



Runnymede Trust Response to HM Treasury *Reforming financial markets* White Paper September 2009

1. Introduction

This is the Runnymede response to the HM Treasury's *Reforming financial markets* consultation paper.¹ In it we reflect on selected questions from Annexes A and B, based on our expertise in BME attitudes and experiences of financial products and services. We have therefore concentrated on the questions relating to consumers and competition. Some responses address more than one question. Where appropriate we also make additional statements and add further comments at the end.

The Runnymede Trust is an independent policy research organisation working to build race equality in the UK. Founded in 1968, Runnymede has established a strong network of relationships with policymakers and community organisations, and has a history of producing and using original research evidence to influence decision-makers and policy debates.

Our current *Financial Inclusion and Ethnicity* research programme involves the collection and analysis of evidence of Black and minority ethnic (BME) experiences of financial products and services in the UK.

Our initial report, *Financial Inclusion and Ethnicity: An Agenda for Research and Policy Action*² explains that BME people are more likely to be at risk of financial exclusion than the white British population, as well as noting the need for further evidence to understand why this is the case. Examples of this exclusion include evidence that all BME groups have fewer bank accounts³ as well as lower levels of financial awareness than the white population.⁴ In terms of the identified need for further research, we are currently pursuing some of the report's recommendations, in particular with respect to whether asset-building measures could enhance financial inclusion and people's choices, and to understand if and why different ethnic groups have varying levels of savings and approaches to financial advice.

Although we recognise the differences and particularities of BME groups, BME groups as a whole experience disadvantage in comparison to the white population in a range of areas, from employment to housing to education. Disadvantage is clearly a significant factor in terms of financial exclusion. This assertion, that members of BME communities suffer financial exclusion due to disadvantage, underpins much of this response, leading us to argue that attempts to protect consumers (particularly low income and vulnerable consumers, many of whom will be BME people) and include new consumers are to be welcomed.

A separate explanation for financial exclusion of BME people relates not to disadvantage but to the specific attitudes, preferences, traditions and practices in various communities, which either act as alternatives to formal financial products and services or are not catered for by the financial services industry.

2. Guiding principle for regulation

In this document we primarily respond to the relevant consultation questions. Before doing so, however, we recommend a key principle for ensuring that regulation responds to the needs of disadvantaged people in the UK, including BME people.

Regulation should ensure that all financial institutions have a statutory duty to demonstrate that they provide their products and services in a fair, non-discriminatory manner.

To ensure the fairness of financial goods and services, we believe that financial institutions must better disclose information relating to their practices. We appreciate that some of this information may be commercially sensitive, but a robust, independent regulatory body can have access to this information without distorting competition or compromising the security of financial institutions.

3. Responses to consultation questions

Annex A: Primary legislation proposals

- 15. What are the advantages and disadvantages of the relevant consumer credit firms contributing to the costs of Money Guidance?**
- 16. The Government believes that some organisations, such as free and impartial debt advice providers, should be exempt from the levy on consumer credit licence holders – do you agree? Are there other cases where an exemption is appropriate?**
- 17. What factors should be considered in designing an appropriate levy scheme for consumer credit firms?**

Runnymede welcomes the piloting of the Money Guidance service and looks forward to the pilot evaluation results with great interest. We agree that there is a need to increase levels of financial capability and to provide free money guidance across society, including in BME communities. We are currently researching BME experiences of money advice services, exploring why people need advice as well as asking where they go or don't go for advice. We expect to publish this research in autumn 2009. The fieldwork for this research partly informs our response here.

The need for the Money Guidance is particularly acute in some BME groups. Firstly, understanding of financial products and services is low for some BME migrants who are unable to speak fluent English and confidently interact with high street banks. This lack of interaction may compound the fact that many products and services may be different from those in people's country of origin. The issue of language is not just about fluency of English. The financial language and jargon used in the world of financial services is difficult for many fluent English speakers to understand, making it even more difficult for those whose first language is not English.

Secondly, as described in our recent report -

“Findings from Ipsos-MORI strongly suggest poorer financial awareness for all BME people... and this was one of the most robust findings of our research. This was one of the widest discrepancies in the data, based on positively identifying different kinds of financial products, and confirms earlier findings reported by Kempson and Whyley.”⁵

Thirdly, although different BME groups may have different advice needs and access different advice sources, there is evidence that all BME groups are more willing than the white population to pay for tailored financial advice.⁶ Coupled with the poorer financial awareness described above, this suggests that many BME people recognise that they need money advice. From our fieldwork we have evidence that people are more likely to trust government-sponsored advice than that provided by financial institutions. The free, impartial Money Guidance service would therefore be invaluable in meeting this demand.

Having affirmed the value of Money Guidance, we agree that free and impartial debt advisors should be exempt from the levy towards the costs of Money Guidance. Debt is a major problem for BME people as well as white people, and may be an increasing problem during the current period of economic fragility. If such a levy were applied it would also reduce the ability of the debt advice sector to cope with demand. The Government is right to focus on issues of regulation of the major financial institutions, particularly during the current recession.

However, here we highlight the issue of developing and strengthening alternative financial providers that have more of a local or community focus. Examples include the proposals for a Post Office Bank, as well as providers that re-invest profits into local communities. The Government is aware of the Community Reinvestment Act in the United States, and should consider further whether and how the provisions of that act could be extended in the UK. More community-oriented providers may become popular over time, particularly as the public questions the social utility of mainstream banks. The Government should anticipate the growth of such providers and consider how they could be supported and regulated.⁷

Many existing consumer credit licence holders do not provide poorer people (including many BME people) with access to credit. Those providers that target poorer people often charge extortionate, unaffordable rates of interest. Debt is therefore strongly linked to lack of access to affordable credit. We mention this to highlight the need to develop appropriate ways of allowing poorer people access to affordable credit. Organisations that do give access to such credit, an example being Fair Finance,⁸ should be exempted from the levy.

To be more specific, we believe that any organisation that offers a majority of credit products to poorer people, that operates on a less profitable basis than mainstream banks, that provides loans under £1,000 and charges 70% or less APR should be exempt from the levy. Whatever its detail, the exemption should cover providers of affordable credit that target poorer people who would otherwise face high-interest loans. Exemption from the levy could also act as an incentive for providers to offer similar criteria. This may result in a larger part of the sector providing affordable credit to many vulnerable and low income people.

Annex B: Areas for discussion

5. What steps could the Government take to increase competitive pressures in the market, to the benefit of consumers?

We welcome the emphasis in *Reforming financial markets* on competition and choice and the role this has in working to the benefit of consumers. New entrants into the retail banking sector and the concomitant increase and diversity of financial products are to be welcomed in the context of the various preferences and specific requirements among different BME people.

We have collected evidence of demand for specific products in BME communities. One example is the preference in parts of the Bangladeshi community (and wider Islamic community) for services that do not allow interest (*riba*) to be charged. The establishment and growth of the Islamic Bank of Britain can be seen as a response to this desire, seen as a BME preference or tradition (although it overlaps with religious preferences). Other institutions, such as Lloyds TSB and HSBC, now offer Sharia-compliant products and services. Increased competition may therefore allow niche products to be introduced and gradually mainstreamed, thereby catering for BME needs.

We recognise the importance of increasing competitive pressures in the retail banking market. However, the Government should also note the welcome development of a variety of non-mainstream organisations offering a range of financial products and services. An example is the rent and home contents insurance products that are being piloted by various Housing Associations.

We welcome the Government's consultation into the social investment market and stated aim to support the growth of this market. Community Development Finance Institutions, as well as providing funds to third sector organisations, can offer some products and services that high street banks can't, such as loans to people who would be refused loans elsewhere. Such initiatives increase competition and may be much more accessible and responsive to the needs of poorer people, including BME people. Indeed, over 40% of Bangladeshi, Black Caribbean and Black African people rent from the social sector.⁹ This is significantly higher than the figure of 19% for the White British population, illustrating how increased competition from providers outside the financial services mainstream, in this case Housing Authorities, may have a valuable role to play in terms of financial inclusion.

6. In addition to the barriers to entry identified by the OFT and the Competition Commission, are there further barriers faced by potential retail-banking providers?

The OFT and Competition Commission have identified the importance of a successful brand, and the loyalty that such brands engender, as a barrier to entry into the retail banking market. Issues of loyalty and trust towards particular banks are particularly acute in BME communities. The Islamic Bank of Britain and the Bank of China are examples of banks that have strong consumer bases in particular BME communities (Bangladeshi and Chinese respectively). These banks cater for specific needs, overcome language barriers and are trusted by people in the relevant communities for reasons of familiarity. Potential new entrants to

the market should consider these issues and see an opportunity for success in the market by catering to the specific needs and preferences of BME people.

9. With the development of new technologies, where might new entrants to the retail banking market come from and how can consumers be encouraged to take advantage of it?

Reforming financial markets rightly identifies mobile phone technology as a technological development that may offer opportunities for new entrants and increase financial inclusion. Such technology could benefit BME consumers in various ways. The opportunity to track finances and make payments remotely may suit people who don't have the opportunity or confidence to deal with banking staff in person. As the technology develops it may become relatively easy to integrate multi-language functions into mobile text communications. Text alerts may help people who can't read written communications in English to keep a track of their finances.

On the other hand, there is evidence that some BME people, particularly older people, save cash in the home rather than (or as well as) in savings accounts. This is done for a variety of reasons, including a lack of confidence in dealing with banks. Such people may find moves towards a cashless system even more challenging and could result in their financial exclusion.

Here it is important to mention the increase in pre-pay card services offered by big retail companies, such as Sainsbury's. Recent chip-and-pin technology means that such services are relatively secure. Though not a retail banking service as such, this development may increase competition in terms of secure ways in which people can pay for goods.

10. Do you support the Government's proposals to embed facilitating market entry into medium-term financial sector policymaking by requiring the FSA and OFT to specifically address the issue in: Cost Benefit Analysis on new regulatory proposals; and the OFT's annual updates to its financial services strategy?

11. Would you support requiring the OFT to consider enforcing the adoption of industry-wide disclosure standards to ensure consumers are well-equipped to make decisions about their financial affairs and to switch suppliers?

Yes, we support all the above proposals due to our belief that market competition is to be increased and embedded in practice, for the benefit of consumers. However, the issue of disclosure extends beyond market competition. We have already argued that financial institutions should have a statutory duty to ensure and disclose the fairness of their products and services. Disclosure is necessary in order to demonstrate that financial institutions do not discriminate in providing their products and services.

12. Would simplified labelling help consumer understanding of financial products? What lessons can be learned from the traffic light system of food labelling and how can these be applied to financial products? Should such labelling be compulsory?

We think that simplified labelling has the potential to improve consumer understanding of financial products. However, language barriers may inhibit understanding for some BME people. Indeed, from our research we know that inability to read English means that some people simply avoid banks and associated products. Multi-language labelling, particularly in branches in areas with large BME populations, should be part of any re-labelling consideration.

We are not sure that the traffic light system of labelling is sufficiently feasible. It is a good idea in principle, allowing a fast and simple guide to products, but light-touch regulation may be inadequate to regulate such a system. It is difficult to imagine a high street bank labelling any of their own products 'red'. Enforcing such a system would require willingness on the part of regulators to intervene and challenge financial providers and would also require additional funding.

We have repeatedly emphasized the importance of protecting consumers, as well as facilitating access for new consumers, and we welcome the Government's efforts to increase financial inclusion. The Government deserves credit for the progress made in the last five years towards the shared goal of halving the number of adults in the UK without access to a bank account. However, financial inclusion involves more than helping people to access products and services. Through accessing financial products and services, people can develop a fuller sense of social inclusion and participation. Alongside the financial benefits we argue that this social inclusion effect should be a real consideration in the ways in which banks are regulated and products and services developed. The wider social role of financial inclusion, which may not necessarily be profitable, is recognized by the Government and there may be a need to highlight this to financial service providers. Otherwise, where efforts to financially include people are not profitable, many people, including those from BME communities, will be left behind and continue to be excluded.

BME groups overall exhibit both lower use, and of a less diverse range, of financial products and services. Encouraging people in these groups to increase take-up will produce more profit for banks as well as further increase financial inclusion.

14. Should price be benchmarked? Should there be disclosure to help people identify products which are relatively expensive?

16. Should the Government extend the concept underlying RU64 to other products – i.e. require firms to demonstrate why a complex or expensive product is better than a simpler or cheaper alternative?

Yes, we think that the above ideas would be beneficial to consumers, particularly those from BME communities who have low levels of financial capability, whose first language is not English and who may not be confident using, or trusting of, British financial providers. Such measures are welcome but may require stricter regulation and a willingness on the part of regulators to directly challenge financial providers.

We recognise that financial regulation is not our area of expertise and appreciate that a pragmatic approach to implementation of such measures will be necessary.

4. Other relevant points

We note that there is some discussion regarding the future of the FSA.¹⁰ Whatever the specifics of the regulatory framework, it should work to deliver financial inclusion for vulnerable consumers, including those in BME communities.

Another question regards whether existing regulation of remittance companies has been effective, an issue of particular relevance for many BME people. The informality of the sector means that costs are often high and there is the danger of funds being lost.

“The most notorious example was First Solution Money Transfer, which owed £1.7 billion to the public, with most of the money headed for the Sylhet region of Bangladesh. Reports have suggested that some savers lost as much as £70,000.”¹¹

We raise this point in order to provoke discussion of whether the major remittance companies in the UK are currently regulated in a way that protects consumers. We appreciate that over-regulating small companies can have negative consequences, and the need for proportionality and feasibility in designing a regulatory framework for this sector.

One of the reasons for overextension of businesses in the UK, given in the consultation paper, is “[o]verdependence on particularly risky product streams, such as buy-to-let mortgages or derivatives.”¹²

We agree with this assessment, but note that risky mortgage derivatives and similar financial products afforded many disadvantaged people the opportunity to own their own home. There is already evidence that the greater risk-aversion of financial institutions has reduced the number of mortgage products, and also the opportunities for poorer people to own property (a widely-shared aspiration in the UK). With deposit rates being as high as 40% in mainstream mortgage products, many disadvantaged and BME people are simply unable to afford home ownership. As this is central to British housing culture and current perspectives on social mobility we ask what options are realistically available for those on low incomes who aspire to own homes.

We also raise this issue because the regulation of financial institutions needs to be linked to wider policy areas, in this case housing. That is, financial regulation has implications beyond the particular products and services that financial institutions provide. For example, it may be necessary to increase the supply of social housing to reduce the reliance on risky mortgages as a means of owning our homes. Given the widespread consequences of the recent financial crash, the relevance of financial reform to other policy areas is perhaps more obvious, and we recommend that financial regulation should now be more explicitly guided by a recognition of these wider effects.

5. Contact details

If you have any questions or comments on this response or our work at Runnymede please contact us using the following details.

Dr Omar Khan

Senior Research & Policy Analyst

o.khan@runnymedetrust.org

Philip Mawhinney

Project Assistant - Financial Inclusion and Ethnicity

p.mawhinney@runnymedetrust.org

The Runnymede Trust

7 Plough Yard

London EC2A 3LP

T: 0207 377 9222

F: 0207 377 6622

www.runnymedetrust.org

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6. References

¹ HM Treasury (2009) *Reforming financial markets*. London: the Stationary Office. Available at: http://www.hm-treasury.gov.uk/reforming_financial_markets.htm

² Khan, Omar (2008) *Financial Inclusion and Ethnicity: An agenda for research and policy action*. London: Runnymede Trust. Available at: <http://www.runnymedetrust.org/uploads/publications/pdfs/FinancialInclusion-2008.pdf>

³ Khan, Omar (2008) *Financial Inclusion and Ethnicity: An agenda for research and policy action*. London: Runnymede Trust, p.25

⁴ Khan, Omar (2008) *Financial Inclusion and Ethnicity: An agenda for research and policy action*. London: Runnymede Trust, p.43

⁵ Khan, Omar (2008) *Financial Inclusion and Ethnicity: An agenda for research and policy action*. London: Runnymede Trust, p.43

⁶ Khan, Omar (2008) *Financial Inclusion and Ethnicity: An agenda for research and policy action*. London: Runnymede Trust, p.41

⁷ For further discussion of community reinvestment, see the Urban Forum's response to this consultation.

⁸ <http://www.fairfinance.org.uk/index.html>

⁹ Khan, Omar (2008) *Financial Inclusion and Ethnicity: An agenda for research and policy action*. London: Runnymede Trust, p.19

¹⁰ Churcher, Joe and James Tapsfield (2009) 'Tory plan to scrap FSA in banking shake-up', *The Independent*, 20th July. Available at: <http://www.independent.co.uk/news/uk/politics/tory-plan-to-scrap-fsa-in-banking-shakeup-1753588.html>

¹¹ Khan, Omar (2008) *Financial Inclusion and Ethnicity: An agenda for research and policy action*. London: Runnymede Trust, p.37

¹² HM Treasury (2009) *Reforming financial markets*. London: the Stationary Office, p.3