Recommendations**

- ♦ The provision of affordable credit, as an alternative to the dominant (high cost) providers in the alternative credit market should be encouraged and supported. Credit unions and banks (particularly on the model of community banks) should have an expanded role focusing on credit provision for those on low income.
- ♦ Competition in the alternative credit lending market should be promoted, with effect to drive down credit prices. Within the alternative credit market competition should be encouraged between moneylenders, particularly those who dominate a local area. Mainstream financial services should also be encouraged to participate within the ‘alternative credit market’ through further reducing the barriers to ‘financial inclusion’: offering more relevant and accessible financial products.
- ♦ Access to mainstream financial services should be actively promoted through shared banking services, the universal bank and in cooperation with credit unions.
- ♦ Savings gateway to be linked to credit unions rather than provided as a separate entity.
- ♦ Skills training in money management, through education, advice services and financial service providers (such as banks and credit unions) should be provided in association with bodies such as the FSA and the Basic Skills Agency.

### Big idea 3: Multiple and complementary financial services

There is no one dominant provider of affordable credit. In the absence of a single source of credit that is both available and accessible, the market must be encouraged to promote affordable alternatives. The Universal Bank, due to be introduced in April 2003, and basic bank accounts are a welcome and important part of developing multiple financial services.

The potential of the Universal Bank will fail to be realised if it is not linked to other financial initiatives that involve the provision of credit. Basic bank accounts alone are not sufficient, what we require is some form of basic bank account *plus*, something that offers more than just the basic services – excluding credit. The extra provision may be provided in a number of ways that enable effective tailoring of financial services to meet the personal needs of individual customers. Financial services available to those on a low income will require a degree of coordination to collaborate and provide effective financial services. Proposed initiatives such as the Savings Gateway would increase their effectiveness if they could be linked to a local credit union. Community banks such as Salford Moneyline, and Portsmouth's PART are useful examples of combined financial services that meet the needs of those living in deprived communities.

Alongside the development of bigger credit unions, the relaxation of credit union rules (e.g. common bonds) and the diversification of membership, a focus on providing financial services for those on low income needs to be maintained. In the National Policy Forum held on

the 6 June we learnt about the credit union movement in the United States where there is a dedicated trade association for those credit unions serving lower-income households. A similar national focus in the United Kingdom would need to effectively incorporate a 'one stop shop' of financial services and advice<sup>30</sup>.

Key elements to this multiple financial service would include:

- ♦ Access to loans service
- ♦ Bill payment service and budgeting assistance
- ♦ Credit union savings account and Savings Gateway
- ♦ Debt redemption scheme
- ♦ Education, debt and money advice.

Government support and investment will be required to adequately develop the spread of locally focused credit unions providing specifically for those on a low income and in areas of deprivation, however, following the set-up phase these credit unions should be self supporting.

The Government need to promote joined-up solutions in the provision of financial services. During the course of the National Policy Forums there was no one source of affordable credit that was going to effectively challenge the dominance of high cost credit lending to those on a low income. However, there is the potential, if the Government take responsibility for promoting the provision of affordable credit, not just through the Social Fund, but through the promotion of collaboration between financial services and initiatives.

***“One lady came to me desperate to open a bank account, she had tried all the other branches in Northampton without success. She had just been promised a job as a cleaner but the employer would only take her on if he could pay her wages into a bank account. At the time basic bank accounts weren't introduced, and there was nothing I could do for her.”***

National Policy Forum participant – 31 January 2002

## Protection for Vulnerable Consumers

**The debt of those in poverty may not reach into thousands of pounds, but it can place a persistent burden and drain on limited financial resources. Debt can ensnare its victims in differing ways, including the unscrupulous practices and small print of credit agreements. But behind all these lies the threat of debt enforcement – court judgements, bailiffs and their punitive consequences. The alternative credit market operates through an imbalance of power between the lender and the borrower. The current debt recovery system is not only outdated and degrading; it is ultimately ineffective in achieving its ends.**

### Key Issues

Without sufficient attention given to the situation facing those in poverty and debt they will be vulnerable to exploitation. Whilst some financial institutions appear to be less interested in providing for customers on a low income, others explicitly focus on deprived communities and provide attractive financial packages for those on a low income (e.g. credit unions and licensed home credit lenders). However, there is little regulation to protect vulnerable consumers from the activities of door-to-door lenders and loan sharks.

There are credit lenders who not only lend at much higher rates but also unfavourable terms. Unfavourable terms mostly relate to debt repayment, and vary in extremity from the repossession of goods due to missed repayment by Crazy George's to the inability, limited ability or restricted ability or renegotiating repayment schedules by many credit companies including utility companies and the Social Fund. In general unfavourable terms are caused by a lack of due and appropriate concern given to the ability to repay a loan prior to the provision of credit by the credit lender. There are also credit lenders who explicitly target those with a history of bad debt<sup>31</sup>, and those living with a low income living in deprived communities. Access to those in deprived communities is often provided through appearing to be of the community – an astute marketing position often strengthened through 'friendly sales' by those who appear as a neighbour.

This current Government has made tackling social exclusion, protecting vulnerable consumers and neighbourhood regeneration high priorities. The Government have recognised that there is little protection for consumers served by the alternative credit market and made a manifesto pledge to "toughen laws on rogue traders, unfair terms in contracts and

*loan sharks*<sup>32</sup>. and have begun to review the Consumer Credit Act of 1974 which provides the majority of the legislation in this area. The extent to which vulnerable consumers are unfairly targeted, both in price and practice, falls under the definition of 'extortion', and should be interpreted both in terms of practice and price.

Companies that operate in deprived communities, in a manner that may be considered exploitative, in addition to personal cost to the debtor, also places a financial drain on the local economy. In one of the policy forums we heard about a street in North East England, in which the majority of households are all in debt to the same credit company, repaying almost double the price of the original loans, and thereby reducing the spending power of local customers. The personal cost of exploitation is most evident at the point of repayment difficulties. The effect of bailiffs' seizure of goods often doesn't result in the debt being fully repaid<sup>33</sup>. The use of bailiffs incurs further costs for which the debtor is liable. As a result of bad practice, when the bailiff seizes necessary goods, the debtor is forced to borrow further to replace the necessary items.

### The myth of 'easy money'

Use of credit has escalated. It is easily available to many with a positive credit rating, but not those who are financially excluded – with the exception of the credit provided in the alternative credit market. Credit offered by moneylenders appears to be particularly easily available to those who are excluded from mainstream finance (primarily because of low income), are frustrated by the procedural nightmare of the Social Fund, and cannot use a credit union. When a credit offer appears at your doorstep, when no security is sought and no credit check made, it appears to be easy money. In a situation where money is needed simply to participate in society (e.g. Christmas presents or school uniforms) or to keep others of your back for a moment (e.g. utility companies, other lenders, even the milkman), or just to make ends meet this offer is hard to refuse. When the offer is made by someone who can pose as a 'friend'; someone who claims to have been helped out of a similar situation by a loan; this 'friendly sell' can apply hard pressure. This pressure, often applied in the time just before Christmas, focuses on the immediate context. Hindsight enables the borrower to look beyond the day-to-day, hand-to-mouth living and reveals the commitment made in the long term to the lender, with all the accumulating cost. Even with the benefit of hindsight the present need may be too great.

### Policy principles:

***“I don’t think anyone can understand properly just how it feels, to dread letters coming through the letter box. When they did come you’d feel so ill you’d put the letters behind the mantelpiece – never even open them sometimes.”***

National Policy Forum participant – 9 July 2001

#### ♦ **Effective financial relationships**

The National Policy Forum meeting of 11 April 2002, which focused on debt recovery and advice highlighted the pain felt by those on a low income who endured pressure to repay their debt, often to the extent of distress caused through the use of bailiffs. The National Citizens Advice Bureaux in their report *Undue Distress* highlighted the abusive practice of bailiffs and the lack of clarity or protection provided by the law and these points were emphasised again during our National Policy Forum. The Lord Chancellor’s Department have recently produced *National Standards for Enforcement Agents*<sup>35</sup>, which, although reliant on self-regulation, is a step in the right direction, providing a benchmark for acceptable practice. Further powers of enforcement to strengthen the duty placed on creditors to maintain an effective financial relationship is required. The provision and availability of advice services is instrumental in enabling the debtor also to maintain an effective financial relationship with the creditor.

#### ♦ **Risk**

The alternative credit market, by definition, operates because of the exclusion of the mainstream financial market. The actions of both the consumer and financial services have served to increase the division between mainstream financial services and the alternative credit market. Mainstream financial services appear reluctant to promote, and provide for, the involvement of low-income customers. Risk is often cited as a cause for this reluctance despite much evidence indicating that low-income customers do not pose the degree of risk feared by financial services<sup>35</sup>. Despite this a number of those Kempson<sup>36</sup> calls ‘respectable’ claim that their higher costs are to cover the additional risks associated with the customer base.

Financial services that operate outside the mainstream financial market are not susceptible to the same level of scrutiny of their product and practices, through either public concern or regulation by the Financial Services Authority. Regulation is required to distinguish between those who target the poor and exploit their poverty, and those who identify vulnerable customers and provide financial services which meet their needs. The alternative credit market needs to be integrated into the mainstream financial market in order

to promote financial inclusion and protect vulnerable customers from those who will operate at the edge of the law.

***“To cut a long story short, I was sent between the Job Centre and Social Services three times. Eventually the travel vouchers were found at the Job Centre, none of the staff knew about them except the person at the top.”***

National Policy Forum participant – 12 March 2001

#### ♦ **‘Poor’ provision**

There is an attitude recognisable for its use of the term ‘poor man’s bank’ that promotes stigma with which those on a low income are viewed. It is perpetuated by the lack of adequate distinction between those who are fraudulent (regarding, for example, benefits or identification for a bank account), and those who are on a low income. The phrase ‘a poor man’s bank’ has been used in regard of Post Offices and credit unions, to differentiate between mainstream provision, and provision for those on a low income. The effect is those who use the Post Office and credit unions are aware of this attitude and do not wish for their financial situation to be known because they are excluded from other financial services. This attitude needs to be addressed. However, to associate it with others knowing your financial business does not address the root of the stigma and resultant treatment. Many community credit unions are built upon the foundation of “people helping people” and therefore knowing each other’s financial business. Whilst knowing other peoples financial business is a particular requisite of social cohesion, it is also a particular aspect of the financial culture of those on a low income, of which advantage may be taken. Principles should be used to create effective codes of good practice, distinguishing between personal security, and interdependence. The Government should also take responsibility for promoting an attitude in which fraud is associated with those who in effect ‘can’t pay’ rather than ‘won’t pay’. The positive promotion of services focusing on meeting the needs of those living in poverty is a welcome adaptation of the negative attitude asserted toward the ‘poor man’s bank’.

### Recommendations

- ♦ The use of bailiffs to enforce domestic debt fails to adequately distinguish between those who won’t pay and those who can’t pay. Enforcement, particularly in the form of distress (or poindings in Scotland) is problematic, often failing to recover outstanding debts.

- ♦ The abolition of bailiff use in the collection of domestic debt is preferable. If bailiffs are not abolished there should be tighter regulation to prevent bad practice<sup>37</sup>. All bailiffs should be attached to the courts and collection of domestic debt should be supervised.
- ♦ Wherever possible, either in cooperation with advice services or through the jurisdiction of the courts, repayment methods other than distress should be employed for all domestic debt.
- ♦ Abolish charging court fees to the debtor for domestic debt.
- ♦ The law appears afraid of removing credit lenders licence. Credit lenders should be subject to tighter licensing laws, and regulators given the powers to investigate, fine or otherwise penalise<sup>38</sup> the trading of companies who do not keep to the spirit of the law.
- ♦ All credit lenders should fall within the jurisdiction of the Financial Services Authority.

### Big idea 3: Abolish bailiffs and regulate relationships

The use of domestic bailiffs should be abolished. Their use is ineffective, inefficient and draconian. If the use of bailiffs is to continue they should be subject, alongside credit lenders to increased regulation to identify and protect vulnerable consumers. There should be a duty placed on bailiffs, credit lenders and the courts to promote the lifting out of poverty, above and beyond the recovery of 'bad debt'. There should be a duty to identify low income and vulnerable consumers and therefore not submit them to a barrage of computerised demands that do not respect or nurture effective relationships. Too often have we heard that a repayment agreement has been established for the debtor to then receive an increasingly strongly worded demand. The Government needs to act to promote effective financial partnerships and interdependence between the lender and borrower.

***“Why loan if I can’t make money? There is no profit from bad debt.”***

National Policy Forum participant – 9 July 2001

## High Cost Credit

**Extortionate lending – the higher cost of credit charged to low-income households by many moneylenders – is a clear injustice. Banks, credit unions and the Social Fund are failing to provide affordable alternatives or enough competition to force down the cost of borrowing. The Government must intervene, provide effective protection for customers and tackle the scourge of extortionate credit.**

### Key Issues

In tackling the problems of debt amongst low-income consumers the continuation of high cost paid for credit by those on a low income must also be tackled. Credit lending at high cost is common for people living in poverty and often results in significantly reduced income. Low income is a cause of the demand for credit, to meet needs and make ends meet, with further reductions to income – one of few vital assets for those in poverty – and thereby acts to amplify the poverty faced. The perpetuation of financial exclusion from facilities shared with mainstream consumers allows this cycle of poverty and debt to continue acting against the best efforts to escape poverty.

The high cost of credit for those who have the least is a clear sign of injustice. Those on a low income are vulnerable precisely because of their low income and they may too easily become the focus for exploitation. The absence of mainstream and high-street financial services highlights the failure of the traditional credit market to provide for those now served by the alternative credit market. It is a priority that those profiting from others poorer situation are brought to account, it is not right that money should be made from those who do not have enough money to fulfil their basic needs.

***“We were given no other alternatives. He was just told he would have to live on what money we could loan him. Being in debt is very stressful for anyone, but when you’re ill it can bring you down even lower and bring you to the brink of suicide.”***

National Policy Forum participant – 12 March 2001

The cost on the borrower is not only financial. Debt for people on low income amplifies the multidimensional affects of poverty. High cost credit, and the resultant extent (measured either by time or expense) committed to repayment of the borrowed

credit affects self-esteem, health (it is both mentally and emotionally draining), and self-reliance.

### Policy principles:

#### ♦ Interest

Whilst APR is not a perfect system (it doesn't allow adequate comparison of overall costs, and it is distorted by short term loans) it does however provide an indication that such lending is extortionate, particularly in relation to mainstream prices where APR provides a more effective, if still complex tool. During the National Policy Forum of 9 July 2001 the distortion of APR due to short term lending was explained: a one-week £10 loan with a £1 charge results in an APR of 14,406%. The expense of loans can be hidden through additional charges, and the overall cost can be disguised in preference to weekly repayment amounts, but perhaps most worrying is the practice of making the customer pay interest repeatedly through multiple loans. At the National Policy Forum on the 9 July 2001, one of the speakers shared her concerns that she was being fiddled. She explained that she had borrowed £100, and managed to repay £70. She was then invited to take out a further loan of £100. She received £70, and the lending company withheld £30 to cover the amount outstanding from the first loan. However, she received £170 in total and was repaying the interest on loans totalling £200. Repetitive small loans also incur separate administration charges for each loan, further adding to the cost of borrowing small amounts. The financial cost of lending should be made applicable, (e.g. weekly repayments), understandable (e.g. total repayment) and comparable with other credit offers.

#### ♦ Flexibility

The coping strategies (such as Provident Financial's reliance on home collection) perpetuate the myth that lending to low-income customers is a business risk. Home collections may suit the door-to-door lenders because they don't ask for any other security against the loan. However, the choice to use other methods of repayment, such as personal payment at a Post Office or lenders branch, or transactions through a bank account, are not afforded to those who borrow. Little recognition is given to the risk taken by the consumer living on a low income who in taking the loan, enters into the commitment to repay.

Credit costs often increase through repayment difficulties, particularly defaulted repayments. Many credit lenders are reluctant to provide flexible repayment plans<sup>39</sup>, including the Social Fund and companies who offer e.g. 'free interest till November'

but if the payment hasn't cleared into their funds by 'November' they will then add extra charges. Banks make overdraft charges and penalty charges are incurred when direct debit payments are missed. If the creditor goes to court the debtor has the charges added to the outstanding debt, and if this isn't paid imprisonment can follow<sup>40</sup>.

**“Why do we have to pay so much?”**

National Policy Forum participant – 9 July 2001

♦ **Affordability**

With the failure of credit unions, banks and the Social Fund to provide enough affordable credit and the failure of licensed moneylenders to be affordable, the price of credit demanded by those on low income will remain high. Because customer demand is high and there is insufficient competition over the price of credit, lenders get away with the price dictated by the market. The market is failing those on low income, it is failing to self-regulate and it is failing to stimulate sufficient competition to affect the price. Whilst the Government continue to hesitate about fulfilling the recommendation by PAT 14 to invest in credit unions through a central services organisation the credit union movement will struggle to grow, and mainstream financial services will more urgently need to provide credit. Government intervention to stimulate the market is required.

**Recommendations**

- ♦ A statutory ceiling on interest charged by credit lenders.

- ♦ Increased provision of guidance on flexible repayment procedures, and a duty on creditors to renegotiate defaulted payment plans.
- ♦ Invest in affordable alternative credit provision, particularly through credit unions and other community finance initiatives.
- ♦ Ensure that the costs of credit, broken down into their constituent parts (e.g. administration, home collection, penalty charges etc.) are both made available prior to the contract agreement, and also published separately.

**Big idea 4: tackling extortionate credit**

The legal definition of extortionate credit needs to be redefined in order to provide effective protection against creditors who charge extortionate prices – excessive prices – or operate oppressive practices or terms. The powers of the Office of Fair Trading<sup>41</sup> require strengthening to enable them to investigate creditors in response to super-complaints, or to apply stop-now orders, or to impose fines and other ‘wheelclamping’ penalties or ultimately to withdraw trading licences from companies found to be trading extortionately in either cost or practice. Importantly, with the progression towards electronic transactions, repayments to credit lenders should be made through bank accounts, a process which will also assist in tackling financial exclusion from mainstream financial services, and encourage mainstream credit provision.

# Joined up Government

**Debt can only be tackled through concerted and joined up action across Government, but the Government's action on debt is currently both uncoordinated and disjointed. Whilst a range of initiatives have been taken by individual departments, these do not amount to a coordinated anti-debt policy. A single unit needs to be put in charge of developing and delivering a coordinated anti-debt strategy involving a specific focus on alleviating the burden on those in poverty.**

## Key Issues

The Government have made pledges towards the eradication of poverty in this country, however, they have given little attention to the problems of debt amongst low-income households in their anti-poverty strategies<sup>42</sup>. An anti-debt strategy requires cross-cutting coordination across at least six Government departments. Each of the Government departments is engaged in relevant areas, and much has been done to promote the agenda of tackling debt affecting those in poverty, but much more needs to be done, most importantly coordination and cooperation between the individual departments.

Following the General Election in 1997, Prime Minister Tony Blair formed the Social Exclusion Unit to help improve Government action to reduce social exclusion by producing 'joined up solutions to joined up problems'. In 2001 the Policy Action Teams' reports (PAT 1-18) formed the cornerstone of the National Strategy for Neighbourhood Renewal. PAT 14 focused on Financial Services, and on three areas in particular: the scope of credit unions; the role of banks, post offices and other organisations in the delivery of financial services to communities in deprived areas; and how to widen the availability of insurance services.

Elsewhere, primarily through the Treasury and the Department of Work and Pensions (previously the departments of social services and education and employment), the Government have promoted employment as the best route out of poverty whilst providing financial support for pensioners and children. Other departments have focused, or not as the case may be, on separate issues (e.g. the enforcement review, the Social Fund respectively), with minimal cross-departmental coordination. Recently the Department for Trade and Industry have encouragingly taken up the Government's 2001 manifesto pledge to 'tackle loan sharks', however, their focus rarely appears to include those in poverty and debt, despite the remit of the 1974 Consumer Credit Act, which is currently the focus of the DTI activity, covering the 'alternative credit market'. With out due consideration and coordination the opportunity for the Government to act to the benefit of those living in poverty may all too easily pass untouched.

In this section of the report all the relevant Government departments are dealt with in turn. For each department the extent to which recognition is given, firstly, to the problem of debt, and secondly, in relation to those in poverty is assessed. Pointers are also given to each department that will help the department act within their own responsibilities, and also in coordination with a more holistic picture of debt, that reaches beyond departmental boundaries. Many of those particularly affected by debt are in receipt of benefits, and so have a particular relationship with the Government, it is imperative that the Government recognises this and bases its development of joined up policy solutions with regard to this existing relationship. The lives of those living in poverty do not fall neatly into individual departmental responsibilities, therefore an effective strategy must be coordinated to tackle debt and all relate to those living in poverty.

## Tackling Loan Sharks

### Department of Trade and Industry (DTI)

The DTI took the lead on debt, following the Overindebtedness Summit Conference on 30 October 2000, by commissioning a Taskforce to continue to explore issues of transparency and principles of lending practice amongst other issues of 'Overindebtedness'. In the general election of 2001, the Labour Party made a manifesto pledge to 'tackle loan sharks', resulting in the DTI consultation on the reform of the Consumer Credit Act 1974. At the time of writing this consultation is yet to conclude. However, the DTI have concentrated on an understanding of overindebtedness which has little relation to the debt of those in poverty and the problems caused by the exploitation of repayments far over and above that originally borrowed. An understanding of the overindebtedness of those in poverty is urgently required.

There are several areas in which the DTI has the power to act and promote fair finance for those on a low income:

- ♦ **Regulation.** Responsibility for the Office of Fair Trading (OFT) falls within the remit of the DTI, and the responsibility of enforcing the Consumer Credit Act is the duty of the OFT. Additionally the Enterprise Bill 2002 provides for third parties to make 'super-complaints' on behalf of the borrower. The DTI must ensure that the OFT have the resources and powers necessary to effectively regulate the provision of consumer credit – the dominant form of credit for people on a low income. Involvement of the Financial Services Authority (FSA) in regulating the consumer credit (particularly alternative credit) market will require coordination between the DTI and the Treasury.
- ♦ **Access to financial services.** The DTI also hold responsibility for the Post Office and in cooperation with the Treasury are responsible for extending financial inclusion to those on a low income. They are currently seeking to do this through promoting the Universal Bank – although this will not provide access to credit. The DTI are also responsible for the Phoenix Fund and other initiatives which could support the development of community finance

initiatives and credit unions to help boost enterprise in deprived areas as part of the Neighbourhood Renewal Strategy.

- ♦ **Extortion (cost and practice).** The DTI are responsible for ensuring vulnerable consumers are not exploited. The DTI are currently addressing the legal definition of extortionate credit. It is recommended that the DTI redefine the legal definition in the Consumer Credit Act so that the concept of an 'extortionate credit bargain' recognises the majority of current loans exceed levels which would be generated by a fully competitive market and are so oppressive that no sensible person, independently advised, would find them acceptable. A new test of whether the transaction involved business activity which was deceitful, oppressive or otherwise unfair – using the same statutory wording as is used to assess the fitness of a trader to hold a credit licence – should be a further factor in determining if the transaction was extortionate<sup>43</sup>. Easier access to the courts to challenge extortionate credit bargains will require the DTI to work with the Lord Chancellor's Department.

***"People tip their collectors, sometimes £20 because of their gratitude, as there are few alternatives".***

National Policy Forum participant – 9 July 2001

- ♦ **Independent Advice.** Finance and debt advice is currently in high demand. The Government need to encourage and support the provision of independent financial advice. The DTI needs to work with the DFES and DWP to ensure that financial and debt advice is both available and accessible early in the debt spiral. The DFES needs to work with the Treasury to promote the availability of debt and financial advice through credit unions and other financial institutions developing a 'one stop shop' financial service. In addition the DTI and LCD need to work to produce simpler law dealing with credit lending and debt recovery, and so reduce the demand placed on financial and debt advisors.

## Tackling Financial Exclusion The Treasury

The Treasury's involvement in the interests of those on a low income stems both from their role in Policy Action Team (PAT) 14 as part of the Social Exclusion Unit's work developing a national strategy for neighbourhood renewal, and in the Government's commitment to tackling child poverty through mechanisms such as tax credits that relate to personal income.

There are several areas in which the Treasury are able to take a lead role in developing a context of fair finance for those on low income:

- ♦ **Credit Union Development.** Credit unions have a role to play 'keeping money in the neighbourhood'<sup>44</sup> and the Treasury are responsible for the Government's commitment to support the development of credit unions in deprived areas. In addition the Treasury has responsibility for banks and the FSA. The FSA became the single regulator for financial services<sup>45</sup> in 2001 following the implementation of the Financial Services and Markets Act 2000. In developing a stronger regulatory framework, the Treasury and FSA need to ensure that the mutual self-help and community-based ethos of many credit unions is not lost. At the same time, the steps to reduce restrictions on credit unions (e.g. to borrow money from other organisations) are to be welcomed. Professionalism amongst credit unions is welcomed, however it is important to ensure that small credit unions are not suffocated in regulation, sustainability is as important as developing an effective community base and should be recognised as priorities for the credit union network. Therefore regulation should be given with sufficient flexibility, for credit unions to meet the need of their local customers, particularly those on low income.
- ♦ **Basic Bank accounts.** The Treasury ordered all major banks to offer basic bank accounts by October 2000 and actively promote them. The Treasury reported on the effectiveness of banking codes on 2001 ('Cracking the Codes'), which now includes further guidance on how banks can treat people in financial difficulties appropriately. In July 2002 the Commons Treasury Select Committee criticised the big banks for failing to open up to competition, and failing to actively promote basic bank accounts. The Treasury needs to take firm action with banks to tackle the criticisms made by the Treasury Select Committee.

*"Provident Financial don't have any competition. If there was competition people would offer lower charges, but it seems there is none. People have little option."*

National Policy Forum participant – 9 July 2001

- ♦ **Charges.** Many banks operating basic bank accounts<sup>46</sup> will charge for unpaid direct debits<sup>47</sup>, such charges are found to be restrictive by those who living on a low income cannot guarantee that there will be sufficient funds available to make a payment that meets the timing of the demand. The FSA has a duty to promote public understanding of the financial system and improve general financial literacy. The Treasury will need to work with the FSA, the DfES, financial institutions (particularly banks and credit unions) and other relevant parties to promote financial competency that meets the changing financial environment. The pilot Community Finance & Learning Initiatives are intended to achieve this goal, and their progress should be monitored closely to this end.
- ♦ **Credit.** The PAT 14 recommendations focused on credit unions as the providers of credit. Credit at the time was recognised as a necessary provision alongside affordable insurance. Without sufficient support by the Treasury to fund the expansion of the credit union network, credit unions will remain unable to fulfil the role of credit providers for many people in many areas of the country. The Treasury will need to work with the DTI and the Office of the Deputy Prime Minister (ODPM) to harness the income directed towards deprived communities to ensure it works to supplement the personal finance resources available to people on low incomes. In addition the Treasury have a key role to play in promoting alternative affordable credit sources. The Government, in promoting basic bank accounts acted to restrict the provision of credit, believing that such measures would prevent customers going into debt. However, since many low-income customers are either already in debt or will simply turn elsewhere to meet their credit needs, this action merely perpetuates financial exclusion. Without offering credit the banks are effectively marketing a form of second-rate financial inclusion believed suitable for those on low-incomes. However, a few banks offering basic bank accounts do include some form of credit<sup>48</sup>, yet the credit provision offered through buffer zones is minimal. The Treasury should take an active role in encouraging banks to provide and extend buffer zones.

## Debt Enforcement

### Lord Chancellor's Department (LCD)

The Lord Chancellors Department have been conducting a review of Enforcement. Following their preliminary review they extended their review. The Enforcement review is currently working on the recommendations from Professor Beatson's *Independent Review of Bailiff Law* informed by responses to the 2001 Green Paper 'Towards Effective Enforcement'. In April 2001 David Amess MP presented a ten minute rule Bill for the regulation of debt management and credit repair. This Bill sought to give the Director General of Fair Trading a duty to establish a Code of Practice for traders who offer consumers the services of debt management and credit repair, and for connected purposes.

- ♦ **Debt Recovery.** The involvement of debt management companies, credit repair companies, and repossession orders granted against council tenants and housing association tenants are examples of activities that arise from failure to repay debt<sup>49</sup>, much of which is caused through the failure to deliver housing benefit. It is not clear how many repossession orders actually lead to evictions. The LCD, which counts repossession orders, does not collect eviction figures or record the grounds for action. Similarly, the LCD does not keep figures relating to the number of imprisonments for local tax default that are found to be unlawful by the High Court<sup>50</sup>. The LCD should, in liaison with the ODPM, collate adequate data that can be used to evaluate the effectiveness of debt recovery and protection for vulnerable customers.
- ♦ **Humane debt recovery methods.** The courts should be encouraged to deal sympathetically with cases of genuine hardship, conduct examinations into reasons for non-payment, identify vulnerable consumers and consider very carefully whether or not to proceed with a committal hearing<sup>51</sup> prior to issuing liability orders. The courts should be able to

identify vulnerable consumers through access to information held by DWP through Jobcentre Plus interviews and other data<sup>52</sup>. [The Rotherham] guidance which provides a definition of 'vulnerable people'<sup>53</sup> should be expanded to include those unemployed<sup>54</sup> and those whose income falls below 60% median income<sup>55</sup>. The recommendation issued in best practice guidance to courts to make full use of means enquiry forms at every possible stage needs to be further enforced.

The use of alternative forms of enforcement (to the dominant method - repossession) is currently being considered by the LCD as part of the Enforcement Review. It is recommended that the LCD encourage the use of alternative forms of debt recovery that employ a means tested relevance such as Administration Orders, and promote the renegotiation of repayment plans prior to court action. The Government need to develop a statutory definition of debt and overindebtedness in order to better inform the courts decisions.

- ♦ **Effective relationships.** The LCD have recently produced *National Standards for Enforcement Agents* in which they set out their aim 'to share, build upon and improve existing good practice and thereby raise professionalism across the whole sector' for use by enforcement agents and major creditors. Although this guidance is welcome, it is not backed up by effective enforcement that would be possible through attaching all bailiffs to the courts and supervising debt collection. It is not enough that bailiffs should be required to regulate themselves. The complaints and discipline should be administered independently, through a body such as the OFT. The LCD should work with the DTI and DWP to develop effective guidance (including appeal, complaint and feedback on decisions) which covers the whole range of debt collection: bailiffs, credit lenders (and home-collection) and Social Fund repayments (taken from benefit payments).

## Financial Education Department of Education and Skills (DfES)

Financial Education has become recognised as an area in need of attention. Financial Education applies both to the customers of the future educated through school and also to existing financial consumers who may be educated, particularly through the workplace, and through contact with financial institutions.

- ♦ **Education.** It is necessary that young people are given appropriate guidance on financial issues as such financial information, knowledge, and skills. Guidance and advice should be included in the school curriculum as part of the new national framework for Personal Social and Health Education and as part of Citizenship in the national curriculum. DfES should ensure the connexions service personal advisers are trained to provide a sign-posting service for financial education<sup>56</sup>.
- ♦ **Financial Literacy.** There are a number of

recommendations made by the Adult Financial Literacy Advisory Group that are worth implementing by the Government. Financial literacy programmes, such as the pilot Community Finance Learning Initiative, can help people adapt to a changing financial environment and provide skills to make informed financial decisions. However, there is only so much that education can do and whilst people on a low income can be experts of their own financial situation, they need to have accessible information and alternatives in order to make an informed choice. The DfES needs to work with the DTI to ensure that the necessary information is made available, that, for example, credit costs are comparable and small print is understandable. The DfES needs to work with many partners in the promotion of financial literacy including financial service providers, independent advice services and the DWP.

## The Government's Use of Loans Department of Work and Pensions (DWP)

In the Social Security Secretary's Annual Report on the Social Fund in 2000 a figure showed that the number of applicants refused a Social Fund budgeting loan had multiplied from 4,856 in 1997/98 to 362,000 in 1999/2000 on the grounds of inability to repay<sup>57</sup>. On 4 April the Social Security Select Committee published their Third Report, on the Social Fund calling for an 'urgent overhaul and injection of funds'. In 2002 The Performance and Innovation Unit published 'The Government's use of loans'.

- ♦ **Basic income.** The DWP need to ensure that benefits recipients are not kept waiting for their

benefits (particularly housing benefit). The benefits system needs to be reformed to ensure that there is no delay when switching benefits, or moving between the labour market and the benefits system.

- ♦ **Social Fund.** The Social Fund is in need of urgent reform. Payments for necessities should take the form of grants, and these can be, on the whole, met in relation to life events (as an extension of the Sure Start grants and the winter fuel allowance). The recommendations made by the Social Security Select Committee in 2001 and in 'Like it or lump it'<sup>58</sup> which presents 'a role for the Social Fund in ending child poverty', should be implemented by the Government.

*“£20 doesn't buy you a school uniform – you need to get a loan.”*

National Policy Forum participant – 9 July 2001

## Neighbourhood Regeneration Social Exclusion Unit and Office of the Deputy Prime Minister (ODPM)

The newly formed **Office of the Deputy Prime Minister** includes responsibilities for housing, the **Neighbourhood Regeneration Unit** and the **Social Exclusion Unit**. The first project of the **Social Exclusion Unit** was to develop a **National Strategy for Neighbourhood Renewal** which brought into existence the **Policy Action Teams (PAT)** of which **PAT 14** focused on tackling financial exclusion. Following the recommendations in the **National Strategy for Neighbourhood Renewal** the **Neighbourhood Renewal Unit (NRU)** was formed.

Personal income, although primarily under the remit of the Treasury and DWP should not be considered in isolation to community regeneration. The Government should promote these two focuses not as separate but as integrated dimensions of poverty. In doing so the Government will create a more acceptable social climate in which to tackle poverty. A strategy to tackle debt can play a key role in motivating social cohesion and building the assets of those on low incomes. In the words of Liam Byrne, the Government must tackle the 'confused, cash-poor and culturally risk adverse atmosphere that hangs over almost every one of our deprived communities'<sup>59</sup>.

- ♦ **Community Enterprise.** Credit unions, and other community finance projects such as Salford Moneyline and Portsmouth Area Regeneration Trust (PART) can have a valuable role in developing a dynamic and sustainable local economy. The ODPM should work with the DTI and the Treasury to involve credit unions in the social enterprise strategy<sup>60</sup>, targeted in areas of neighbourhood renewal. In addition to the Phoenix Fund (incorporating a challenge fund to help resource Community Development Finance Institutions), the NRU provides resources to the 88 most deprived local authority areas in England and is responsible for the New Deal for Communities programme. The Urban Policy Unit (UPU) has a Special Grant's

Programme which currently supports national social enterprise bodies including the Association of British Credit Unions (ABCUL).

- ♦ **Draining community regeneration.** The American Community Reinvestment Act is not an easily transferable model to the United Kingdom, however, it does indicate a suitable direction for socially responsible businesses, ensuring that money does not leave the local area. A credit lender, operating in a street in which it lends to forty households, is effectively draining that street of available income through debt repayments at almost double the amount initially borrowed. The money that flows into areas of deprivation through neighbourhood renewal schemes will have a limited affect whilst the personal income of the low-income inhabitants of the area is undermined through extortionate lending practices, and therefore their ability to financially participate in the area's regeneration is restricted.

### Big idea 5: A Debt and Financial Inclusion Unit

At present, as the preceding section has shown, responsibility for tackling the various aspects of debt and financial exclusion are scattered throughout government. The Social Exclusion Unit needs to undertake a thorough cross-cutting review of Government anti-debt policy, and develop proposals for coordinating policy across government. The Neighbourhood Renewal Unit, which emerged as a key recommendation from the SEU's work on 'Bringing Britain Together', has proven to be highly effective mechanism for coordinating action on community regeneration. It is our recommendation that a similar unit is needed to tackle debt and financial inclusion.

### **A Debt and Financial Inclusion Unit**

Housed in the Office of the Deputy Prime Minister, a Debt and Financial Inclusion Unit would have responsibility for:

- ◆ Coordinating departmental policy and working with the devolved administrations in Scotland, Wales and Northern Ireland to ensure a clear focus on debt and financial inclusion strategy.
- ◆ Leading on developing a major expansion in the provision of affordable credit, linked with a major reform/ replacement of the Social Fund with a target of ensuring that within 5 years affordable credit is available to all, including the 3-6 million people currently excluded from affordable credit.
- ◆ Leading on the development of joined up local provision of financial services to low income households (including savings and credit, money advice and education, bill payments services etc).
- ◆ Pooling existing resources for financial inclusion initiatives (Community Finance Learning Initiatives [CFLIs], Savings Gateway, money advice and credit union development) into a single Debt and Financial Inclusion Fund (similar to the Neighbourhood Renewal Fund). It is anticipated that to achieve the above targets, this fund will need to be substantial (£100 - £150 million a year).
- ◆ Development of a Debt and Financial Inclusion Network (similar to the NRU's Community Network), to bring together grassroots activists and local practitioners to advise on strategy and implementation on the ground.

***“People get into debt over  
Christmas presents, clothes...  
Not cars and luxuries”.***

National Policy Forum participant – 9 July 2001

# Conclusion

Throughout this report the task of tackling poverty is imperative. Debt is a serious issue with serious consequences for many. This report acknowledges many of the initiatives and actions taken to tackle the issue of debt, and in particular overindebtedness. Despite it feeling like three long years of the Debt on our Doorstep campaign, this is really a very short time, particularly in the context of those struggling to pay off their debts and climb towards a position of self-sufficiency. There are signs of activity, and, in words attributed to the Labour Party in the General Election of 2001, 'much has been done, but there is much that remains to be done'.

Many experts have contributed to the writing of this report through the National Policy Forums, and others have played their part in informing the debate. A prominent position alongside academics and politicians, policy makers and decision takers is given to those experiencing poverty about whom many policies are designed and in whose name many decisions are taken, but with whom less time is spent, even understanding their issues. The work of Church Action on Poverty is different. The work of the National Policy Forums and the writing of this report has involved and relied upon the participation, experience and expertise of those living with poverty and debt. More than anyone else it is the involvement of these people, living with the issues that are discussed, that have provided the understanding of the situation, explained the relationship between poverty and debt, and endorsed the recommendations that will make a difference.

***“People are still trapped in debt and poverty. When will change come?”***

National Policy Forum participant – 9 July 2001

Any attempt to tackle the problems of debt and overindebtedness should pay particular attention to the context of those on a low income. The evidence

provided in this report is a testimony to the effect caused when debt and poverty together wreak havoc on the finances of those living in poverty. Debt and poverty combine to form a cycle in which those on a low income swiftly descend into a long hard struggle with few opportunities to escape.

There are three principle achievements made by this report:

- ♦ It provides a sound basis for the profile of both the problems and solutions of debt to be raised significantly, and should lead to cross party support and prioritisation by the Government.
- ♦ This report is produced through the involvement of people living in poverty in collaboration with a broad variety of stakeholders. It is a witness to the expertise of those experiencing poverty and their active involvement and participation in the development of policy that has an effect on them.
- ♦ This report gives impetus and direction for a cross-governmental approach to tackling debt as part of the anti-poverty strategy.

It has been said that there is a risk in lending to people living in poverty, the banks aren't willing to provide credit facilities as part of their basic bank accounts and companies that do lend go to great lengths to reduce the perceived risk through door-to-door weekly collections. However, without providing the flexibility that credit offers, the risk of not meeting the needs of those living on low incomes lies not just with them. Without an appropriate response to the situation of debt facing many people living in poverty the Government's progress on anti-poverty strategies will be severely inhibited. Debt has a particularly effect on the Government's commitment to end child poverty and deliver neighbourhood renewal, it places a burden on the economic health of the country and inhibits the shared potential of our society. Is it worth the risk?

## Appendix I

### The National Policy Forum policy process

The policy presented within this report is forward thinking, portraying a picture of financial inclusion and citizenship extended to those living in poverty, low income and persistent debt. The accompanying scenarios take a five-year glance into the future revealing the likely effect and impact of policy choices, based on informed prediction of social, political and economic trends. The policy making process detailed here is innovative and flexible, encouraging new ideas, and where appropriate, making established ideas work better. Established policy and existing proposals have continuously been considered throughout the entire policy development process, and we have evaluated policy effectiveness wherever possible. Wherever possible the process has been open to comments and suggestions from others through the 'policy in the round' model. The recommendations are based on the best available evidence from a wide range of sources including those living with poverty and debt. This inclusive approach is clearly demonstrated through utilising the pastoral cycle. From the outset one of the principle aims of the process has been to present joined-up policy, looking beyond the Government's departmental boundaries to the Government's strategic objectives in the establishment of an ethical and moral base for this policy. We hope to present policy which learns from experience of what works and what does not work and recognise the central role of those affected by policy decisions in the formulation of effective policy.

There are two particular aspects of the policy process to highlight in more detail. The first of which may not be a recognised model, but it has its roots in the development of a shared story; the other is developed from the experience of the Christian tradition.

#### Policy in the round

Much of the policy presented in this report was formulated through the involvement of a wide variety of stakeholders in the five National Policy Forums. The themes of the five Policy Forums were based on government's departmental differentiation of the issues, thus we tackled the Social Fund, high cost credit, banking initiatives, debt recovery and advice, and the communities' response separately. However, throughout the process, from the first to the fifth Policy Forum of this series we looked to join-up the policies. The first policy forum specifically involved the other four areas in relation to the Social Fund, examining how the recommendations would affect these other issues. The

fifth Policy Forum enabled a broad approach to the issues through the communities' response. In addition, a group of participants attended several of the Policy Forums, and a few participants attended all the Forums. Of those participants a number with direct experience of poverty and debt met on a couple of occasions and spent time drawing the threads that transcended the individual issues, and focusing on the context of poverty and debt these themes developed to provide the substantial content and structure of this report.

Each Policy Forum was structured to enable participants, many of whom had differing, and some who held diametrically opposing views of the issue, to reflect on their own perspectives and explore the situation and views held by others. The Policy Forums worked to enable many participants to take what may appear to be small steps towards a joint and holistic approach to the issues. Occasionally this involved participants making some concessions whilst searching together for practical measures that could tackle the problems of financial exclusion, poverty and debt. The perspective presented by this report is not that of an individual, through the process of policy development facilitated by the Policy Forums it is a perspective shaped by many, and reflects the dominant agenda framed by a position more susceptible to a broad support than when we began. There is, however, a bias evident in this report and it is a bias towards those living in poverty. It is not a bias to be ashamed of, neither is it extreme. Importantly it is a bias shaped by the involvement of many other stakeholders. The policy process has been educational; it has tackled misconceptions and given attention to a neglected area of policy, and we have promoted greater financial, social and political citizenship.

#### The pastoral cycle

Each policy forum was based on the pastoral cycle. The pastoral cycle was developed through liberation theology in Latin America. Liberation theology has its origins in the reality of the 'premature and unjust death of many people', as Gustavo Gutierrez puts it. The starting place is not detached reflection but on the present lives of those living in poverty.

The pastoral cycle moves through five stages and is a development of the 'see, judge, act' method used by base ecclesial communities:

- ♦ **Experience.** Each policy forum began with stories based on personal experiences. Most of the stories were shared by those living in poverty who had

particular experiences relating to the issue upon which that forum focused. Their stories were joined, on occasion, by the academic experiences, and the experiences of practitioners (e.g. administering the Social Fund, or lending money).

- ♦ **Reflection.** Our reflection, initiated in the retelling of personal experience, was further developed by those who listened to, and later joined the stories with their own views. In addition the process of reflection was guided with closing reflections that focused on providing a political, faith and grassroots perspective.
- ♦ **Analysis.** The analysis began by listening to the stories and developed further in workshops. For example, in the Policy Forum on banking initiatives each group provided barriers to and benefits of financial inclusion, which they then used to assess the banking initiatives.

- ♦ **Action.** Through the workshops, and particularly through the plenary sessions we looked for steps by which we would be able to tackle the problems discussed relating to this issue. These recommendations formulated the action proposed by the participants of the Policy Forum.
- ♦ **Celebration.** Space was given for celebration through the concluding reflections. The participants of the policy forum were able to celebrate the steps that had been taken to tackle financial exclusion and debt, in their work prior to our discussions that day. And also the participants were able to celebrate the steps that had been taken through the course of our coming together and sharing our positions and understandings on the day itself.

And thus we return to our experience. Our experience of the policy forums leading us towards better policy and a better situation facing those living in poverty and debt.

## Appendix 2: Bibliography

### General

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# Endnotes

<sup>1</sup> *How people on low incomes manage their finances*, “Life on a low income”, ESRC, 13 December 2001.

<sup>2</sup> Guardian article ‘Young people boast about their debts’, 20 February 2002.

<sup>3</sup> Defined by the National Policy Forum, January 2002.

<sup>4</sup> Defined by Adult Financial Literacy Advisory Group, DfES, January 2002

<sup>5</sup> *Faith in the City* p195. Church of England 1985.

<sup>6</sup> £6.8 billion new debt in November 2001

<sup>7</sup> Graduates are averaging around £12,000 debts on leaving University. In September 2001 the National Association of Citizens Advice Bureaux reported that it was dealing with £1.2 billion worth of new debt cases a year. The average of this per household was £10,700, whilst the average income was only £800 a month – less than the overall UK average income.

<sup>8</sup> Kempson *et al.*, 1994; Kempson, 1996; Kempson and Whyley, 1999).

<sup>9</sup> Elaine Kempson, supplementary note to evidence taken by the Social Security Select Committee, Third Report, The Social Fund, 4 April 2001.

<sup>10</sup> Paul Jones, ‘Access to Credit on a Low income’ in Economic and Social Research Council’s report, ‘How people on low incomes manage their finances’, December 2001.

<sup>11</sup> This figure was shared at the National Policy Forum on 11 April, by Sue Edwards, NACAB Policy Officer.

<sup>12</sup> A point widely recognised amongst those living in poverty and also attested to by the members of the Social Security Select Committee during their Third Report on the Social Fund.

<sup>13</sup> On 1 October 2002 the Minimum wage rises ten pence to £4.20.

<sup>14</sup> Radio 4 *Inside Money* 3 August; Zacchaeus 2000 Trust.

<sup>15</sup> Parliamentary Questions by Mr Kirkwood 24 April – column 344W; by Mr Clappison 10 April - column 1W; Dr Julian Lewis 5 March - column 146/147, etc.

<sup>16</sup> For example, “Social Fund loans take claimants’ income level 15% (and often more) below the official poverty line. This might be acceptable where the official poverty line were set at an adequate level. But a long tradition of rigorous research...has demonstrated the inadequacy of basic social assistance benefit levels.” Professor Gary Craig’s memorandum submitted to the Social Security Select Committee and published in their Third Report on the Social Fund on 4 April 2001.

<sup>17</sup> Access to financial services, Policy Action Team 14, November 1999

<sup>18</sup> Echoing recommendation K of the Social Security Select Committees’ Third Report on the Social Fund, published on 4 April 2001.

<sup>19</sup> In October 2001 borrowing rose to £6.5bn new debt. In November 2001 the Bank of England recorded figures of £6.8bn new debt, the highest since records began in 1993. Elaine Kempson, in her paper *Life on a low income*, p 16, “How People on Low incomes Manage their Finances”, ESRC, 13 December 2001, highlights the increasing use of credit over the last two decades.

<sup>20</sup> ePolitix, *Forum Brief: Financial Literacy*, 20/02/2002.

<sup>21</sup> 2 Nearly 30% of those without a current account do so voluntarily preferring to use cash only.

<sup>22</sup> This point is supported by the Treasury Committee, Fifth Report, Banking Consumers and Small Businesses, 30 July 2002

<sup>23</sup> Lord Chancellors’ Department, April 2002.

<sup>24</sup> This evidence is also repeated to the Social Security Select Committee for their Third Report on the Social Fund, p 49, paragraph 169, published on 4 April 2001.

<sup>25</sup> Elaine Kempson’s and Sue Middleton’s papers published in the Economic and Social Research Council’s report, ‘How people on low income manage their finances’ gives a clear indication that, in general, people on low income manage their finances with care, skill and resourcefulness. There is no evidence to show that there are some people on low incomes who cope, whilst others don’t.

<sup>26</sup> Sue Edwards, NACAB, speaking at the National Policy Forum on 11 April 2002

<sup>27</sup> Elaine Kempson speaks of a ‘hierarchy of acceptability’ for the various strategies for raising the money needed for items that cannot be met out of the household budget. ‘How people on low income manage their finances’, p19, and Whyley *et al.*, 2000.

<sup>28</sup> Banks insist on particular forms of identification, the less identification you can supply the more restricted credit becomes (basic bank accounts). High street lenders (including banks, building societies, credit card companies and store cards) will also restrict credit lending on the basis of income and credit rating.

<sup>29</sup> See section two, ‘Hidden Agendas’ in which reports how the prices were compared at the National Policy Forum on 9 July 2001.

<sup>30</sup> A similar scheme ‘A Factor Four Approach’ is promoted as effective in ‘Ending fuel poverty and financial exclusion’, a research study undertaken by National Energy Action, New Economics Foundation and the Personal Finance Research Centre. March 2002.

<sup>31</sup> Kempson and Whyley, 2000.

<sup>32</sup> p11, *Ambition for Britain*, Prosperity for all, Labour’s manifesto 2001.

<sup>33</sup> Only 20.8% of outstanding debt is recovered through the use of domestic bailiffs.

<sup>34</sup> ‘Effective Enforcement – National Standards for

*Enforcement Agents*, April 2002.

<sup>35</sup> Debates continue to focus on the distinction between customers who 'can't pay' and those who 'won't pay' – those taking place as part of the Enforcement Review by the Lord Chancellors' Department is just one example.

Research conducted for Provident Financial by Opinion Leader Research in 2000 *Reputation Audit* has shown that customers argue that "people on low incomes are usually good at managing their budget – they have to be". The research concluded that "We [national opinion leaders] have an image of low income families not repaying and I would question that."

<sup>36</sup> Kempson, *How people on low incomes manage their finances*, p18 ESRC 2001.

<sup>37</sup> *Undue Distress*, Chapter 4, 'abuses of power', NACAB, 2001.

<sup>38</sup> 'Wheelclamping' powers are required in addition to, stop-now! orders and super-complaints.

<sup>39</sup> Provident Financial operate a flexible repayment policy which enables those who cannot make a repayment this week to merely extend their repayment plan.

<sup>40</sup> Ten Minute Rule Bill - committal to prison in default of fines local taxes etc. (abolition) - Andy King MP - 02.07.02

<sup>41</sup> And the Financial Services Authority if they are given jurisdiction over licensed credit lenders.

<sup>42</sup> Fabian Society and New Policy Institute, expressed this view in their 2001 report *Responsibility for All*, and subsequent conference involving Alistair Darling and John Prescott as guest speakers.

<sup>43</sup> Similar recommendations were made by the Office of Fair Trading in the report *Unjust Credit Transactions* in September 1991, and again in January 1999 in the report *Vulnerable Consumers and Financial Services*.

<sup>44</sup> Social Exclusion Unit, January 2001. *A new commitment to neighbourhood renewal*, p89,

<sup>45</sup> With the exception of moneylenders operating in the alternative credit market such as Provident Financial.

<sup>46</sup> The British Bankers' Association, in July 2001 listed 13 banks. This information is published by the FSA in their leaflet *'No bank account?'* August 2001.

<sup>47</sup> 10 of the 13 banks listed in *'No bank account?'*

<sup>48</sup> 7 of the 11 banks offer a free buffer zone, described in the FSA's *'No bank account'* as 'a free temporary overdraft, so you can take money from a machine if there is less than £10 in your account'.

<sup>49</sup> More than 30,000 repossession orders granted in England and Wales against tenants of council and housing association properties in 2001. Repossession orders have more than doubled since 1994.

<sup>50</sup> According to Zacchaeus 2000 Trustee, Ian Wise – Barrister, dealt with 1000+ council tax imprisonment cases and states that the High Court found 997+ cases of imprisonment unlawful.

<sup>51</sup> 2 Several of these points were raised by Baroness Scotland of Asthal in her letter of 2 May 2002 to Reverend Paul Nicolson of Zacchaeus 2000 Trust.

<sup>52</sup> p16, *Privacy and data sharing*, Performance and Innovation Unit, Cabinet Office, April 2002.

<sup>53</sup> The definition used by Baroness Scotland of Asthal in her letter of 2 May 2002 to Rev. Paul Nicolson of Zachaeus 2000 Trust.

<sup>54</sup> Unemployed people are included in the definition of potentially vulnerable people provided in *'National Standards for Effective Enforcement'* in April 2002.

<sup>55</sup> Or other definition of income poverty given priority use by the Government following their consultation, *Measuring Child Poverty*.

<sup>56</sup> This recommendation is made by the DfES Adult Financial Literacy Advisory Group.

<sup>57</sup> This figure is exaggerated by a change in the Social Fund rules which prevented applications for a second Social Fund loan until a major part of the first loan has been paid off.

<sup>58</sup> *'Like it or lump it'* is a report containing draft proposals for discussion by Marilyn Howard for the National Council for One Parent Families, Child Poverty Action Group and Family Welfare Association, published in April 2002.

<sup>59</sup> Liam Byrne (a former advisor to Tony Blair) *Cities of Enterprise Social Market Foundation*.

<sup>60</sup> *Social Enterprise: a strategy for success*. DTI, July 2002.

