Financial inclusion and ethnicity: An agenda for research and policy action

Despite growing research and policy agendas aimed at tackling financial exclusion, there is virtually no research, data collection or analysis on levels and experiences of financial exclusion by ethnicity. This summary therefore reviews current evidence on black and minority ethnic (BME) communities' experiences of disadvantage, and considers how this might affect their access to, and use of, financial services. It suggests a new approach to financial exclusion that might improve their life chances, building personal autonomy, economic well-being and social justice.

BME communities are not homogeneous; different ethnic groups have very differing experiences and expectations in a range of factors, including educational attainment, occupation, risk-taking behaviour and choice of credit supplier. In addition, individuals may make choices and decisions in relation to education and employment that result in increased risk of financial exclusion.

However, there is clear evidence that many BME communities suffer disadvantages in education, employment and housing. These have a direct impact on an individual's ability to access financial services. For instance, some BME communities are more likely to be living in social housing, or in deprived areas, which can affect individuals' ability to access affordable financial services as they are seen as higher-risk customers. This risk assessment is twofold – an individual lack of assets, and the more general effect of postcode analysis of risk.

Conclusion

Policies to tackle financial inclusion among BME communities will be effective only if they accommodate the diverse circumstances and preferences of differing groups. This study suggests that taking a more individual approach, one that focuses on personal well-being, autonomy and social justice, will facilitate new, and more responsive, solutions to financial exclusion.

What's inside

Policy and practice context

Financial inclusion is a relatively new research and policy topic, but in the past few years the Government has adopted a range of policies aimed at tackling it, including basic bank accounts, the Savings Gateway and access to money advice and affordable credit. However, policy is being rapidly developed in this area without gathering and considering evidence on the possible differential impact of the policy on black and minority ethnic (BME) groups.

About the study

This study, carried out by the Runnymede Trust, reviewed available evidence on BME communities' experience of financial exclusion, as well as their behaviour and preferences in relation to financial services. The study comprised a literature review of significant primary and secondary research, together with discussions with prominent academics, policymakers, civil servants, funders and third sector organizations working to promote financial exclusion. In addition, Ipsos-MORI was commissioned to analyse its large existing dataset on financial services.

Disadvantage among BME people

A low income, poor education and insecure employment are all recognized contributors to financial exclusion. Significant numbers of BME communities have a low income – 59 per cent of Bangladeshi and Pakistani groups and 37 per cent of the black population live in low-income households (2004/05), compared to 19 per cent of the white population. Although there is little existing evidence on how inequalities are affecting BME communities' access to financial institutions and services, the study found a number of indicative trends.

Given the complexity of financial markets, education is clearly crucial in becoming financially capable. However, educational attainment figures continue to reveal significant inequalities for some BME groups. In addition, while people from all BME groups now attend higher education institutions in greater proportions than white groups, their results are poorer.

There is arguably even greater evidence of an ethnicity gap in employment than in education. *All* BME groups have employment rates below white groups. Whereas the rate for the total working-age population is 74.6 per cent, for BME communities it is only 60.3 per cent. Bangladeshis and Pakistanis have the lowest rate of employment (45 per cent).

There is strong evidence of disproportionate low-paid work amongst most BME groups. This results in higher rates of in-work poverty, notably among Bangladeshi and Pakistani households. In addition, some groups are more likely to be self-employed, and are over-represented among those self-employed people with low incomes.

Housing tenure may also contribute to the financial exclusion of some BME groups. Fifty-five per cent of Bangladeshis, 47 per cent of Black African and 42 per cent of Black Caribbeans rent social housing, compared to a national average of 19 per cent. Those in social housing are more likely to be financially excluded because such tenure is associated with greater risk and can lower a credit score. There are less likely to be branches of mainstream financial institutions in such areas, reducing access to banking services.

Five areas of financial inclusion

Banking, credit, insurance, savings and financial advice have been identified as the key areas of financial inclusion.

- **Banking** Not having a bank account is the most obvious way that people are financially excluded. Being 'unbanked' makes it more difficult to gain regular and stable employment, and to receive benefits. It can also result in social stigma. The identity requirements for opening a bank account can pose a problem for BME people, as it does for low income groups, because they may not have, or be confident in supplying, the requisite identity documents (e.g. passport, driving license or utility bill). Language – whether lack of English as a first language, or not understanding technical jargon – can also be a barrier. With the advent of Post Office Card Accounts and basic bank accounts there has been progress in reducing ethnic disparities in basic banking services.

- **Credit** Disadvantaged groups have greater difficulty in accessing affordable credit. As with banking, BME groups may face language, identity and cultural barriers. The cost of credit can be higher for poor people because the risks of lending to them are seen to be higher. BME communities are more likely to use informal channels to obtain credit, and they are more willing to take on credit than white British/ Irish communities. BME people's participation in particular areas of the labour market, such as catering and taxis, is also significant, in that the insecure and unstable nature of their income can lead to problems in obtaining credit. There is also evidence of BME-owned firms being less successful in applying for credit.

- **Insurance** Amongst the poorest fifth of households only 50 per cent have home contents insurance, compared with an average of 80 per cent for all households. Yet social housing households are twice as likely to be burgled as those in privately owned properties. These higher risks make purchasing insurance more expensive. As large proportions of BME communities live in deprived areas, there is an indirect impact on them because of their ethnicity. The underlying questions relating to the impact of ethnicity on access to and take-up of insurance are difficult to answer, and relate to much bigger questions in terms of market functioning, statistical credit scoring and incentives. While the data on contents, buildings, life and health insurance reveals significant differences for BME people, there is little evidence about why this is the case.

- **Savings** To the extent that BME households are overrepresented among poorer groups, they will find it more difficult to save and are likely to have fewer assets. Most BME groups are far less likely to save using Premium Bonds and ISAs, and nearly twice as many black and Asian groups have no savings compared with white groups. They also use fewer types of investment. One reason for lower saving rates may be the amount of money sent abroad. The recent Remittances Working Group suggested that 2.7 million people may be sending money abroad, despite many being on low wages. This sector is often informal, which can lead to high costs, fees, and possible loss through bankruptcy. In terms of pensions, BME groups are more likely to be self-employed, and working in less profitable and more risky businesses. Self-employed people are less likely to have an adequate pension. People from BME communities are generally less likely to have a pension.

- **Money advice** The benefits of money advice may not affect all groups equally, but not necessarily due to discrimination. Ipsos-MORI analysis strongly suggested poorer financial awareness across all BME groups. Different BME groups turn to different institutions or individuals to ask for money or debt advice, and have differences in their preferences for particular kinds of products, and this may be further complicated by differing considerations across the generations. To be effective, money advice will need to be tailored accordingly.

Risk, assets and social justice

Many of the reasons that BME and other disadvantaged groups are financially excluded stem from risk evaluations. Postcode risk scoring is being increasingly used across a range of financial products, and to the extent that BME groups are clustered in particular postcodes there is a possibility that postcode risk-scoring may indirectly discriminate against them. A lack of assets can also result in higher risk scores.

Ipsos-MORI analysis found significant differences by ethnicity in terms of risk aversion. BME groups were more willing to take a financial risk than white UK/Ireland groups, but were less financially aware. However, the issue of risk aversion needs further research and analysis.

Whereas social justice requires that every individual's claim is treated fairly and impartially, markets do not always result in just outcomes. Where social inequalities make it uneconomic for markets to treat everyone as equals, disadvantaged groups, including BME individuals, are likely to be worse off.

(Continues on back page)

RESEARCH RECOMMENDATIONS AND POLICY ACTIONS

1 Understanding ethnic disadvantage: Analysis of BME financial/social exclusion should distinguish more clearly the different reasons why BME groups have poorer access. Policy makers and researchers need a more refined understanding of race inequality, in particular to distinguish the different reasons for unequal outcomes for BME groups.

2 Tailored policy: Further research on how to target effectively, including by ethnicity, is needed. Research and policy should try to unpick whether differences derive from preferences, opportunities, discrimination or for other reasons to target effectively to increase financial inclusion.

3 Education: Research is needed into the impact of poorer attainment among BME people on labour market outcomes, and how this may affect financial inclusion. This should also address whether A-level and university outcomes are due to different preferences or other reasons.

4 Labour market: Further quantitative and qualitative research on the kinds of work in which different BME groups engage is necessary to understand the reasons for differential labour market participation.

5 Restaurant, catering and transport industries: Qualitative research is needed on the experience of workers in these areas and their potential vulnerabilities in terms of informal work. This would address why Pakistani, Bangladeshi and Chinese people are more likely to work in the restaurant, catering and transport industries.

6 Housing: Further research is needed on the relationship between housing – from tenure to postcode to homelessness – and financial exclusion, particularly for BME groups.

7 Banking (closures and cash machines): Evidence is needed on whether bank closures and fee-charging cash machines are more likely in areas with higher proportions of BME residents. Given the Government commitment to installing 543 non-charging cash machines, some of these should be targeted at areas with large BME populations.

8 Banking (basic bank accounts/Post Office Card Accounts): Research is needed to confirm differential take-up, to understand why this occurs, and how policy should respond.

9 Credit (microfinance): Research should consider whether microfinance responds to the needs of affordable credit in the UK, particularly as it initially addressed business loans (and not consumption loans). Important questions include the profitability of such loans and what sort of APR microfinance would need to charge to cover non-business loans.

10 Credit (evidence of discrimination): As evidence has been found of discrimination in BME small and medium enterprises' access to credit, other areas such as sub-prime loans, mortgage rejections and repossessions should be analysed by ethnicity.

11 Credit (loan sharks, ethnicity and the Social Fund): Further research should be undertaken on whether and why BME people use loan sharks. In policy terms, the Social Fund should be extended to include those not on benefits, including economically inactive women.

12 Insurance: Further research is needed to understand why BME people are less likely to take up a variety of insurance products. Research could also investigate how government intervention in insurance would affect premiums, and whether there is a case for low-cost, low payout insurance.

13 Savings: Qualitative research is needed to explore why BME groups have fewer savings. In particular, it is important to understand why BME people are less likely to take up schemes such as premium bonds and ISAs. The Saving Gateway Bill should publicize its race equality impact assessment, and ensure close monitoring of take-up when the policy is rolled out.

14 Savings (pensions): Research should be conducted into the impact of pensions policy on the self-employed, particularly the poorer self-employed. Similar research is necessary to determine whether pension uptake among groups that have historically worked in the public sector – including Black Caribbeans – will be adversely affected as their labour market experience diversifies. Although stakeholder pensions are relatively new, research needs to explore whether people are responding to incentives differently.

15 Advice: A mapping project is needed to determine the institutions – formal and informal – that BME individuals currently access in terms of money guidance. Research will need to determine why different people use these services differently, or respond to the advice differently. The findings should feed into and build on the Thoresen Review, which reported on 3 March 2008.

16 Risk (how institutions risk-score): The code of acceptable statistical scoring requires proper political debate. Government should work with financial institutions to ensure that characteristics are not directly discriminatory, and may need to consider whether some practices result in unlawful indirect discrimination. The UK needs a balanced understanding of statistical scoring's benefits and pitfalls.

17 Risk (how individuals assess and behave): Further research should be done to confirm findings on differential risk-aversion by ethnicity, and also on whether and how different groups respond to risk differently. Given the robust findings in the field of behavioural economics, there are important models for this research.

18 Risk (refining our understanding of behaviour): More refined data are necessary to determine whether and why BME groups are more or less likely to be willing to take various kinds of financial risks.

19 Assets (home ownership and ethnicity): More data is needed on the distribution of assets among BME people. A full assessment of the value of property by different ethnic groups would indicate the real assets held by different ethnic groups.

20 Assets (understanding the consequences of Right to Buy): Robust empirical research is needed into the impact of Right to Buy on social housing stock, including its uptake by ethnicity. This would throw light on the relationship between housing and ethnicity, and potentially could feed into policies to reduce community tensions, and enhance community cohesion.

21 Assets (a balanced welfare policy): While home ownership is important, the Government needs to focus on other asset-building policies. This may require further policy on the rental housing market or more inventive policies on 'shared' equity, all of which require further research. One possible solution is the development of particular sorts of bonds or funds, which may start at lower levels. The UK needs a balanced asset-based welfare policy, focusing on both income and assets; cash savings are not the only type of asset.

22 Social justice (markets, inequality and fairness): Financial inclusion should be more explicitly linked to social justice, through such concepts as economic well-being, personal autonomy and citizen participation, a link already suggested in some parts of government policy, especially the National Curriculum and (partly) in the Child Trust Fund.

23 Social justice (risk-pooling, non-discrimination and cohesion): Further research is needed into the extent to which justifiable financial procedures can undermine other important social and political goals, namely non-discrimination and social cohesion. Policy makers may need to decide how to strike a balance between the benefits of risk-pooling and the importance of cohesion.

24 Social justice (personal autonomy and differential preferences): In designing financial inclusion policy (especially on assets and savings), we should consider personal autonomy and well-being as well as market constraints. This suggests that financial inclusion needs a broader social justice perspective.

Conclusion

If financial exclusion is to be tackled only by existing market mechanisms and services, this may well disadvantage those BME groups whose behaviour and preferences do not accord with current provision. In addition, there is no clear argument for why financial institutions should find solutions to the financial barriers facing a particular group of citizens.

Instead, a new approach to tackling financial exclusion is needed, one that builds personal autonomy and economic well-being, and thereby enhances social justice. The Child Trust Fund scheme provides good insight into this shift in emphasis, as it aims to provide 18-year-olds with some financial capacity that will hopefully increase their life chances. In this sense the policy contributes to personal autonomy. Other asset-building schemes are one example of possible future policy response to financial exclusion.

Building personal financial knowledge, well-being and autonomy will enable financial inclusion policies to take into account the particular views and needs of BME communities. It may prove impossible to include all citizens in every existing financial institution and service, but building their capacity to access the services they need will strengthen their life chances in the long term.

Further information
This summary is available in print and pdf from Friends Provident Foundation (foundation.enquiries@friendsprovident.co.uk and www.friendsprovidentfoundation.org). The full report, *Financial Inclusion and Ethnicity: An Agenda for Research and Policy Action* by Omar Khan, is available as a pdf from the Runnymede Trust at www.runnymedetrust.org/uploads/publications/pdfs/FinancialInclusion-2008.pdf.

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