LLOYDS BANKING GROUP

WRITTEN SUBMISSION TO THE FINANCIAL INCLUSION COMMISSION

5 December 2014

1. INTRODUCTION

Firstly, we welcome both the establishment of the Commission, and our opportunity to give oral evidence on the 24th November, 2014. We were represented at the Commission hearing by Ms Sara Weller acting in the capacity both as a Lloyds Banking Group Non-Executive Director and also, as a Non- Executive Director of the Department for Communities and Local Government.

Lloyds Banking Group would like to reinforce our offer of any support to the Commission, in creating a sensible road map for the way forward. The overall observation is that all sectors must be in this together, and we need to work in partnership, to make a sustainable difference for customers who are at risk of financial exclusion.

2. OUR COMMITMENT TO FINANCIAL INCLUSION

At Lloyds Banking Group we are building a simple, efficient, UK-focused retail and commercial bank. Our goal is to become the '*Best Bank for Customers'* by offering a wide range of simple relevant products in all of our brands, such as Halifax, Lloyds Bank, Bank of Scotland and Scottish Widows. We serve all customers, not just those customers enjoying relative prosperity, but also those facing financial difficulties, coping with disabilities, striving to buy their first home, setting up a business or finding their first job. To be the 'best' we are committed to helping all of our customers, and by doing so hope to re-build trust in our brands, and the financial services sector as a whole.

During 2014, we launched our '*Helping Britain Prosper Plan'*, to help address some of the big issues facing Britain today. One of our seven key commitments is to "take a lead in financial inclusion to enable all individuals to access, and benefit from, the products and services they need to make the most of their money". Specifically, we pledged to support Credit Unions by giving them additional funding of £4m (£1m every year from 2014 to 2017), having a 1 in 4 share of basic bank accounts, and delivering financial education to community support workers, so they can support financial capability on the front line in their communities. These commitments build on our support of the existing industry agreed minimum standards for basic bank accounts.

To shape our thinking and financial inclusion priorities, we commissioned independent research which fed back early in 2014. The research told us many customers at risk of financial exclusion were on lower incomes and paying a 'poverty premium', mainly due to the extra costs of cashing cheques and paying bills, where they do not have a functioning bank account. This is exacerbated by a lack of confidence in using direct debits and access to affordable credit. Feedback also centred on our large share of basic bank accounts (currently 28% compared to 25% of the PCA market), and how we could improve our support for these customers, which should be a priority, before thinking about additional services we could offer.

As a result of the research, we developed a group-wide financial inclusion strategy focused on using our scale to the advantage – rather than detriment - of customers. We are delighted that Lloyds Banking Group has already started improving services for our basic bank account customers, and will complete the first phase of our plan during the first half of next year. Phase One or our 'getting the basics right' transformation includes:

- The establishment of a dedicated financial inclusion team to lead the delivery and shaping of our strategy, seconding in a colleague from respected charity Toynbee Hall, so we can stay close to the challenges for customers at risk of financial exclusion.

- From July 2014, all our basic bank account customers were able to access any of the 45,000 free LINK ATM machines, and basic bank accounts can be opened online.

- In Q1 next year, we will open basic bank accounts in branch, so these customers will benefit from the same great service we give all our customers, and in Halifax, we are opening up the use of the counter and access to colleagues in branches.

- From Q2 next year and annually thereafter, all colleagues within the Group will have financial inclusion training, as part of broader training on how we treat customers.

- Finally, recognising we are not able to help all customers with requests for funding, for example loans under a £1000, we have started to signpost customers to Credit Unions or support services, for example Money Advice Service or Citizens Advice Bureau. We will roll this out to all our branches in Q1. We will also be developing local relationships with a number of key Credit Unions across the country, and supporting their growth activities with skilled volunteers.

We haven't stopped there: Phase 2 of our strategy is evolving, by using the experience of our trusted external stakeholders. The emerging themes from an External Stakeholder Advisory Session we held in September 2014 include:

- supporting customers on a 'pathway to greater participation in mainstream financial services',
- a focus on mobile technologies to enhance multi channel access,
- improving our needs-led product design, for example supporting customers in creating a savings habit and building up a rainy day savings fund,
- ensuring financial exclusion remains a cross-industry action with strong partnerships and signposting capacity.

In summary, Lloyds Banking Group is committed to becoming the '*Best Bank for Customers'*, and helping all of our customers have access to the products and services they need to make the most of their money. We support the aims of the Financial Inclusion Commission, and welcome the opportunity to play a role and work in partnership, to make a sustainable difference for customers who are in, or at risk of, financial exclusion.

3. SUMMARY OF KEY RECOMMENDATIONS

Lloyds Banking Group through the '*Helping Britain Prosper Plan'* and wider Financial Inclusion Strategy believe the following recommendations are key outputs to embed within the Commission's future work. (We have expanded on these points within section 4):

- To have a financially inclusive society, all sectors must be in this together, and we need to work in partnership, to make a sustainable difference for customers who are in or at risk of financial exclusion. There is a collective obligation for all parties to play a role and be part of the solution.
- Multi-channel strategies and the importance of digital and mobiles are key to financial inclusion, for example, post offices providing access to transactional banking and Skype connecting customers to expert colleagues.
- The link between digital and financial inclusion is clear, so there is a need to support the entire country on digital inclusion.
- Importance of financial capability, and how financial education should be provided from an early age in schools, and financial awareness increased for everyone. The UK welfare reform changes are a great opportunity to drive significant change to the delivery – and accessibility - of financial capability.
- Financial inclusion is dynamic and can impact everyone, for example, people at risk of financial shocks (interest rate rises), and customers in financial difficulties.
- Product and service proposition needs to be simple and driven by customer needs. Customers should also be supported on their 'pathway to participation', so they can access the right products and services to make the most of their money, for example text alerts, T&Cs and alternative to direct debits.
- Government to incentivise rainy day savings to support consumers to develop a savings habit and have an emergency fund in case of income shocks or life events.
- Minimum standards on basic bank accounts, aligned to the European Parliament Payment Account Directive, and which all the financial services industry signs up to.

4. FINANCIAL INCLUSION COMMISSION QUESTIONS:

1) How has the financial downturn changed the nature of financial exclusion?

Financial exclusion is by its nature dynamic, and with the financial downturn more consumers are at risk of financial exclusion as a result of limited (if any) pay increases and increased cost of living, as well as the ability to recover from financial shocks and prepare for life events.

In addition, the financial downturn has meant that the government and local councils have made significant reductions in budgets which have implications on customers at risk of financial exclusion, many of whom are on lower incomes. Budget cuts have meant that the emergency fund has been withdrawn, and this provided a lifeline for many customers who were experiencing delays in their benefits or had experienced life events that put pressure on finances. Restricted budgets are also impacting benefit support services and for some consumers this is impacting on the lead time to receiving revised or new benefits.

The requirement for companies to be more efficient – and customer demand – is leading a technology revolution which has implications for customers that are not digitally savvy, many of whom will be at risk of being financially excluded or will be paying a poverty premium.

Our financial culture in the UK relies on credit and many consumers have debt, however the squeeze on household budgets has meant an increase in problem debt, with more consumers at risk of having debt problems if they have a financial shock or life event.

The downturn has also ensured the (relative) decline in savings and the saving habit in recent years has continued with consumers either needing every penny as disposable income or choosing to pay down debt where able.

2) What do you see as your organisation's role in financial inclusion?

At Lloyds Banking Group we are building a simple, efficient, UK-focused retail and commercial bank. Our goal is to become the '*Best Bank for Customers'* for <u>all</u> customers not just those enjoying relative prosperity, but also those facing financial difficulties.

We want to take a lead in financial inclusion to enable all individuals to access, and benefit from, the products and services they need to make the most of their money.

Working in partnership with the sector, including the Financial Inclusion Commission, to achieve sustainable change for customers in, or at risk of financial difficulty.

3) What are your road blocks?

Announcements on minimum standards on basic bank accounts. Focus should be on legislation to transition to the European Parliament Payment Account Directive, with the outcome of the CMA review driving any additional changes.

As we are in a competitive marketplace, creating compelling business cases to support delivering new or innovative changes, that would benefit customers on lower incomes at risk of financial exclusion can be challenging.

Changing culture within the organisation. Reward changes from next year, are fundamental to doing the right thing for basic bank account customers and training will recognise that colleagues may have an unconscious bias towards customers on benefits, or who don't understand the banking language.

4) What practical steps can be taken to promote financial inclusion?

Sector working in partnership together to create more awareness and understanding about financial services, and signposting consumers to services and information, if needed.

Minimum standards on basic bank accounts to create parity for consumers and across the industry.

Government to incentivise rainy day savings to support consumers to develop a savings habit and have an emergency fund in case of income shocks or life events.

Financial capability:

- Financial education should be provided from an early age in schools, and incorporated consistently into the curriculum (for example academies can opt out, and universities are not included).
- Financial awareness and information to be increased for everyone. The UK welfare reform changes are a great opportunity to drive significant change to the delivery – and accessibility - of financial capability, but more will be required.

Holistic support when customers are having financial difficulties or through life events, and another opportunity to increase financial capability.

Consistent industry approach agreed with the regulator on T&Cs, so products and services are simple to understand and compare for consumers.

Digitisation is an opportunity to connect customers to services and information, that would not have been accessible before.

5) What policy change would most support increased financial inclusion?

Minimum standard for basic bank accounts, aligned to the European Parliament Payment Account Directive. Key elements to include:

- Fair share of basic bank accounts, and market share independently measured,
- Eligibility for basic bank account should complement no fees,
- UK citizens who do not qualify for a full facility account are eligible for a basic bank account,
- One basic account allowed unless in financial difficulties, and needed to open a new safe account up. Switching should apply.

Savings incentives to act as a carrot to encourage consumers to have an emergency fund and empower them to develop a savings habit.

6) What impact, positive or negative, does the increasingly digital delivery of financial services (e.g. prepaid cards, online banking) have on financial inclusion?

Need for current products to be reviewed as many developed for a face to face environment, additionally prompts to support customer awareness and understanding.

(Ease of) accessibility of credit is both an opportunity and a threat.

Opportunity to keep customers up to date with their finances and prompt them with other services or information depending on customer behaviour.

Giving customers options on how they want to do business with their bank is increasingly important, to give consumers choice. Where digital or mobile is an option, it is vital that the customer has options and is supported to make an informed choice, for example, an overdraft may not be the best form of credit for the consumer even though they've asked for a loan.

Digital exclusion is a contributing factor to financial exclusion and the lack of digital accessibility (to broadband) or capability can impact the consumer's ability to make the most of their money.

7) What opportunities are there to use technology to facilitate financial inclusion?

Automatically offering a basic bank account, if customer fails the credit score for a full facility account.

Budgeting tools and prompts/links to money management information.

Prompts on money coming out/in or set minimum account balance reached (text alerts etc), with options for the customer to easily defer (or stop) payments.

Know customers and understand their usual spending patterns to pick out when they are deviating from the norm, and may need more help or information.

Develop products and services for a digital (mobile) world.

Support awareness and understanding of what services available and how they can support consumers manage their money – or make informed choices.

Transactional banking services

8) What transactional services do households on low or unpredictable incomes, or who have experienced a life shock, need and want?

Primarily a functioning payment account that gives them visibility and a sense of control. This might include access to a card that gives them access to their money (via a universal free ATM network) and can be used to pay for goods or services online. Access to services that support reducing the impact of the poverty premium are also beneficial, for example direct debits, recognising that direct debits may not be right for all consumers.

"Rainy day" savings are also vital for consumers on lower incomes - to protect them from financial shocks, support reducing the impact of the poverty premium and potentially make up for the lack of insurance cover - so developing a savings habit is essential.

9) What improvements are needed to make basic banking fit for purpose?

Minimum standard for basic bank accounts, aligned to the European Parliament Payment Account Directive. Key elements include:

- Everyone would have their fair share of basic bank accounts, and market share would be independently measured;
- Eligibility for basic bank account should complement no fees,
- UK citizens who do not qualify for a full facility account would be eligible for a basic bank account;

- One basic account allowed unless in financial difficulties, and needed to open a new safe account up. Switching should apply

No returned item fees/interest rate charges would go a long way to giving customers the confidence to use direct debits, however there are still some customers on irregular income or who want more control over their money, and for whom direct debits do not work.

The Financial Services industry should work in partnership with Direct Debit originators such as utilities and mobile phone companies to increase flexibility in the offering, for example, by giving customers the opportunity to send money easily to suppliers via mobile (like PayM) and give notice/control via text to pay, defer or cancel the direct debit.

10) Can technology help deliver better transactional banking?

Technology can help people be more in control of their money and have products and services to support managing their money and give them options for example products, services and info designed for mobiles, text alerts.

Technology could help with the evolution of the Direct Debit proposition in conjunction with Direct Debit originators.

Affordable and fair credit

11) Is there scope to bring people into mainstream credit that are currently excluded?

Depending on why people are currently excluded, there are a range of options:

- ensuring people have a personal account in order to build up an account and credit history, even if a joint account or a partner's account is the primary household account,

- support for people to understand their credit score and then be able to improve it ,

- expansion of credit decisioning data to potentially include rental data and value accounts that have been run without the need for credit.

There may also be a need for education around mainstream credit. There is perhaps a self-fulfilling prophecy amongst lower income consumers who feel that "banks would turn me down anyway" when this may not be the case. There is also a potential fear amongst these customers that it would count against them in future, if they were turned down for credit at this time.

12) For people who are unlikely to qualify for mainstream credit, what might affordable alternatives be? Should banks, building societies and others play a role in provision?

Credit Unions are an alternative to mainstream sources of credit, as are regulated pay day loans.

Government has a key role through the Credit Union expansion programme in supporting Credit Unions to be more sustainable, and there is also the option for banks, building societies etc to also support.

13) How does credit scoring contribute to financial exclusion, and are there viable alternatives to traditional credit scoring?

For consumers who do not use credit, have relied on their partners account or are in rented accommodation, there may be limited information held about them to contribute to a positive credit decision.

Credit scoring data could be expanded to include broader data to support making a credit decision, for example rental data. Alternatively, value could be given to running an account and not using credit.

14) What reforms could be considered to ensure consumers getting into financial difficulties are protected including those who become insolvent?

Debt management fees are now spread across the first 6 months of a plan where the customer is with a commercial organisation. They must also be signposted to free options.

Reconsider the appropriateness of the existing model that allows some commercial companies to withhold payment to creditors, distributing only token payments, in the hope of obtaining a partial settlement at a later date. (A few companies offering this model have now been closed down with the company having held on to significant funds which were not distributed to creditors.)

Consider how best to strengthen existing regulations to ensure that customers seeking a debt solution can be assured that they will be offered the same solution regardless of which provider they choose to go to. If the provider does not offer all solutions, they should refer the customer on to another provider who may be able to offer a more appropriate solution. (Some providers have historically only offered the solutions they have available and that are more commercially viable, and not a 'best fit' for the customer - i.e. if customer resides in Scotland, they should be considered and signposted for a Debt Arrangement Scheme or a Trust Deed, even if the provider they first approach does not offer this solution.)

Consider the appropriateness of debt management providers 'cross selling' products to customers on a debt management plan - if there is a cost to the customer - are they adding benefit and value? (i.e. some providers offered managed bank accounts with a monthly fee ~£10-15 p.m.). This is probably on the FCA's radar, but potentially an area that has been closely looked at before.

Comparison search engine for the industry, enabling the consumer to easily compare services/costs.

Insurance

15) What role should the state and the insurance sector play in providing a financial safety net in the event of an unexpected life event? e.g. bereavement, family breakdown, unemployment and illness?

The Insurance sector should have accessible and affordable products for lower income customers, allowing for the fact that there is still a commercial balance to be met.

Insurance is arguably a choice, albeit not one that many lower income customers may make when there are more immediate requirements. It may also be competing with a need to increase savings. The State could be a supporter of last resort.

There may be a lack of awareness and understanding of the value (as opposed to the cost) of insurance.

16) Is the insurance market functioning appropriately and competitively?

This is a complex issue – and whether you are looking at how the market operates (increasingly through price comparison websites, which have been the focus of a negative thematic review by the FCA) or product development (and in particular whether a number of products are appropriately designed for all socio-economic groups).

It also depends whether we want to talk about the (financial) hierarchy of needs and how we support consumers in their basic financial requirements (typically basic bank account, home insurance and retirement saving) before developing a wider package of products – savings, protection, etc.

Financial education is key and helping consumers understand what they need at various life points.

17) How can we ensure that people on low incomes, especially private tenants, have access to appropriate and attractive insurance products for their possessions and property?

As a Group we have a commitment to providing clear, simple, transparent and competitive products. These are distributed through our branches and on-line.

18) Will pension reforms enable inclusion, and what further improvements could be made?

Auto-enrolment will significantly increase the take up on saving for retirement in the UK and is something we welcome.

In terms of the new pension freedoms: our research shows that one barrier to saving is the desire for flexibility and early access. These reforms remove these barriers and will, we hope, encourage greater levels of savings.

There is potential for the reforms to increase financial exclusion in certain areas – for example retirees who take and spend their 'pot' early and are at greater risk as they grow older with an insufficient income.

Savings Products

19) Should policymakers enable and encourage people on low incomes to save, particularly in the economic downturn?

Having rainy day savings is essential for everyone, to build up a 'safety net' if an emergency occurs, and to protect against income shocks and life events.

We have had the recent introduction of auto-enrolment. There are a number of ways in which this can be improved – for example basing automatic enrolment contributions on full salary rather than 'band earnings' can have a significant impact, particularly for those on lower salaries, which assuming the full 8% contribution rate earning £10,000, would see £800 a year going into a pension rather than around £320.

We have also found a risk aversion amongst the UK population that compounds the short-term attitudes discussed. While we don't save enough in the first place, the money we do save isn't working as hard as it could be for us because we're worried about losing it, so we focus on security over return potential. For example, almost half of us have a cash ISA, but only 13% have a stocks and shares ISA.

Government should incentivise savings (carrot approach) to build up an emergency fund, and support consumers developing a savings habit. The habit of saving is a vital one and even a small amount saved now could support greater amounts being saved when consumers become more able to.

20) To what extent can savings act as a preventative measure, helping people to avoid debt?

The Scottish Widows Savings Report highlights the importance that savings can have in protecting consumers from specific individual circumstances. Our research shows that:

- 15% don't know how much savings they have,
- 19% of people have no savings,
- 55% have between £1 and £50,000 in savings,
- 12% have over £50,000 in savings.

However, a wider challenge is that when it comes to savings many people don't have a real understanding of how savings habits translate into tangible benefits later on.

Ultimately an amount saved can increase a consumer's feeling of empowerment, as they are able to manage small financial shocks without reverting to emergency, and potentially high cost, credit.

21) What incentives to save work best for people on low incomes, and how might the costs of these incentives be met?

We need to learn the lessons from Auto-enrolment and nudge economics. Once Auto-enrolment is fully embedded, we should consider whether we can extend this to workplace ISAs.

Some in the Credit Union and CDFI sectors have built up ideas and innovation in this area.

22) What practical steps could be taken to foster a savings culture in the UK?

Education is key – ensuring that people understand the potential personal benefits of saving for their own future and ensuring they can make a rational choice to save. We also need to consider when to help people save. Each stage in life seems to have interesting implications for our savings habits, not least when it comes to responsibility for our financial welfare. The fact that only around half of us believe individuals should take responsibility for saving more is a concern, particularly as this figure has dropped from 61% in 12 months. But only 40% of 18-24 year olds agree with this opinion, compared with 63% of the over 50s.

Expectation that a savings plan is set up as the same time as credit is taken out, and the affordability includes both, so that whilst credit is being paid off savings are being built up. Credit unions and CDFIs have some experience of this concept.

Incentivising of savings plans by the Government or through mainstream banks and building societies – in terminology that's relevant to the consumer (e.g. fixed "reward" amounts rather than AERs

Employers to encourage savings plans through active information and by creating the option to save money from source and not be taxed (if government supports).

Welfare Reform

23) What is the impact of welfare reform on financial inclusion and what support should be available to people as a result?

Any organisation that requires payment or charges a fee (e.g. Council tax, HMRC, utilities, retailers, subscriptions etc) needs to understand the potential impacts of the move to Universal credit on the disposable income of those transitioning to the new benefit and have strategies in place to support these customers, particularly during the period of transfer from old to new.

With Welfare reform encouraging people to move into work the number of self-employed has increased by 573,000 since the recession of 2008-09 - a rise of 15%.

The financial services industry has a role to play in supporting the self employed both to help them develop their businesses and to prevent any business debt being loaded onto any personal debt, so increasing the overall debt burden of the individual.

END.