

**UNDERSTANDING AND COMBATING FINANCIAL  
EXCLUSION AND OVERINDEBTEDNESS IN IRELAND:  
A EUROPEAN PERSPECTIVE**

**What could Ireland learn from Belgium, France  
and the United Kingdom?**

**GEORGES GLOUKOVIEZOFF**

In association with



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Studies in Public Policy: 26



in association with



2011

First published 2011  
by The Policy Institute  
Trinity College, Dublin 2, Ireland  
[www.tcd.ie/policy-institute/](http://www.tcd.ie/policy-institute/)

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A catalogue record is available for this book from  
the British Library

ISBN: 978-1-902585-52-9

Cover design by Ed Miliano, Dublin  
Origination by TypeIT, Dublin  
Print Management: Custodian Consultancy

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# Paper Outline

Unlike the UK, France and Belgium, Ireland has not developed a framework to promote financial inclusion. The aim of this report is to review the research and assess the effectiveness of the different strategies and policies that have been introduced to the UK, France and Belgium, in order to inform future Irish policy on financial inclusion.

## **I. A revised definition of the process of financial exclusion**

This report provides a revised definition of the process of financial exclusion:

*The process of financial exclusion is the process whereby people face such financial difficulties of access or use that they cannot lead a normal life in the society to which they belong*

Such a definition has at least two essential consequences regarding the development of an effective strategy to promote financial inclusion.

First, it links access and use difficulties. Access difficulties result directly or indirectly from use difficulties. Therefore, targeting one type of difficulty may have consequences for the other. It implies that an effective strategy needs to consider the process of financial exclusion as a whole.

Second, linking access and use difficulties with their consequences implies addressing both the causes of these difficulties and the negative consequences. The explanation lies in the intensification of financialisation led by market logic. This phenomenon impacts on both citizens and financial service providers. The widespread use of financial services has resulted in new rules and norms without which it is impossible to lead a normal life. At the same time, the market logic favoured by neo-liberalism since the 1980s has impacted on wages, social benefits and public services, making consumer credit often the only response available to deal with unexpected expenses or to make ends meet.

Even though financialisation is common in the four countries

studied in this research, its nature is not exactly the same in each. For example, Ireland and the United Kingdom give a more important role to consumer credit than do France and Belgium. On the other hand, in France and Belgium it is necessary to have a bank account to receive wages and social benefits, while this is not required in Ireland and the United Kingdom.

This dependency of citizens on financial services is made problematic by the profitability constraint on providers. As a result of the market logic that informs the intensification of financialisation, financial service providers define norms and rules of access and of use that are inappropriate for a cohort of the population. Given that every relationship has to be profitable, personalised products and advice are considered too costly to be provided to the poorest customers.

The process of financial exclusion is a result of the intensification of financialisation led by a market logic that has made financial services socially unavoidable for all citizens even though these are provided by commercial institutions that only target profitable customers.

The definition of the process of financial exclusion adopted in this report emphasises that in order to promote financial inclusion it is necessary:

- to limit the influence of market logic in relation to the intensification of financialisation;
- to ensure the appropriateness of services provided.

Tackling financial exclusion is simultaneously a political and a technical issue.

## **II. A political regulatory framework**

As a political issue, reducing the influence of financialisation led by market logic can be achieved in two ways. The first is to promote appropriate alternatives so that people are less dependent on financial services providers. The second is to reduce the influence of market logic on financial services providers.

First, it is possible to limit the consequences of market logic by giving households access to alternatives to financial services, especially to consumer credit. The provision of these alternatives involves questioning the level of wages, the characteristics of social

welfare benefits and the quality of public services. Even though these are different issues from financial inclusion, they are important elements in the promotion of responsible credit.

The second way involves limiting the influence of market logic over commercial institutions like financial services providers. Such a goal requires selecting a way that would have a stronger influence, an example being the development of corporate social responsibility (CSR) which is at the heart of the British strategy. The United Kingdom, France and Belgium tried to tackle financial exclusion through self-regulation. These choices, made at a time of strong belief in free market effectiveness, have systematically failed despite marginal improvements.<sup>1</sup> In France and Belgium self-regulation has been replaced by regulation, while there are numerous calls for a similar development in the United Kingdom.<sup>2</sup> However, not every regulation is effective, as the failure of the French “Right to an account” has shown.

An analysis of the various international examples of regulation indicates that three key elements are required for effective regulation:

- The definition of precise targets on financial inclusion based on a range of indicators
  - Targets regarding basic banking services and credit should be related to both dimensions of financial inclusion: access and use. Therefore indicators will need to be quantitative and qualitative.
- The carrying out of independent assessments of the policies implemented and the results obtained regarding the targets adopted
- The implementation of incentives and sanctions in a way that ensures the involvement of all stakeholders
  - This could involve the implementation of different mechanisms such as the creation of a financial inclusion fund which could be used to cover part or all of the costs of dedicated services, e.g. MABS, which contribute to financial inclusion.

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<sup>1</sup> These improvements were mainly obtained when financial providers were threatened by the implementation of a potentially more coercive regulation.

<sup>2</sup> See Devlin (2005) and Mullineux (2009) as well as the *Financial Inclusion Manifesto* of the Financial Inclusion Centre:  
[http://inclusioncentre.org.uk/doc/financial\\_inclusion\\_manifesto\\_summary.pdf](http://inclusioncentre.org.uk/doc/financial_inclusion_manifesto_summary.pdf)

A regulatory framework based on transparency and accountability could limit the influence of market logic without suppressing its positive elements. While financial inclusion goals are usually defined by governments, the more technical aspects in relation to the implementation is the responsibility of all stakeholders, including financial services providers. A financial inclusion taskforce (or the existing Steering Committee on Financial Inclusion) could be a useful body to promote and monitor a financial inclusion strategy.

Based on the assessment of what has been done in the United Kingdom, France and Belgium, it is possible to outline some guidelines regarding the promotion of access to appropriate basic banking services and responsible credit.

### **III. An Irish strategy to promote access to appropriate basic banking services**

In order to improve access to basic banking services it could be made compulsory to receive social benefits and wages through a bank account. However, as the British, French and Belgian examples show, this promotes financial inclusion only if appropriate basic banking services are available. A possible Irish basic banking service could be a mix of the approaches implemented in the United Kingdom, France and Belgium. This is because the Irish banking sector shares common points with these three countries.

The Irish basic banking service could be characterised as follow (very close to the recommendation of Corr (2006, p.172)):

- a current account;
- flexible account opening requirements around identification;
- no exclusion, with possible exception of a history of fraud;
- no minimum or monthly balance;
- a monthly account statement;
- possibility to lodge cheques and to make deposits in cash;
- direct debit and standing order facilities;
- a €20 buffer zone;
- no overdraft facility;
- a debit card with real-time authorisation without stamp duty;
- weekly bill payment account;

- financial advice and information (when banking difficulties occur, contact with a MABS advisor should be facilitated).

The basic banking service should be provided at no cost and the charges that occur when customers break a term of their contract (unauthorised overdraft, failed standing order, bounced cheque, etc.) should be capped. If possible a minimum amount should be protected from seizure in the account.

The basic banking service should be provided by every financial service provider. Therefore customers could apply for it in a bank branch of their choice. It would be pertinent to include credit unions and building societies as potential providers, although they would need to be part of the clearing system. The An Post network could be used by other providers when customers would prefer to have access through the post office or when there is no bank branch in a locality.

In order to finance the basic banking service, a compensatory fund supported by banks and the state, as a Service of General Economic Interest, should be set up. Such a fund would promote solidarity within the industry. It would ensure that providers welcoming a bigger market share of the target group would be compensated for their extra costs. Conversely, those not contributing to the improved access of this target group would be penalised.

The basic banking service should be implemented through law, since codes of practice are ineffective. Its legal definition would prevent a heterogeneous provision of services among providers. In order to be effective, such a law should be preceded by a large consultation of key stakeholders. This consultation would identify a group to oversee the implementation of the law – possibly the Steering Group on Financial Inclusion. It is very important to involve different government departments (e.g. Department of Finance, Department of Social Protection, etc.) as such an issue is clearly cross-cutting.

It should also be based on two principles:

- scientific evaluation of quantitative and qualitative results in terms of access to and use of the basic banking service;
- incentives and sanctions based on the scientific evaluation in order to ensure that the law is effective.

#### **IV. An Irish strategy to promote responsible credit**

In order to define an effective strategy to promote responsible credit, Ireland has to address its weaknesses by building on its strengths. Such a strategy should ensure as wide as possible access to consumer credit, while at the same time ensuring that the access is appropriate and the negative consequences of repayment difficulties do not result in people falling into poverty. It is a difficult exercise as these different goals are partly contradictory.

Firstly, credit providers are commercial entities and it is in their interest to make as much profit as possible, even if this may sometimes have a negative impact on the borrower. An effective regulatory framework would need to reconcile the interests of the lenders with those of the borrowers. Such a goal could be achieved by ensuring that inappropriate lending practices are not profitable or are impossible. Potential solutions include regulation on prices and arrears management as well as better evaluation of credit applications. Credit unions could play an important role within this strategy.

Secondly, it is necessary to ensure that borrowing practices are appropriate. Information and financial education have a role to play in this respect. However, the availability of fair and independent advice is an absolute necessity to help debtors develop a clear understanding of their situation and of the implications of the credit for which they are applying. MABS is already well placed to take on this role.

The third and final element of such a strategy involves addressing the financial difficulties of households within a more appropriate framework. Even though some debtors refuse to pay, the vast majority is willing to pay. Some people would need to see their debt rescheduled, while others, unable to repay, would need to see their debt written-off. A personalised, comprehensive and gradual approach is needed. MABS and other registered debt advisers could play an important role. This approach could be seen as a three-step process:

- First step: commercial negotiations. MABS could advise the debtor and negotiate with the creditor(s) in order to find an appropriate solution;
- Second step: amicable collective debt settlement procedure. Very similar to the commercial negotiation except that creditors' participation is compulsory;

- Third step: judicial collective debt settlement procedure. Where an amicable phase has failed, the judge makes a decision about a repayment plan or a total write-off, allowing a fresh start for the debtor.

At each step MABS and registered debt advisers could intervene in order to provide their expertise to debtors and to facilitate negotiation with creditors.

The effectiveness of such a strategy would be increased if each aspect were developed within a legal framework that would ensure regular assessment. The British approach has favoured self-regulation based on the involvement of the industry as well as social corporate responsibility and “name and shame” mechanisms to encourage professionals to respect their commitments. The involvement of the industry as well as all other stakeholders is a key element. However, the effectiveness of self-regulation is undermined by the profitability constraint. Belgium has favoured a more appropriate option based on the involvement of all stakeholders and the implementation of a proper regulatory framework which is able to limit the influence of the profitability constraint. The challenge is therefore to define appropriate sanctions in order to encourage stakeholders to implement such a strategy.

The costs of a responsible credit strategy in Ireland should be carefully assessed at different stages (short-, medium- and long-term). These costs would be significant in the short term but would be diminished over time. Certainly the need for such a strategy is urgent given that the consequences of the crisis are becoming more challenging by the day. Finally, it needs to be remembered that:

- the French way to deal with overindebtedness is hampered, despite the appropriateness of the procedure, because there is a lack of investment in independent debt advisers such as MABS;
- the British strategy to promote appropriate credit alternatives is facing challenges in being mainstreamed despite the high level of financial investment. This is due to the refusal to regulate interest rates which makes it difficult to compete with high cost lenders who are able to provide easier access even if at a higher cost.

For an Irish strategy to be effective, it would have to be implemented in a comprehensive and coherent way. Otherwise the regulatory framework implemented or the money invested would be partly wasted.

## Acknowledgements

I wish to thank The Policy Institute, Trinity College Dublin, and the Combat Poverty Agency (now the Social Inclusion of the Department of Social Protection) for funding my Visiting Research Fellowship. I am also very grateful to the Institute for International Integration Studies (IIIS) for hosting my six-month visit to write this paper.

Thanks in particular to Professor James Wickham and Helen Murray of The Policy Institute, to Professor Alan Matthews and Colette Keleher for their support during my time in the IIIS and to Jim Walsh, Joanne Mulholland, Deirdre Bodkin, Caroline Corr, Joanna Wydenbach and Kasey Treadwell Shine of the former Combat Poverty Agency (now the Social Inclusion Division).

I am most grateful for the insightful and useful comments from the referee of this paper.

The views expressed are those of the author and do not necessarily reflect those of the Combat Poverty Agency (now the Social Inclusion Division) or The Policy Institute, Trinity College Dublin.

## General Introduction

Financial services are a necessity for people in their everyday lives. In order to receive wages, make payments or face unexpected expenses, bank accounts, payment cards and consumer credit are crucial. Their role varies from one country to another. In France, access to a bank account is a necessity as it is impossible to receive wages or social benefits in cash, while this is still possible in Ireland. Conversely, access to credit in Ireland is often necessary in order to deal with unplanned expenses, while in France the same needs are partly met through social benefits and public services.

Over the past 10 years, financial inclusion has become an important policy issue at national and European level. In Ireland, due to the key role played by consumer credit, the first effort to address financial inclusion was the establishment of the Money Advice and Budgeting Services (MABS) in 1992. MABS advisers deal with all kinds of financial difficulties including overindebtedness and difficulties in accessing appropriate forms of credit. However, after this early start, financial inclusion disappeared from the Irish political agenda until recently. It was only in 2006 that the phenomenon of financial exclusion was properly documented in a report by the Combat Poverty Agency (Corr, 2006). This report provides an analysis of the difficulties faced by Irish people in accessing and using financial services and makes recommendations on how to improve access to basic banking services. Regarding overindebtedness, most of the research and policy analysis has focused on the inability of the Irish legal system to deal with the issue. Both the Free Legal Advice Centre (FLAC) and the Law Reform Commission (LRC) have highlighted problems in the Irish judicial system in relation to issues of credit and have recommended reforms to deal appropriately with the consequences of a credit society (FLAC, 2009; LRC, 2009). These research studies have had a significant influence on promoting interest in financial inclusion.

Until recently, financial inclusion was not part of the policy discourse in Ireland (Carbo *et al.*, 2005; Corr, 2006). However, in the past few years there has been a number of significant developments.

The National Payments Implementation Programme (NPIP) was established in 2005 with the aim of changing payment behaviour in Ireland in order to make it more secure and cost-efficient. One of its objectives is to promote financial inclusion. The current financial crisis has increased the involvement of the government in relation to access to basic banking services. As a result of the guarantee scheme for Irish credit institutions announced in September 2008, the Credit Institution (Financial Support) Scheme 2008 brought into law the requirement that the guaranteed institution should report bi-annually on, among other issues, the promotion of financial inclusion. In the early months of 2010, an expert group was set up to make recommendations on rescue plans for heavily indebted borrowers. Finally, in September 2010 a Steering Committee was established to promote financial inclusion.

At European level, financial exclusion has also become an important policy issue involving DG Employment, Social Affairs and Equal Opportunities, DG Internal Market and Services and DG Health and Consumers. The understanding of financial exclusion and overindebtedness has improved as a result of the funding of two studies by the European Commission (RFA, 2008a; OEE, 2008), while a special module dedicated to these topics was included in the EU-SILC survey of 2008.<sup>3</sup> Alongside these efforts, the need to ensure that, by a certain date, no EU citizen or resident would be denied access to a basic bank account has been stressed by the European Parliament in its resolution in the Green Paper on Retail Financial Service, adopted on 5 June 2008,<sup>4</sup> and has been the aim of public consultations in 2007<sup>5</sup> and more recently in 2010.<sup>6</sup>

### **Aims of this study**

It is imperative that these efforts to promote financial inclusion are successful in order to address the consequences of the current financial crisis. In that regard, Ireland has a strong advantage. It can learn from the strategies that have been implemented in other

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<sup>3</sup> The European Survey on Income and Living Conditions (EU-SILC) is the reference source for comparative statistics on income distribution and social exclusion in the European Union.

<sup>4</sup> See: <http://www.europarl.europa.eu/sides/getDoc.do?pubRef=-//EP//TEXT+TA+P6-TA-2008-0261+0+DOC+XML+V0//EN>

<sup>5</sup> See: [http://ec.europa.eu/internal\\_market/consultations/2009/financial\\_inclusion\\_en.htm](http://ec.europa.eu/internal_market/consultations/2009/financial_inclusion_en.htm)

<sup>6</sup> See: [http://ec.europa.eu/internal\\_market/consultations/2010/payment\\_account\\_en.htm](http://ec.europa.eu/internal_market/consultations/2010/payment_account_en.htm)

European countries. It is the aim of this report to provide an assessment of these strategies and examine what policies could suit the needs of Ireland. Therefore, this report does not provide a collection of “best practices” but assesses different ways to promote financial inclusion in order to identify their strengths and weaknesses as well as their appropriateness regarding the Irish context.

The report focuses on two issues. Firstly, strategies on financial inclusion are assessed in relation to basic banking services and consumer credit. Mortgages are taken into account only in relation to overindebtedness. They are not considered separately, as such an assessment would require an in-depth exploration of the housing market in order to make pertinent recommendations. Savings and insurance, likewise, are not taken into account.

Secondly, the analysis focuses on three countries: the United Kingdom (UK),<sup>7</sup> France and Belgium. These countries were chosen for two reasons:

- All three have implemented ambitious strategies to promote financial inclusion, and these strategies are marked by their differences:
  - The UK has based its strategy on market mechanisms such as self-regulation.
  - France has based its strategy on regulation and the heterogeneity of its financial industry (private, cooperative and public financial institutions).
  - Belgium has based its strategy on strong regulation.
- Ireland shares common points with each of these countries. Therefore it can learn from their diverse experiences and choose efficient and appropriate practices regarding its own needs.
  - Similar to the UK, Ireland has a high level of access to consumer credit, but this access is partly provided at a very high cost through moneylenders.
  - France has a strong financial cooperative movement which plays an important role regarding financial inclusion; the credit union movement in Ireland could replicate this characteristic.

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<sup>7</sup> In this report, the emphasis will be placed on the action of central government in London even though Scotland, Northern Ireland and Wales have introduced specific action plans on financial inclusion.

- Belgium is the European country that is most committed to tackling financial exclusion. One similarity it has with Ireland is that its debt mediators play a similar role to that of MABS advisors.

### Overview of the study

The first part of the report is dedicated to the understanding of financial exclusion, while the second part provides an assessment of the strategies to combat financial exclusion in Ireland, the UK, France and Belgium.

Financial exclusion is a phenomenon that has been documented at national and international levels since the 1990s (for example: Leyshon, Thrift, 1995; HM Treasury, 1999; Kempson, Whyley, 1999; Carbo *et al.*, 2005; Devlin, 2005; Corr, 2006; RFA, 2008a). Basically it is understood as a difficulty experienced by sections of the population in accessing financial services. Overindebtedness is considered as a separate issue even if both are closely linked (RFA, 2008a; OEE, 2008). This report adopts a different understanding of financial exclusion and overindebtedness as it considers the actual *process* of financial exclusion (Gloukoviezoff, 2004, 2005, 2008).

*Access* difficulties are part of this process but they are the consequences of *use* difficulties. If financial services providers refuse access to certain potential customers, it is because they anticipate that these people will face use difficulties and that they are too poor to be profitable. For example, providers prefer to refuse a bank account to customers who have a high probability of becoming overdrawn and who will probably be unable to reimburse money owed, particularly as a result of irregular transactions. Similarly, some customers refuse to have a current account or a credit card as they know that their financial situation may lead to difficulties because of the terms and conditions that apply.

Therefore in order to tackle *access* difficulties it is necessary to consider *use* difficulties. These occur when:

- people do not use services they have access to because of lack of confidence or awareness of the risks;
- people who use financial services face negative consequences because the services are inappropriate or they have used them inappropriately.

Financial exclusion is a process that links access and use difficulties. At the start of this process people have access to financial services but this access is inappropriate. They face use difficulties at this point. The development of the process sees access difficulties becoming prevalent. At the end of this process, people have no access to any financial services and face real financial exclusion.

Overindebtedness is a stage of this process, characterised by the prevalence of use difficulties (inappropriate forms of credit). The fact of being unable to have a bank account is another stage of this process, characterised by the prevalence of access difficulties. Of course access and use difficulties are a component of the financial exclusion process only when they produce negative consequences. The process of financial exclusion contributes to the wider issues of social exclusion and poverty.

Therefore, this report provides a revised definition of the process of financial exclusion:

*Financial exclusion is the process whereby people face such financial difficulties of access or use that they cannot lead a normal life in the society to which they belong*

The first part of this report examines the development of this definition and explores the cause and consequences of the process of financial exclusion. Such an analysis develops a better understanding of financial inclusion which will inform a more efficient strategy.

The second part of the report assesses the financial inclusion strategies of the four countries under consideration. It examines:

- appropriate access to basic banking services: this issue deals with services (i.e. current account, cheques or payment cards) considered as a minimum requirement in order to lead a normal life in a modern society;
- the promotion of responsible credit: this issue examines access to appropriate forms of consumer credit which respond to the customer's need (involves taking into account overindebtedness).

Appropriate access to basic banking services and the promotion of responsible credit are both taken into account in relation to access

and use difficulties. For example, when strategies to promote responsible credit are assessed, the analysis considers not only the promotion of appropriate access (adequate evaluation of the borrowers as well as the characteristics of the available credit) but also the framework set up to deal with repayment difficulties (i.e. personal debt management and debt enforcement). Such a global approach is needed in order to assess the efficiency of a financial inclusion strategy, acknowledging that access and use difficulties are linked. A policy that only targets access difficulties could increase use difficulties and therefore be ineffective in promoting financial inclusion.

The assessment of financial inclusion strategies takes into account the context within which these strategies are implemented. Therefore, the recommendations of this report are not “best practices” but guidelines for action. They draw on the successful responses in the other countries under study, in order to suggest improvements that could be implemented in the Irish context.

## **PART ONE**

### Understanding Financial Exclusion and Overindebtedness as a Social Phenomenon



## Introduction

Financial exclusion and overindebtedness are often seen as two different issues. This distinction could be explained by the fact that the interest in these two problems (inability to access basic banking services and inability to repay debts) is fuelled by the need to find quick solutions. In such a scenario, issues need to be defined (e.g. which services are basic banking services; what is the difference between someone who is indebted and someone who is overindebted) and basic mechanisms need to be understood in order to offer immediate answers.

Nevertheless, the distinction made between difficulties of access to basic banking services and overindebtedness is not sustainable. In the UK, for example, the remit of the Financial Inclusion Taskforce has covered banking, credit, savings and insurance, but not overindebtedness. This has been the responsibility of a cross-governmental ministerial group led by the Department of Business, Innovation and Skills (BIS). However, the Taskforce has had to deal with overindebtedness, and it has done this through the Financial Inclusion Fund face-to-face debt advice project, which has provided debt advice to financially excluded people.

Access difficulties to basic banking services and overindebtedness are therefore two interlinked though distinct dimensions of financial exclusion. It is crucial to understand this rationale in order to be able to design financial inclusion policies that reach their ultimate target (e.g. a financially inclusive society).

To clarify the continuity between access difficulties to basic banking services and overindebtedness, it is necessary to adopt a clear definition and to pay attention to the causes and consequences of these difficulties. This involves examining the subject within its institutional context.

# The Process of Financial Exclusion

## **1 The process of financial exclusion: a result of financialisation**

The way a phenomenon is defined conditions the way it will be targeted as a social policy issue. Numerous researchers have attempted to define financial exclusion, in particular its causes and consequences. Nevertheless, definitions of financial exclusion remain very basic. Financial exclusion is generally understood as the inability to access basic banking services.

Such an understanding prevents the development of appropriate policies to tackle financial exclusion. Despite its name, financial exclusion is more than a question of access. Financial exclusion is a social phenomenon which is explained by difficulties faced within the financial relationship between financial providers and households. It is also explained by the institutional context within which this relationship takes place.

### **1.1 A comprehensive definition of the process of financial exclusion**

Leyshon and Thrift (1995) proposed the first definition of financial exclusion. According to them, financial exclusion involves the “processes that serve to prevent certain social groups and individuals from gaining access to the financial system” (Leyshon, Thrift, 1995, p.314). Clearly, the focus is placed on mechanisms that create access difficulties. This approach has had a significant influence on subsequent research studies.

Basically, Leyshon and Thrift (1995) emphasised the role of geographical exclusion, e.g. the difficulties experienced by certain individuals in accessing financial services because of the lack of a bank branch in their area or because of the closure and relocation of a branch. It is based on an “in and out” logic where people either have access or do not. At the time, this seminal work echoed the interest of New Labour which implemented the *National Strategy for Neighbourhood Renewal*, of which financial exclusion was one of the key issues.

Not surprisingly, subsequent research studies adopted this “in and out” approach but explored other causes which explained access difficulties (Kempson, Whyley, 1998, 1999; HM Treasury, 1999; Kempson *et al.*, 2000). They emphasised that difficulties of access can also be explained by condition exclusion (e.g. requirements to access financial products are inappropriate), price exclusion (e.g. services are too costly), marketing exclusion (e.g. information about new products is not displayed to non-desirable customers), self-exclusion (e.g. people do not access financial products because of fear or distrust of banks or because they have already been refused) (Kempson, Whyley, 1999).

Despite the interest in the factors identified, this approach does not offer a definition of what financial exclusion actually is. It only describes the causes of access difficulties to financial products. Two main weaknesses of this approach can be identified.

The first is related to the fact that access difficulties to financial products are considered a problem for households although no explanation is given for this. For example, a 6-year-old child does not suffer from the lack of a bank account but his/her parents do. It means that in order to experience financial exclusion, there must be negative social consequences for those concerned. This link between financial difficulties and their consequences lies at the heart of financial exclusion. Without it, it is simply a market problem which does not constitute a policy issue.

This link emphasises that financial exclusion is a cause and a consequence of poverty and social exclusion. If financial difficulties exist without contributing to poverty and social exclusion, they cannot be considered part of financial exclusion.

Having identified this link, it is necessary to understand that previous approaches only take into account some financial difficulties. By focusing on *access* difficulties, they completely ignore *use* difficulties. This is the second weakness of previous approaches. The gap can be explained by a specific British trait of distinguishing between alternative providers and mainstream providers. When these researchers look at *access* to financial products, they only pay attention to access to mainstream providers (Devlin, 2005). This standpoint is clearly insufficient.

When *use* difficulties are mentioned, they are limited to when people have access to banking products but do not use them. This is only part of use difficulties. The main part is when people face

negative consequences because they use these products. For example, someone using a credit card without knowing the rules and cost could face some very unpleasant surprises at the end of the month. Similarly, someone who desperately needs a loan to meet health expenses may only have access to the most expensive form of credit which could lead him/her to overindebtedness.

A British study by Regan and Paxton (2003) did emphasise the importance of the appropriateness of access. They explained that financial exclusion produces its effect in breadth (through a variety of appropriate, accessible products) and in depth (the capability of people to use them appropriately, having regard to their own situation). This understanding allowed the researchers to define financial inclusion as the situation “when citizens have access to appropriate financial products and services and the opportunity, ability and confidence (and appropriate support and advice) to make informed decisions about their financial circumstances, as would be regarded as a minimum to organise their finances in society effectively” (Regan, Paxton, 2003, p.8).

Such an understanding favours quality of access over the “in and out” approach. This is because it can sometimes be as harmful to have inappropriate access to financial products as to have no access at all. The approach highlights that fact that financial exclusion is a process with its own dynamic which varies from one person to another.

These different elements and the author’s research led to proposing the following definition of financial exclusion:

*Financial exclusion is the process whereby people face such financial difficulties of access or use that they cannot lead a normal life in the society to which they belong.*<sup>8</sup>

### **Box 1: Toward a European definition**

This definition formed the basis of the definition proposed in a European Commission report: “Financial exclusion refers to a process whereby people encounter difficulties accessing and/or using financial services and products in the mainstream market that are appropriate to their needs and

<sup>8</sup> See Gloukoviezoff (2004, 2008).

enable them to lead a normal life in the society in which they belong" (RFA, 2008a, p.9).

This development of the author's definition is insufficient as it restricts financial services to the mainstream market. The key is access to financial products (regardless of the nature of the provider) that would allow people to lead a normal life. In addition, the concept of mainstream markets only applies to the UK and Ireland because such a dual market does not exist in continental Europe.

It is also unnecessary to specify that services and products need to be "appropriate to their needs" as access and use will enable people to lead a normal life. By definition, if access allows people to lead a normal life, the characteristics of the products and services are therefore appropriate.

The way access and use difficulties are considered has interesting implications regarding the articulation of financial exclusion and overindebtedness. If financial exclusion is defined as access difficulties to financial products, it is obvious that it is a different issue to overindebtedness. Generally, European governments consider that overindebtedness arises when people are unable – in good faith – to face their financial commitments (OEE, 2008).

However, if financial exclusion is defined as *the process whereby people face such financial difficulties of access or use that they cannot lead a normal life in the society to which they belong*, the distinction between access difficulties and overindebtedness disappears. Overindebtedness is one aspect of the process of financial exclusion which is the result of inappropriate access to credit and to financial commitments. It could be argued, justifiably, that debts related to utilities or rent are part of overindebtedness and therefore overindebtedness is a wider issue than financial exclusion.

In the current author's opinion, debts accumulated with a landlord or energy provider can clearly be viewed as a type of informal credit. This is because when overindebtedness occurs, it is not only one month that is unpaid. Debts have accumulated over a period of time and this changes their nature. These debts become more like loans which the providers have been constrained to grant to their customers (in the way a banker would be constrained to grant credit to someone who has overdrawn).

If financial difficulties include all difficulties related to the access or use of financial products and services (including financial commitments such as debt accumulated with a utility for example), overindebtedness is clearly a component of the process of financial exclusion (Gloukoviezoff, 2008).

Even if difficulties accessing appropriate basic banking services and overindebtedness are part of the same social phenomenon, it does not mean that the exact same tools should be used to address them. Nevertheless, it means that they interact (actually, it is difficulties of use and of access which interact) and that they can be explained in the same way. In order to understand the causes of these difficulties (access and use) and their negative consequences, it is necessary to analyse the process of the financialisation of society.

## **1.2 A framework: the financialisation of society**

Why is not having access to a bank account such a burden for people? Why do some people find themselves in a situation where they cannot meet their financial commitments anymore?

Common answers given to these questions include illustrations (e.g. the inability to receive social benefits without a bank account) or examples of econometric analysis which show that unemployed people are more at risk of overindebtedness. Even though these responses are valid, they only answer part of the question.

The hypothesis presented by the current study is that the answer lies in an institutional process: the intensification of the financialisation of society. Financialisation in this context is defined as the growing constraints experienced by people, companies or governments to use money, banking and financial services to meet an increasing number of needs.

### **1.2.1 From financialisation of the economy to financialisation of society**

Initially, the concept of “financialisation” was used to describe the change from companies financing themselves through credit provided by banks to funds (shares, obligations, etc.) provided by financial markets. From the end of the 1970s “financialisation” slowly began to take over “intermediation”.

As a result, researchers began to pay more attention to the consequences of this development. It became apparent that being financed through financial markets was far from a neutral activity

for these companies. It changed the way companies were assessed and the way they were governed. This was deemed necessary in order to meet the requirements of financial market investors – a short-term return on a growing level of equity.

Governments also began using financial markets to finance their debts. In order to have access to a low rate of interest, economies had to fulfil the requirements of orthodox economic policy (low inflation, low level of public deficit and public debt). It became more and more difficult to implement Keynesian economic policies which were at odds with these new monetary rules. This development led to the first definition of “financialisation” as the “increasing importance of financial markets, financial motives, financial institutions, and financial elites in the operation of the economy and its governing institutions, both at the national and international level” (Epstein, 2001, p.1).

Following on from this definition, an interest began to develop on the effects of financial market requirements on companies and governments (Krippner, 2005; Palley, 2007). But these studies focused more on the financialisation of the economy than on the effect of “financialisation” on households.

Nevertheless, other researchers began to explore the effect of financialisation on households (Lordon, 2000, 2008; Gloukoviezoff, 2005, 2008; Servet, 2006; Dembinski, 2008; Scharwtz, Seabrooke, 2008).

People could be affected:

- as employees: their job or work conditions could change dramatically as a result of the company’s need to be more profitable and flexible in order to generate a satisfying return on equity for financial market investors;
- as citizens: the government’s need to pay attention to its deficit implies that it may reduce its intervention through the welfare state. So, benefits could become less generous or less accessible (due to eligibility criteria);
- as customers: their relationship with banks or other financial institutions is affected by financialisation as these firms have also to reach the profitability expectation of the financial markets and therefore make as much profit as possible from their customers.

These three dimensions of the impact of financialisation on households are all closely related to the phenomenon of financial exclusion.

As it is presented, financialisation can be defined as the increasing influence of financial market logic on the rest of the society. This is evident in the current economic climate. Since the financial crisis, there is a general recognition that financial markets have an impact on society. However, such a recognition implies that this development is natural and progressive and that it relies exclusively on the markets. This is incorrect, for at least three reasons:

- First, the influence of financial markets on the economy was as strong in the 1920s as it was in the 2000s, while it was much less strong in the 1960s. This influence, therefore, is not progressive but can increase and decrease. It is also useful to remember that credit was extremely important for poor people in the Middle Ages and that speculation is not a modern invention but was also in operation at that time.
- Second, this development is an institutional one and is highly political. It is the result of political decisions, the most important of which (in relation to the current situation) was the end of convertibility of the dollar into gold in 1971 (this decision led to higher possibilities of speculation on currencies) and the liberalisation of economies following the promulgation of neoliberal principles in relation to the development of financial markets.
- Third, even though financial markets are the cornerstone of the current financialisation, they do not work by themselves. Financialisation also relies on the transmission of money and banking services.

In order to understand how financialisation influences society and why some people cannot live a normal life because of financial difficulties, a further discussion is needed.

### **1.2.2 Financialisation: needs, forms and logics**

Based on the previous approaches, it is possible to build a new framework of the process of financialisation. Basically, financialisa-

tion means that people need to use financial services in order to meet a growing number of needs. These needs can be grouped in two:

The first type of need is related to the necessity to receive money and to make payments in order to lead a normal life, e.g. to receive wages.

The second type of need involves a relationship with time and relates to promotion and protection:<sup>9</sup>

- Promotion refers to the improvement in a person's situation. For example, consumer credit could be used to buy a car which increases the possibility of finding a job, or to refurbish an apartment which improves the person's standard of living.
- Protection refers to the need to avoid a decline in an individual's situation. For example, a loan could be used to repair a car in order to be able to go to work but also to pay for bills that are larger than planned.

These two groups of needs (perception/payment and promotion/protection) are influenced by financialisation, in three different ways:

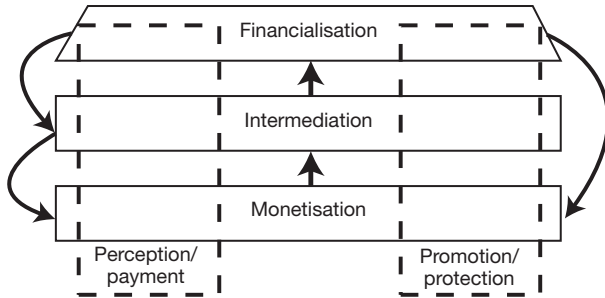
- **Monetisation:** refers to the conversion of non-monetary elements (or parts of them) into a monetary payment. For example, before urbanisation many people produced much of their own food in their own garden. Today, home-growing is less common and food is generally bought. This is an example of the monetisation of food. The pocket money given to children by their parents could also be seen as the monetisation of a part of their parental relationship.
- **Intermediation:** refers to the intervention of an intermediary (e.g. banks) between people and their money. Based on monetisation, it could take the form of a payment card to pay for the food mentioned in the previous example, or the fact that the pocket money is more likely to be put into a child's current or saving account than his/her pocket.
- **Financialisation:** refers to the overall interconnection of an individual's financialised needs with an entity representing

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<sup>9</sup> For the distinction between promotion and protection, see Drèze and Sen (1989).

a collective. This could be the financial markets or a political representation in a planned economy.

These three forms are interconnected. There would be no intermediation or financialisation without monetisation. Likewise, monetisation and intermediation are strongly influenced by the nature of financialisation.



Clarifying the link between the two groups of need and the three forms of financialisation helps to explain the link between financialisation and financial exclusion.

People need money because money is needed to satisfy a large number of needs (monetisation), and a bank account and modern means of payment are a norm to deal with money (intermediation). But if these people have no access to a bank account or to certain means of payment, it is because they are not profitable for the bank regarding the expectation of the financial markets (financialisation).

Financial exclusion (the experience of financial difficulties that leads to negative social consequences) is a result of the link between the three forms of financialisation.

A fourth element needs to be introduced in order to define appropriate answers to financial exclusion: the logic behind the process of financialisation. The current process of financialisation is led by financial markets and their logic. But this logic is not the only one possible. Other principles of production and distribution can be called into play. For example, Polanyi (1944) made a distinction between three such economic principles:

- The principle of **market exchange** is based on personal interest. It is a contractual arrangement coordinated by

prices, with no influence from social relationships. What is paid equals what is given. For example, consumer credit sold by a credit card provider is led by the logic of market exchange. The lender only takes into account the supposed level of risk of the borrower, while the borrower is supposed to base his/her decision only on the price and the conditions of the offer.

- The principle of **redistribution** organises production and distribution from the centre, towards which all the commodities converge before being redistributed to the members. This principle takes into account the potential irregularity of production and income. The best example of exchange led by redistribution is taxation versus payment of benefits by the welfare state or grants given by the state to students who do not have the financial resources to afford college costs.
- Within the principle of **reciprocity**, the exchange is still inter-individual but it is influenced by the nature of the relationship and the collective interest. There is no strict equality in the exchange but this could be compensated for at a later stage by the person who received the service or by another member of the group. For example, the credit union movement (or cooperative banks) lends to its members at a price which does not perfectly reflect their level of risk but includes their membership of a community (i.e. a common bond).

Both redistribution and reciprocity acknowledge that each individual is a member of a community, while market exchange relies on an asocial contract. Furthermore, market exchange is only led by individual interest, while redistribution and reciprocity take into account collective interest. Despite such differences, these three economic principles are always simultaneously present in every society, even if one is dominant.

Of course, these principles are just conceptual tools which clarify the different logics that lead production and exchange. It is possible to link the different pieces of our framework (needs/forms/logics) in order to advance the following theoretical description:

- In order to **receive payments**, it is possible to rely on a

current account in a commercial bank (market exchange), in a public bank (redistribution) or in a credit union (reciprocity). Each of these account providers is inspired by a different logic which affects the terms and conditions applied to their customers. Public banks and credit unions are usually seen as playing a greater role in financial inclusion by opening accounts for people who would be refused by commercial banks.

- In relation to health care (**protection**), it is possible to have private insurance (market exchange), to benefit from the welfare state health care system (redistribution) or to subscribe to a health insurance cooperative (reciprocity). The individual customer will be offered different terms and conditions (the way the risk is assessed, the cost of the premium, the rate of reimbursement of health costs, etc.) in each instance.
- In order to improve employability (**promotion**), a student may work towards upskilling with the support of a loan from a commercial bank (market exchange), a loan from a credit union (reciprocity) or a grant from the state (redistribution). Again, the individual student will experience different costs and conditions of access in each instance.

These three examples show that increasing financialisation does not necessarily mean a greater influence of market exchange logic. For example, financialisation developed through public banks and a planned economy does not have the same consequences (better or worse) as that led by financial markets and market exchange logic.

So it is now possible to rephrase the definition of the financialisation of society.

*The financialisation process influences the way people (or firms, or state) meet their needs (reception/payment – promotion/protection) through the rules and norms applying to access to and use of money, banking services and financial services. These rules and norms reflect the dominant logic of the financialisation process (market exchange, redistribution, reciprocity).*

This framework will be applied to the mechanisms that produce

financial exclusion. It will explain why financial exclusion developed so much during the past thirty years that its prevention has now become one of the dominant policy priorities of the European Union.

### **1.3 Why do banking difficulties have negative consequences?**

During the past fifty or sixty years, financial products became less and less avoidable as a result of the intensification of financialisation (e.g. its intermediation form). There is a lack of historical research on this topic, but it is interesting to examine to what extent bank accounts, means of payment and consumer credit are distributed among the four countries under study.

#### **1.3.1 Basic banking services: accounts and means of payment**

Basic banking services are unavoidable when they become a social norm. When they are distributed among society, it becomes normal to organise transactions with a bank account or modern means of payment. It is presumed that the situation is the same for everyone. These norms may have been preceded by rules making it compulsory to have a basic banking service, or the rules may have followed later.

For example, during the 1960s in France, it became compulsory to pay wages on a monthly basis and – over a certain amount, often lower than monthly wages – to receive wages into a bank account. Even though the law did not directly make it compulsory to have a bank account, it nevertheless became the norm as almost all employees had to have one in order to be paid. Given the increasing use of bank accounts by the general population, in 1978 the French government decided to make benefit payments accessible only through a bank account, increasing again the necessity to have one.

In 1966 only 17% of French households had a deposit<sup>10</sup> or current account and this increased to 62% in 1972 and to 92% in 1984 (Bonin, 1992). The proliferation of bank accounts among the general population in France made it more and more difficult to live a normal life without a bank account. This development of social norms and rules explains why the French government introduced a law in 1984 which made having a current account a legal right.

As the operation of basic banking services become more common in society (in the EU-15, only 5.9% of the population have no access at all), the more those who do not have access face negative consequences due to norms and rules. In theory, a person is better

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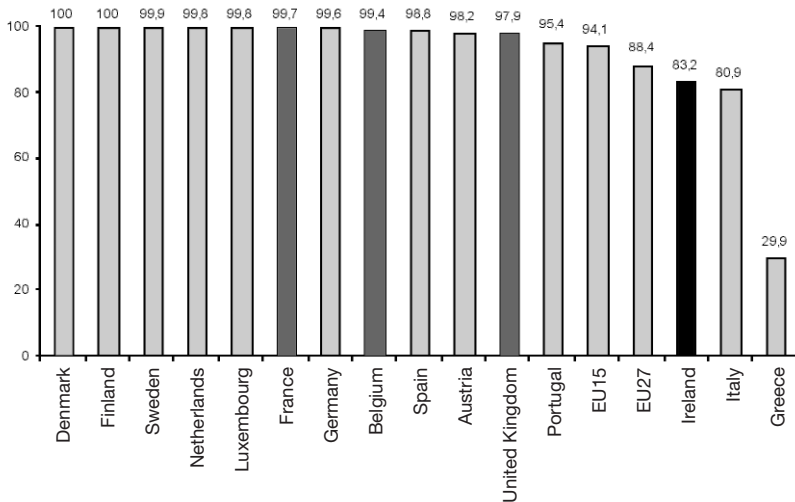
<sup>10</sup> Excluding “Livret A”, a specific and very popular savings account.

off without a bank account in a society where the majority of the population are in the same situation, since the social norms would be more appropriate (as in some of the EU-12 countries where on average 35% of the population have no access at all) (EU-SILC, 2008).

It is difficult to give a precise European comparison of levels of access to bank accounts, because until recently there was a lack of rigorous research in relation to this matter. However, data from the special module of EU-SILC 2008 dedicated to financial exclusion have now been made available.

In order to give an idea of the proportion of people with access to a current account, Figure 1 presents data for the global population and Figure 2 presents data for people at risk of poverty.

*Figure 1: Proportion of people with access to a current account (% , 2008)*



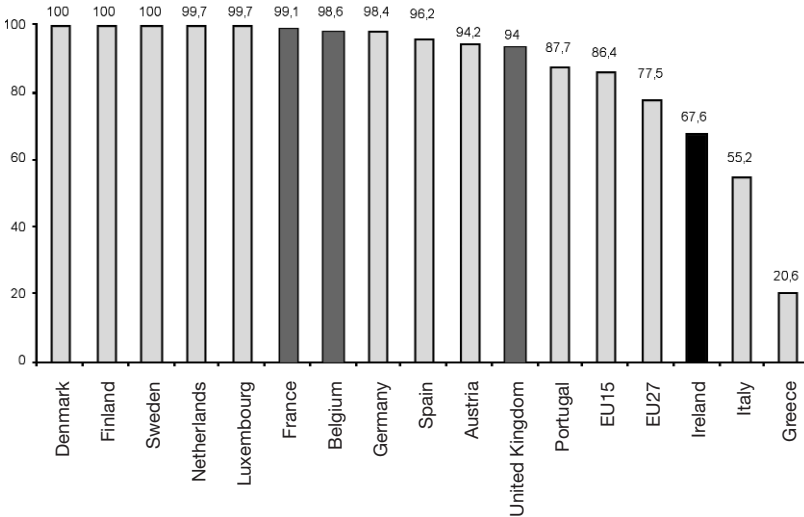
**Source:** Eurostat (EU-SILC, 2008)

These graphs show how widespread current account ownership is within the EU-15 countries.<sup>11</sup> Even when considering people at risk of poverty, it appears that over 98% have access to current accounts within the eight first countries. When considering both populations,

<sup>11</sup> Greece is an exception. In this country people use mainly saving and deposit accounts, explaining why access to a current account is so low. It must be noted that Greek saving and deposit accounts offer the same services as a current account (i.e. making and receiving payment).

it also appears that the situation is relatively similar in France (99.7%/99.1%) and in Belgium (99.4%/98.6%), while the access is somewhat lower in the United Kingdom (97.9%/94%) and significantly lower in Ireland (83.2%/67.6%).

Figure 2: Proportion of people at risk of poverty with access to a current account (% , 2008)



Source: Eurostat (EU-SILC, 2008)

The level of financialisation of these countries defines social norms that are problematic for people without a bank account. Not having a bank account has many negative consequences:

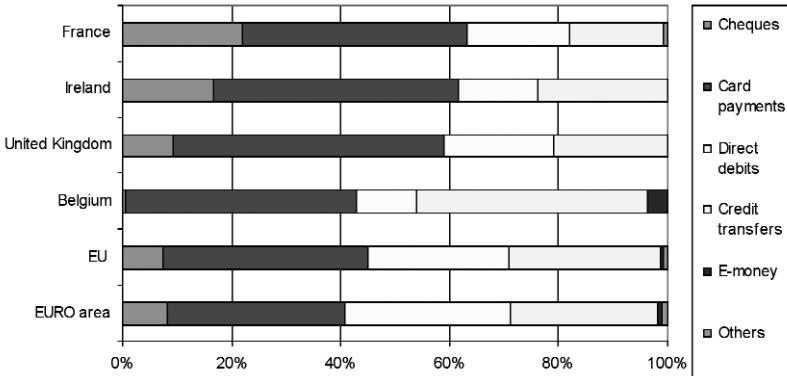
- It is impossible or more costly to receive wages or social benefits.
- It is more difficult to gain employment.
- It is impossible or more costly to receive cheque payments.<sup>12</sup>

Along with a current account, access to modern means of payment (cheques, debit card, direct debit, etc.) is also essential in order to

<sup>12</sup> See for Belgium, Collard and Dejemeppe (1996); for France, Gloukoviezoff (2004, 2008); for Ireland, Corr (2006); for the UK, Kempson and Whyley (1998), Burden (1999), Kempson *et al.* (2000), Herbert and Hopwood Road (2006), and at European level, RFA (2008a).

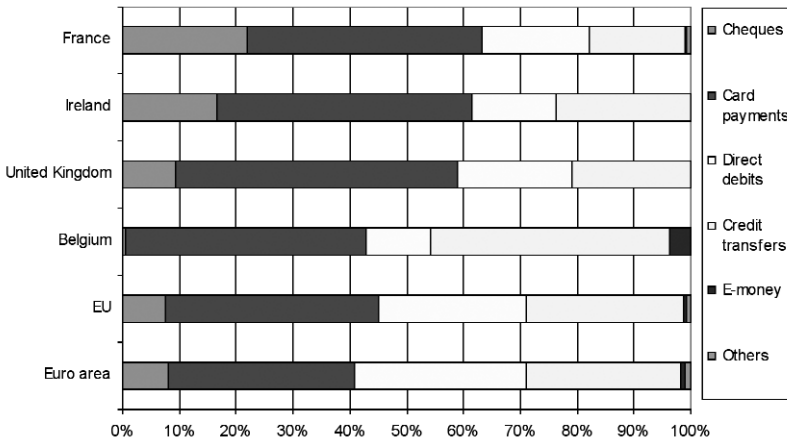
lead a normal life. Figures 3 and 4 demonstrate the relative weight of various means of payment among the four countries under study.

Figure 3: Relative importance of payment instruments in 2008 (as a percentage of total number of transactions)



Source: based on data from the European Central Bank payment statistics 2009

Figure 4: Number of transactions per capita in 2008



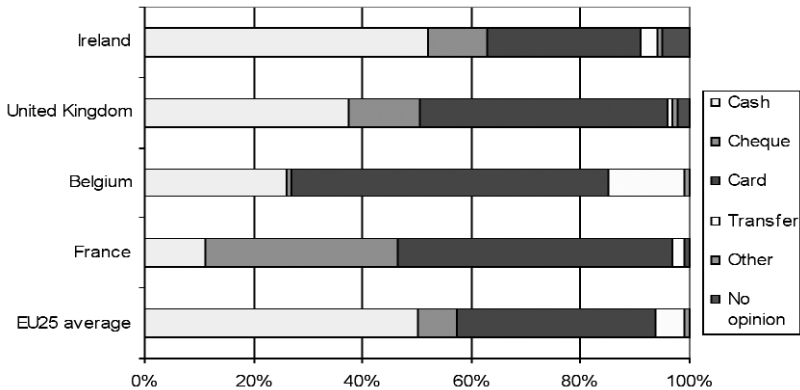
Source: based on data from the European Central Bank payment statistics 2009

These two graphs demonstrate how the relative weight of cheques and payment cards varies among countries. Cheques are a really

popular means of payment in France and Ireland, while they are less used in the UK and they have almost disappeared in Belgium.

An initial conclusion could be that France and Ireland need to ensure access to cheques for financial inclusion, while in the UK and Belgium a payment card would be more important. But, while this conclusion is not completely incorrect, it is necessary to examine a household's preferred means of payment for a €100 expense (Figure 5).

Figure 5: Preferred means of payment for €100 or more in 2005



Source: based on data from the Eurobarometer 63.2

Figure 5 gives a clearer understanding of the social role given to means of payment in a household's daily life. The inclusion of cash payments completely changes the representation of the level of financialisation of these four countries. Cash payments are the least popular in France. Any person who has tried to pay with a €50 note (never mind a €100 note) in a retail shop in France will understand the strength of this social norm.

Figures 3 and 4 do not show that it is in fact far more problematic to live in France without access to a chequebook than it is in Ireland. Even if these two countries have a higher usage of cheques than Belgium and the UK, their tendencies to use cheques instead of cash is not comparable. Over half (52%) of Irish people prefer to pay an expense of €100 in cash compared to 11% in cheques, while 11% of French people prefer to pay in cash compared to 35% in cheques.

It is also important to note that Ireland is the only country to have an absolute majority of people in favour of cash for such an expense, while other countries favour modern means of payment, in particular payment cards.

The fact that it is rare to pay an expense of €100 in cash in France can create difficulties for people who have no other option but to pay in cash. Consequently, people might tend to avoid these types of situations (e.g. eating in restaurants), thus reducing their contact with friends or relatives (Gloukoviezoff, 2004, 2008). There are a number of negative consequences resulting from not having access to modern means of payment:

- Not having a direct debit facility excludes people from this method of paying bills, while energy providers may charge more for other methods.
- Not having a debit card excludes people from internet offers and buying online.
- Charges for misusing debit cards or cheques is also a cause of impoverishment.<sup>13</sup>

Despite the fact that Belgium, France, Ireland and the UK are all highly financialised, they present some differences regarding the way the process of financialisation has produced norms and rules. Ireland is closer to the UK regarding the percentage of people who do not have access to a bank account and the prevalence of cash payments. However, similar to France, Ireland has a relatively high usage of cheques although this is likely to decrease given that the government is beginning to penalise their use. Conversely, Ireland differs significantly from Belgium where the level of financial access is very high and where electronic payment (as opposed to cash and cheques) is significantly more developed.

### 1.3.2 Consumer credit

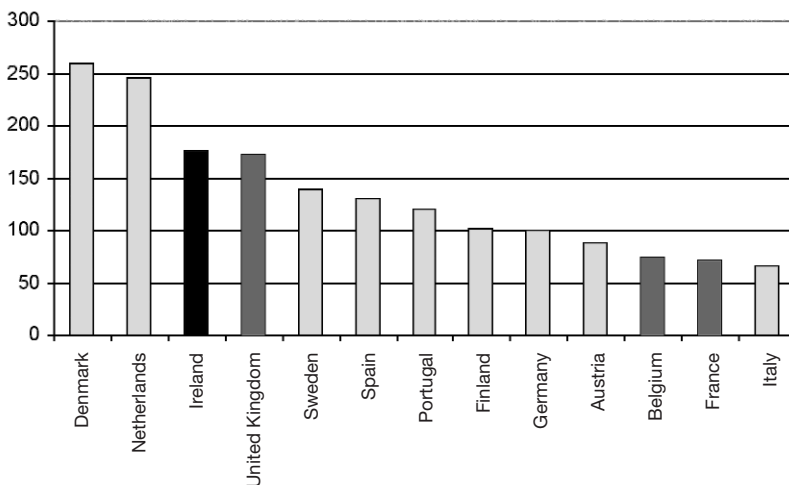
Credit – under very different forms – has always played a significant role for households.<sup>14</sup> It allows them to face income irregularities and unplanned expenses or to make investments to improve their situation. The ratio of household debt to disposable income (see Figure 6) is a good indicator of the role of credit in the life of households.

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<sup>13</sup> See Kempson and Whyley (1998), Kempson *et al.* (2000), Gloukoviezoff (2004, 2008), BMRB (2006), Corr (2006).

<sup>14</sup> See Fontaine (2008) on the role of credit in the Middle Ages.

Figure 6: Household debt as a percentage of disposable income, 2008



Source: Amárach Research (2009) <http://www.amarach.com>; note that data are from 2005 to 2008, depending on the countries.

Figure 6 demonstrates that the countries in this study can be classified into two groups.<sup>15</sup> Household debt represented 176% of disposable income in Ireland in 2008 and 173% in the UK, while it represented “only” 75% in Belgium in 2006 and 72% in France in 2008.

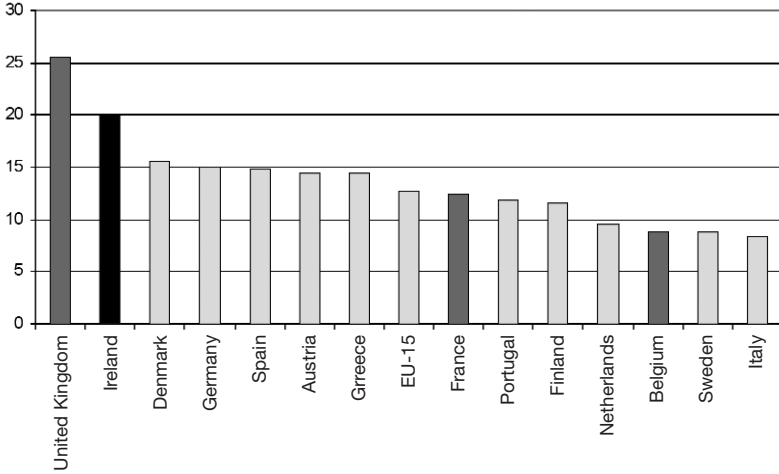
This means that the process of financialisation in Ireland and the UK has increased the use of credit far more than it has in Belgium and France. However, these results may be skewed by mortgages as during this period home prices in Ireland and in the UK rose more than in France or Belgium. Furthermore, home ownership is the norm in Ireland and in the UK, while rented accommodation is more common in Belgium and France. In order to remove this bias, Figure 7 focuses on consumer credit.

Even when mortgages are excluded, the differences are still meaningful. In 2006 consumer credit debt represented 25.5% of disposable income in the UK and 19.9% in Ireland, while it was only 12.3% in France and 8.9% in Belgium. This means that a greater part of consumption in the UK and in Ireland is financed by consumer

<sup>15</sup> Other countries are included within the following figures. However, comparison with the four countries studied in this report would be meaningless as the institutional context of those other countries is not taken into account. The comparison of Ireland and the UK on one side and France and Belgium on the other makes sense regarding the work of Esping-Andersen (1990).

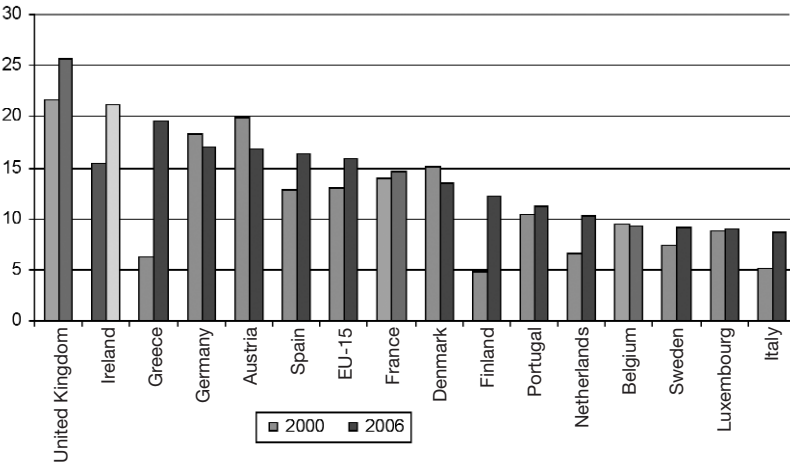
credit compared to France and Belgium. This is confirmed by Figure 8.

Figure 7: Consumer credit as a percentage of disposable income, 2006



Source: Vandone (2009)

Figure 8: Consumer credit as a percentage of consumer expenditure in 2000 and 2006



Source: Vandone (2009)

These figures show that for every €100 spent by households, €25.7 was financed by consumer credit in the UK and €24.1 in Ireland but only €14.6 in France and €9.3 in Belgium. Therefore, around one quarter of consumer expenditure in the UK and Ireland is financed by consumer credit. It is a clear illustration of difference in the nature of the financialisation process in the UK and in Ireland compared to that in France and Belgium.

The consequences of the distribution of consumer credit are not exactly the same in Ireland and the UK where credit is widely accessible (even if this is sometimes through the subprime market), as opposed to Belgium and France where access to consumer credit can be a problem for households but where no subprime market exists.

Having no access to consumer credit can result in a person's situation deteriorating (e.g. when consumer credit could have helped to pay for car repairs or for health expenses) or can prevent people escaping from poverty (e.g. when consumer credit could have been used to buy a car in order to get a job or to refurbish a house) (Gloukoviezoff, 2008). However, such consequences also have to take account of quality of access. These potential borrowers may not have been better off with a loan because providers may have applied conditions that make the transaction very profitable to themselves.<sup>16</sup>

It is precisely this type of consequence that borrowers face in Ireland and in the UK. In these two countries consumer credit is highly accessible and can be acquired through mainstream providers, home credit companies, payday loan companies or unlicensed moneylenders (Collard and Kempson, 2005). This access, even if it solves difficulties in the short term, could lead to problematic consequences. Mainly, the consequences are related to the extremely high cost of these loans<sup>17</sup> and to the practice of refinancing loans (rollover) that maintain people in debt and even increase it. Such commentators argue that these practices maintain people in poverty and sometimes impoverish them (Byrne *et al.*, 2005; Gloukoviezoff, 2008).

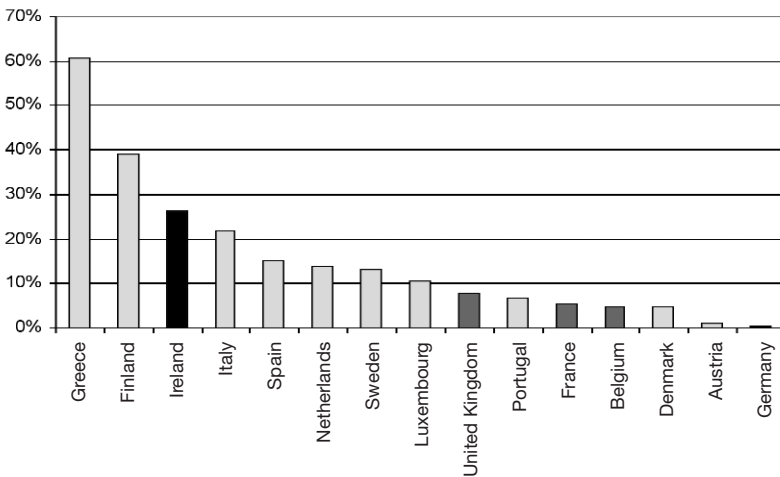
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<sup>16</sup> Policis (2004) notes that people without access to consumer credit in Belgium, France, and Germany may borrow money from illegal lenders. This would exacerbate their situation. However, this finding needs to be considered with caution as it has not been confirmed by any research in these three countries, and because its methodology seems to be weak on this point (Thiel, 2009).

<sup>17</sup> Home credit loans' APR range from 100 to 400%, sometimes more (Collard and Kempson, 2005).

It is useful to take into account the dynamic dimension of consumer credit in order to understand why such a distribution could be a risk for Ireland and the UK. Figure 8 shows that the Ireland/UK and France/Belgium divide was not as clear in 2000 as it was in 2006. In 2000, for the same €100 spent, €21.7 was financed by consumer credit in the UK, but Ireland was very similar to France (€15.3 and €14 respectively), while Belgium still had the lowest amount at €9.4. This means that the pace of financialisation in these four countries has varied significantly (Figure 9).

Figure 9: Consumer credit average annual growth rate (% , 2000-2006)



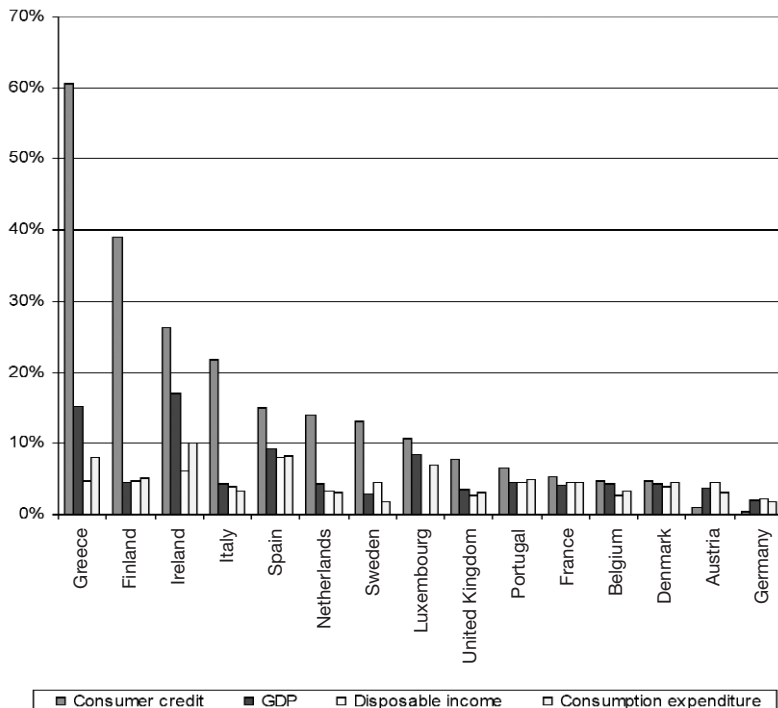
Source: Vandone (2009)

The UK, France and Belgium, with growth rates of 7.7%, 5.3%, 4.7% respectively, could be considered as relatively “mature markets” (according to economists), while Ireland is on a completely different level with a growth rate of 26.3%. Such a distribution of consumer credit could be viewed as proof of a dynamic society. However, this should be validated by evidence of a coherent growth of other indicators such as GDP and disposable income (Figure 10).

First, it is important to pay attention to the difference between the growth of disposable income and consumption expenditure. Only Ireland and Greece have substantially higher growth for

consumption expenditure than for disposable income. Table 1 outlines the differences for the four countries.

Figure 10: Comparison of growth rates (% , 2000-2006)



Source: Vandone (2009)

Table 1: Comparing growth rate

	Disposable income growth	Consumption expenditure growth	Differential (in point)
Ireland	6.1%	10%	+3.9
UK	2.7%	3.1%	+0.4
France	4.5%	4.4%	-0.1
Belgium	2.6%	3.4%	+0.8

The growth rate of consumption expenditure is much stronger than disposable income in Ireland compared to the other three countries.

This disequilibrium is disturbing with regard to the sustainability of such a trend.

Regarding credit, a high growth rate can be seen as positive because it can be a sign of a dynamic credit market that meets the credit needs of households. But a low level of growth is not necessarily a negative sign. It can be explained by a mature market where those needs are already met (i.e. the UK).

Many economists, consumer credit providers and policy makers support the argument that a higher distribution of credit is better than a lower one as it provides an answer for borrowers. This kind of argument is also used to oppose the introduction of a usury ceiling in the UK or in Ireland (Thiel, 2009).

Nevertheless, such an explanation appears to be too simple. How can the growth rate of consumer credit be sustainable when the difference in relation to the growth of disposable income is so significant? An indication that this growth was probably not sustainable is that four of the countries most damaged by the current financial crisis (Greece, Ireland, Italy and Spain – only Portugal is not included) are in the top 5 countries in Figure 10.

Another indication is given by comparing the growth of consumer credit and of disposable income. Figure 10 shows that growth rates are:

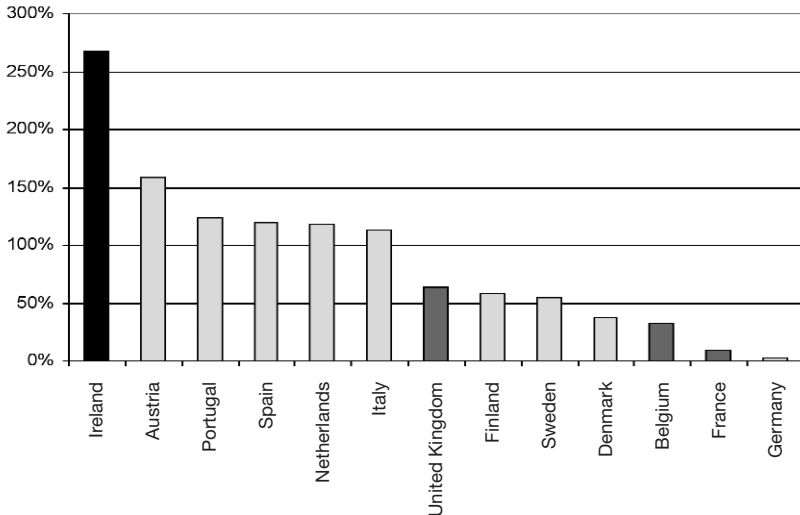
- 60.6% for consumer credit and 4.8% for disposable income in Greece;
- 39% for consumer credit and 4.8% for disposable income in Finland;
- 26.3% for consumer credit and 6.1% for disposable income in Ireland;
- 21.8% for consumer credit and 4% for disposable income in Italy.

In these four countries consumer credit has grown between 4 and more than 12 times quicker than disposable income.

These gaps between consumer credit and disposable income are concerning as the ratio of household debt to disposable income is a good indicator of households' financial difficulties and its rise is associated with an increase in arrears (Del Rio, Young, 2005; Rinaldi, Sanchis-Arellano, 2006). In other words, the observed rise in the ratio of household debt to disposable income is an indication of growing

concern regarding overindebtedness. In order to have a more accurate picture it is necessary to also include mortgages (Figure 11).

*Figure 11: Growth of household debt/ disposable income ratio 1995-2005/2008*



**Source:** Amárach Research (2009)

Figure 11 shows that the ratio of household debt to disposable income in Ireland grew by 267% between 1995 and 2008, to reach 176% in 2008. This shows that Ireland was at high risk of experiencing overindebtedness among its citizens. With a more “moderate” growth rate of 63% the UK is also in a difficult situation as its ratio was close to the Irish one at 173%. In comparison, Belgium (growth rate of 32% and ratio of 75%) and France (9%/72%) look safer, even though overindebtedness is rising as a result of the financial crisis.

Overindebtedness is a particularly traumatic experience for households. All aspects of the lives of households are strongly affected in the short and long term by their financial difficulties (LRC, 2009). Self-esteem and family relationships can be seriously damaged (Gloukoviezoff, 2008). Additionally, accommodation arrangements (as homeowner or renter) and employment (risk of redundancy) can be affected (Duygan-Bump, Grant, 2008). Finally, indebted people can suffer from psychological and physical health problems such as

depression, insomnia and panic attacks (Women's Health Council, MABS ndl, 2007; Duygan-Bump, Grant, 2008).

These negative consequences may be stronger in Ireland and in the UK compared to France and Belgium. This is because Ireland and the UK place a greater emphasis on the social role of credit to meet the needs of promotion and protection.

Despite the variations experienced by different countries, the intensification of financialisation creates an environment where financial products are unavoidable. Even though most of the population are able to cope with these new norms, a significant cohort faces difficulties which intensify along with financialisation.

This is an important issue to remember when designing financial inclusion policies. Negative consequences need to be taken into consideration and safety nets designed to ensure that nobody falls into poverty because of banking difficulties. Another issue is the need to prevent banking difficulties and their consequences. In order to achieve such a goal, it is necessary to understand the causes of these difficulties.

#### **1.4 Why do some people face banking difficulties?**

A report for the European Commission categorised the causes of financial exclusion into demand factors, supply factors and societal factors (RFA, 2008a). Even though this distinction is pertinent, the analysis fails to connect the different factors. This section, therefore, reorganises the analysis by examining demand factors versus supply factors while integrating the influence of societal factors.

##### **1.4.1 Do households lack financial skills?**

Financial education is often advocated as a solution to difficulties in accessing basic banking services or in relation to overindebtedness. Without discussing the effectiveness of financial education, it is interesting to note the attitude of these proponents regarding banking products.

###### **1.4.1.1 Confidence and skills**

Self-exclusion is sometimes cited as a reason for not accessing financial products. As defined by Kempson and Whyley (1999), people exclude themselves because:

- they believe that banks would refuse them;

- they (or someone they know) have been refused in the past;
- they are afraid to lose control of their finances if they use such products.

Self-exclusion is generally seen as the result of lack of knowledge and of confidence (self-confidence and confidence in the banks) which could be solved with financial education (RFA, 2008a). Furthermore, some customers do not inform their bank about their financial difficulties and try to find solutions themselves, resulting in even more difficulties (Gloukoviezoff, 2008). Research needs to be carried out to test the affirmation that financial education could address these issues.

The Financial Service Authority in the UK funded a study to assess the financial capabilities of British people (Atkinson *et al.*, 2006). This study highlighted three key findings.

First, on average rich people have the same level of budgeting skills as poor people, but it is easier to manage a rich budget than a poor one. In other words, everybody with a sufficient level of income is able to make ends meet regardless of his/her level of budgeting skills.

Second, financial capability levels increase alongside the use of financial tools. Therefore the use of financial services is the best way to improve one's financial skills and confidence.

Third, people with a very low level of income and who manage to make ends meet have a very low level of access to financial services. This result is not developed in the report. However, other research has shown that people who do not have access to financial services are able to develop budgeting skills that would be at odds with banking rules which would lead them to difficulties (Gloukoviezoff, 2008). For example, people who budget on a weekly basis find it difficult to make ends meet when having to deal with loans that have to be reimbursed on a monthly basis. Even though these people experience the negative consequences of non-access, they are more able to maintain control of their finances without accessing inappropriate banking products. Financial inclusion is not only about access but about appropriate access.

Therefore, the problem of skills and confidence (e.g. financial capabilities) is not a one-way issue. Even though these people lack banking skills and confidence, their so-called "irrational" banking behaviour also suggests that banking rules are not compatible with their knowledge of how to manage a budget.<sup>18</sup> The financial behaviour

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<sup>18</sup> It also includes difficulties that some migrants face when they come from countries where banking services are not widely accessible.

expected from customers (and considered as rational) is not suitable in a context of structural difficulties (e.g. poverty) or sporadic difficulties (i.e. loss of job, health problems, divorce, etc.). This expected behaviour is not suitable for at least two reasons.

First, difficulties have an impact on the way people make decisions because of the emotions generated. When someone is made redundant, is let down by his/her spouse, or has a health problem (physical or psychological), that person is not able to make use of his/her skills with the same effectiveness. For example, a lone parent who does not have any more money and who needs to pay for the school uniform of her child will borrow money even if she knows that this loan will make her situation even more difficult. The loan gives her a short-term solution, which is what she needed. When a person is living in poverty, planning ahead and neutralising emotions is often just a wish (Gloukoviezzoff, 2008).<sup>19</sup>

Second, a rational behaviour is not suitable because of:

- lack of room for manoeuvre: when facing a limited and potentially irregular budget and having to repay borrowed money, rent or subscriptions, it is often difficult for a household to organise these different constraints and unexpected expenses;
- lack of alternative answers to accessible credit: to “over borrow” could also be seen as the lack of alternatives to meet finance needs. It could indicate the impossible task of trying to increase wages to an acceptable level or of finding a response from the welfare state. For example, sometimes overindebtedness is caused by difficulties in repaying, directly or indirectly, debt related to health expenses, even though it could be argued that these expenses should be the responsibility of the welfare state.
- lack of availability of appropriate financial services: people often use inappropriate financial services because these may be the only ones available.

In order to understand why these “decisions” seem to lead people into difficulties, it is necessary to take into account the situation in which such decisions are taken, and the characteristics of the services supplied.

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<sup>19</sup> This effect deals with the impact of emotions on decisions. Although the same theme is explored by behavioural economics, the theories do not satisfactorily explain these behaviours because even though they identify the behaviour, they are unable to explain why it occurs.

#### 1.4.1.2 Lack of financial room for manoeuvre

According to the literature (Kempson *et al.*, 2004; Kempson, 2006), access to bank accounts is correlated with the levels of inequality in society (the higher the levels of inequality, the lower the access to a bank account), while access to consumer credit is influenced by macroeconomic variables (disposable income, consumption expenditures), welfare policies, efficiency of a country's judicial system and socio-cultural factors (Vandone, 2009).

Socio-cultural factors will not be examined here, because when they are considered at national level they are related to the norms of a country and cannot be considered as a source of financial exclusion. A country's judicial system will be explored in Part Two of this text.

Two other interconnecting variables are significant here: the household budget (disposable income, consumption expenditures) and welfare policies. The hypothesis presented in this text is that the role of consumer credit varies among countries depending on the level of poverty and the level of welfare state intervention. Despite the dearth of econometric analysis on the topic, it can be argued that consumer credit represents the "ultimate market-based social welfare programme" (Sullivan *et al.*, 2000, p.138) in countries with higher levels of poverty and with lower levels of welfare state intervention. This exposes people who are in difficulties and are relying on consumer credit to a higher probability of defaulting and a higher risk of poverty (Ramsay, 2003; Gloukoviezoff, 2008).

This point is illustrated by considering the United Nations Development Programme's *Human Poverty Index* for developed countries (HPI-2) and the European "At-risk-of poverty" rate (see box 2).

#### **Box 2. Definition of Human Poverty Index and At-risk-of-poverty rate**

The HPI-2 measures deprivation in four dimensions:

- A long and healthy life – vulnerability to death at a relatively early age, as measured by the probability at birth of not surviving to age 60.
- Knowledge – exclusion from the world of reading and communications, as measured by the percentage of adults (ages 16-25) lacking functional literacy skills.

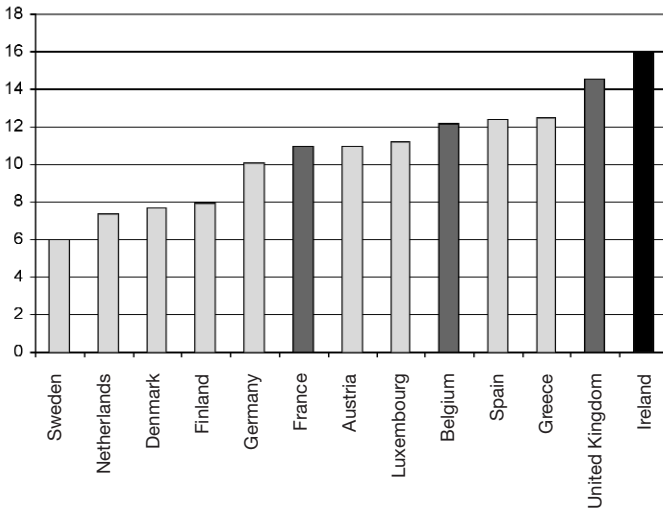
- A decent standard of living – as measured by the percentage of people living below the income poverty line (50% of the median adjusted household disposable income).
- Social exclusion – as measured by the rate of long-term unemployment (12 months or more).

The “At-risk-of-poverty rate after social transfers”

The at-risk-of-poverty rate is the share of the population living below a defined poverty line (and therefore likely to suffer social exclusion) according to equivalised disposable income (here, 60% of disposable income).

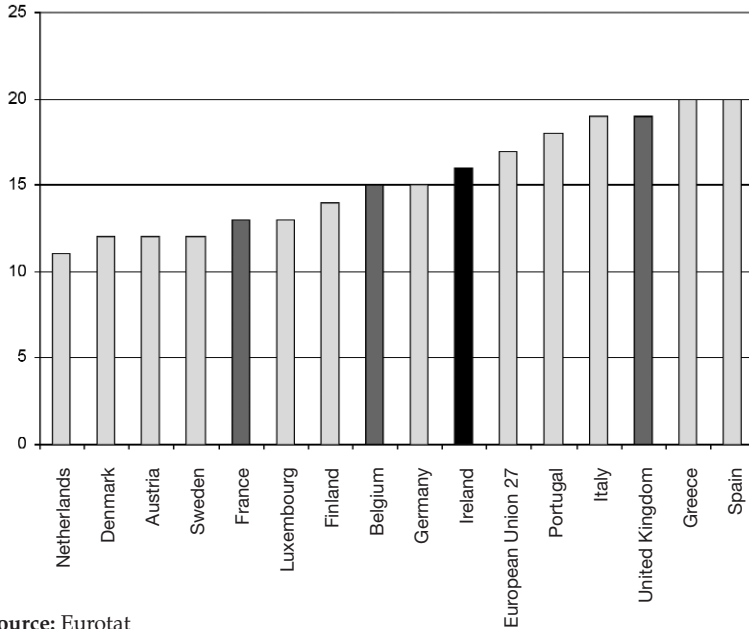
**Source:** United Nations Development Programme (<http://hdr.undp.org>) and Eurostat website (<http://epp.eurostat.ec.europa.eu/>)

Figure 12: Human Poverty Index (HPI-2) (% , 2009)



**Source:** United Nations Development Programme

Figure 13: At-risk-of-poverty rate in 2008 (%)



Source: Eurostat

The data show that Ireland and the UK, which have higher levels of access to consumer credit, also score highly on the Human poverty index and the At-risk-of poverty rate. These results support the current author's hypothesis that the role of consumer credit varies among countries depending on the level of poverty and the level of welfare state intervention. When, therefore, the lack of budgeting or financial skills is pointed out as the main factor for financial difficulties, it is useful to remember that with no room for manoeuvre it is more difficult to respect banking norms and rules. In that regard, it is necessary to consider the role of welfare states in these countries so as to understand the role of consumer credit as a tool of market-based social welfare.

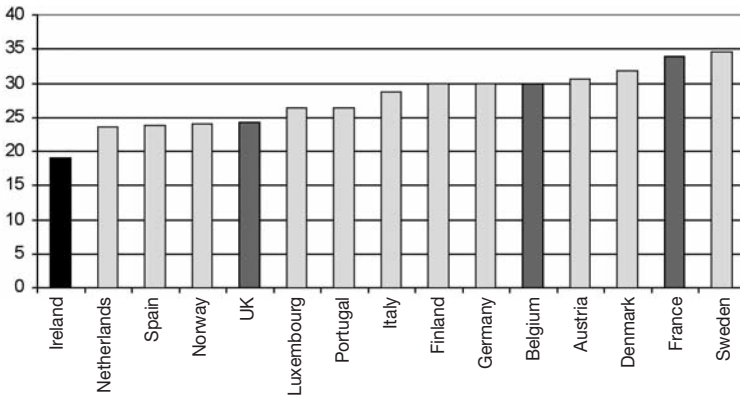
This can be done by using the work of the OECD (Adema and Ladaïque, 2009) which outlines three ways of measuring social expenditure:

- gross public social expenditure, which is commonly used for international comparison but does not give a very good picture of social expenditure in a particular country;

- net publicly mandated social expenditure, which takes into account direct and indirect taxes affecting social benefits as well as mandatory private benefits;
- net total social expenditure, which includes net public expenditure as well as net private expenditure (mandatory or not).

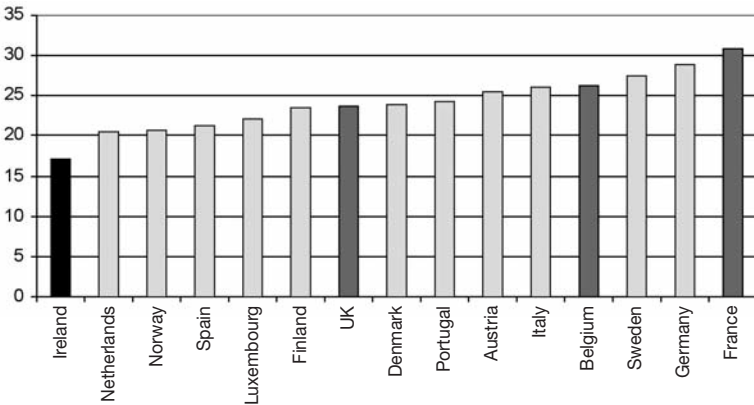
The comparison of social expenditure among the EU-15 countries is presented in Figures 14 to 16.

Figure 14: Gross public social expenditure (% of GDP at factor costs, 2005)



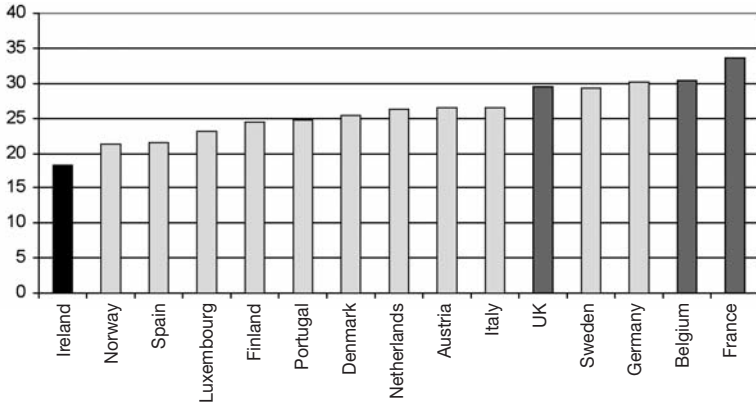
Source: Adema and Ladaique (2009)

Figure 15: Net publicly mandated soc. exp. (% of GDP at factor costs, 2005)



Source: Adema and Ladaique (2009)

Figure 16: Net total social expenditure (% of GDP at factor costs, 2005)



Source: Adema and Ladaique (2009)

Except for the fact that France and Belgium can – again – be distinguished from Ireland and the UK, it is interesting to note that the two former countries are not similar regarding the role played by private social expenditure. A comparison of net publicly mandated social expenditure (e.g. net social expenditure controlled by the state) with net social expenditure reveals that Ireland's contribution increased from 17.2% of GDP to 18.3%,<sup>20</sup> while the UK increases went from 23.7% to 29.5%, almost as much as Belgium (30.3%).

At first glance it would seem that social expenditure is much less of a priority in Ireland and in the UK compared to France and Belgium. However, further consideration shows that the UK has adopted another strategy which gives a significant part of the

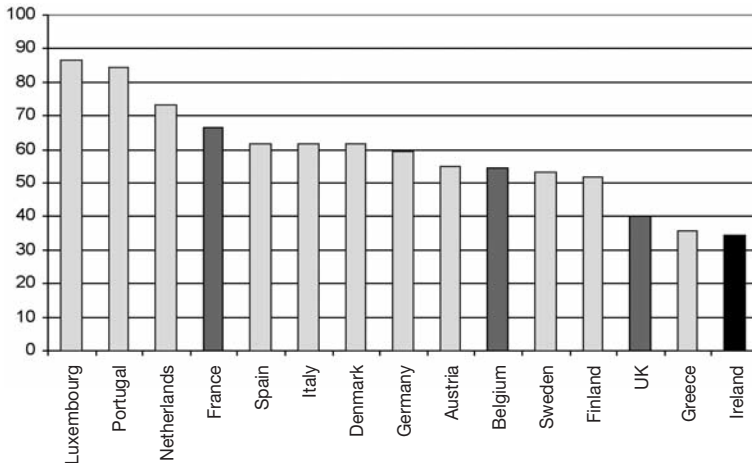
<sup>20</sup> It has to be noted that to consider GNP rather than GDP for Ireland makes a difference as gross social expenditure in Ireland in 2006 was 18.2% of GDP and 21.4% of GNP, but Ireland is still far behind the UK with 26.4% of GDP, Belgium with 30.1% and France with 31.1% (EAPN Ireland, 2009).

responsibility to private non-compulsory social expenditure.<sup>21</sup> So, contrary to the situation in Ireland, a large part of the UK's social expenditure relies on the voluntary decisions of private actors. Both countries rely primarily on a market economy to reduce poverty (as opposed to state intervention through social expenditure), but the UK has institutionalised private non-mandatory expenditure as part of social expenditure.

Therefore, it is logical that consumer credit plays such an important social role in Ireland and in the UK as opposed to France and Belgium where responses to poverty are not (yet) primarily market-based. Without alternatives such as collective protection, consumer credit appears more appealing.

Loss of employment (OEE, 2008) and lack of access to basic banking services (RFA, 2008a) are significant factors contributing to overindebtedness. The net replacement rate compared to average wages when people lose their jobs (Figure 17) and the value of

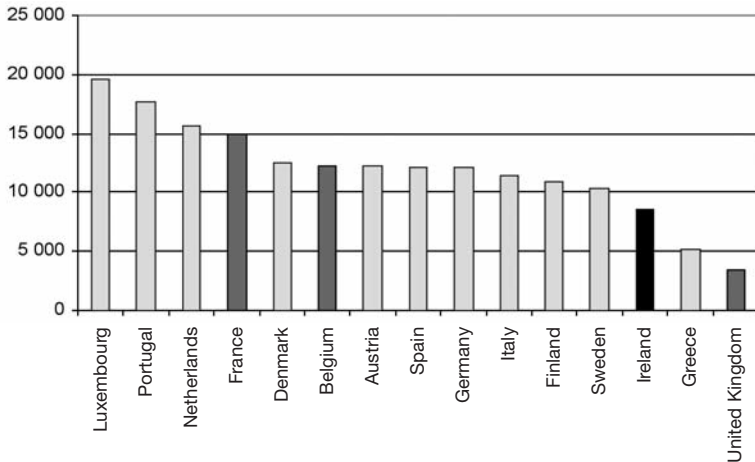
Figure 17: European net replacement rate compared to average wages (% , 2007)



Source: EAPN Ireland (2009)

<sup>21</sup> Mandatory social expenditure comprises social supports that are stipulated by legislation but operated through the private sector (e.g. direct sickness payments by employers to their absent employees as legislated for by public authorities, or benefits accruing from mandatory contributions to private insurance funds). Voluntary private social expenditures are benefits accruing from privately operated programmes that involve the redistribution of resources across households and include benefits provided by NGOs, and benefits accruing from tax-advantage individual plans and collective (often employment-related) support arrangements, such as, for example, pensions, childcare support, and in the US, employment-related health plans (see Adema, Ladaique, 2009, p.13).

Figure 18: Unemployment benefit 2007 single person (€ – Comparative price level indices)



Source: EAPN Ireland (2009)

unemployment benefits (Figure 20) offers further insight into the role of the market and the State in meeting the need for protection in the four countries under study.

The graphs show that not only are Ireland and the UK the least generous regarding net replacement rates, they also provide a very low level of unemployment benefit. This means that unemployed people in these countries could face real difficulties in making ends meet, and this has two consequences:

- It could become extremely difficult to repay existing debts, given that income has dropped so significantly.
- In order to continue to face basic expenses, people may turn to home credit companies or unregulated money-lenders as a short-term solution.

Both of these factors contribute to increased financial difficulties and can result in overindebtedness.

None of the previous data are strong enough to allow a definitive conclusion on the social role of consumer credit, by themselves. However, taken together, key themes emerge.

An examination of the level of indebtedness of households shows

that the role of credit in Irish and British society is much more significant than that in France and Belgium. This reflects different consequences of a financialisation led by market logic:

- Low-paid and low-skilled workers have seen their situation deteriorate since the 1980s following the deregulation and increasing influence of financial markets.
- The welfare state and public services are perceived to be too costly and inefficient and the result has been a transfer to the market of part of their responsibilities.

This transfer has meant that the poorest households are obliged to borrow so as to meet their consumption needs. This trend has been supported by the rise in property prices, giving the impression to homeowners that they were becoming richer and that they could borrow more money.

The current financial crisis shows that this type of economic model is not sustainable. Even in the short term, only a minority can benefit from it as only they can fulfil the requirements of the financial institutions. High levels of inequality and of poverty are a reminder of the limitations of such a model.

Financial exclusion (difficulties accessing basic banking services and overindebtedness) is a result of the constraint that financialisation has put on households following government decisions. For instance, in Ireland and the UK, the welfare state and social protection are weaker and rely more on private intervention (mandatory or not). Given the level of household indebtedness in these two countries, it seems that Ireland and the UK have allowed the credit industry to meet needs which in France and Belgium tend to be managed by collective protection and public services (even if the influence of the welfare state is also on the wane in these two countries).

Credit dependency has risen among those who are least able to pay the price asked by the subprime credit industry. A British report noted that “most of their clients are now continuously in debt, which is partially caused by the business models of subprime credit, and partially because of the decline in real incomes that creates a continuous need for credit to make ends meet” (Thiel, 2009, p.5).

This transfer of essential elements of social cohesion to financial institutions is explained by the influence of market-led financialisation. Unfortunately, financial institutions are also under its influence.

### 1.4.2 The profitability constraint and financial providers

Even though financial institutions are not responsible for every difficulty people face in managing their finances, the important role played by the financial industry is discussed less and less frequently in the literature dealing with financial exclusion. For instance, a report for the European Commission on overindebtedness not once mentioned the role of the credit industry as a potential cause of overindebtedness (OEE, 2008).<sup>22</sup> Conversely, the literature review of supply side causes of financial exclusion offered by another report for the European Commission, (RFA, 2008a), is more convincing even if there is no analysis of the causes of these practices.

#### 1.4.2.1 Supply side causes of financial exclusion

Banking service providers could create difficulties for households in three different ways: selection, indirect selection and inappropriate access.

Selection lies at the heart of banking activity. It is essential for providers to assess if potential customers are credit-worthy, or if they will be profitable, before beginning a commercial relationship. Providers can refuse to give access to a large range of banking services, or consumer credit, to people with a history of bad debt, or who are unknown and whose situation is deemed by credit scoring tools to be highly risky (Gerrard *et al.*, 2006). People with low levels of income, who have experienced financial difficulties, who are in a precarious professional situation or who are unemployed, single parents, or migrants, etc. face serious difficulties in accessing financial products (Kempson, Whyley, 1999; Kempson *et al.*, 2000; Carbo *et al.*, 2005; Devlin, 2005; Corr, 2006).

However the selection criteria implemented by financial services providers is not entirely reliable. Some customers' applications are turned down because they are not known by credit bureaux or because insufficient information is supplied by applicants. Perhaps more information should be collected in the providers' database. Conversely, it could be pointed out that the reliance of financial services solely on this kind of information is part of the problem. Credit scoring can be useful but it is an imperfect tool (Leyshon, Thrift, 1999). An interview with a bank employee could be a way to fill this gap, even when the customer has a record of his/her financial consumption.

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<sup>22</sup> It only mentions loss of income, low income, money management and over-commitment or over-spending as potential causes of overindebtedness. See OEE, 2008, pp 22-32.

Apart from these direct practices of selection, there are other ways financial services providers avoid “undesirable” customers. One way is to refuse customers who are unable to provide appropriate documents to prove their identity. Following the tightening of money laundering rules in response to terrorism, banks have to control the identity of their customers in a stricter way (Kempson *et al.*, 2000; Anderloni, Carluccio, 2006). Nevertheless, it seems that these requirements are sometimes used as an excuse to create difficulties in countries where documents such as ID cards or driving licences are not widely used (Corr, 2006).

An indirect way to avoid some customers is to be inaccessible to them. This issue of the geographical distribution of bank branches became the starting point for studies on financial exclusion. At the heart of the issue were the difficulties that people living in rural areas or disadvantaged areas faced in accessing bank branches due to bank closures or relocations (Leyshon, Thrift, 1995). This cause of financial exclusion has become less prominent in financial exclusion debates during the past decade.<sup>23</sup> Nevertheless, it is still contributing to access difficulties for numerous people (French *et al.*, 2008).

Besides the physical barriers, it is also possible to build technological barriers. The delivery of banking services through the internet creates difficulties for those who do not have regular access to the internet, who do not use it or who do not trust it (Hogarth, O’Donnell, 2000; Lee, 2002). Yet another effective way to avoid some customers is to avoid proposing services that could suit their specific needs. Banks show a lack of interest in the specific needs of customers who are perceived as not profitable. The quick development of financial products compatible with Islam is the proof that when banks realise they can make a profit, they are willing to adapt their offer.

Providers also avoid “undesirable” customers through inappropriate product design (this can also be used to make them profitable). Terms and conditions or the cost of products could either deter a consumer from establishing a relationship with the provider, or make the relationship profitable for the provider even if it implies a deteriorating situation for the customer (Gloukoviezoff, 2004, 2008). This practice can partly explain self-exclusion. People may give up accessing a transaction account, a debit card or consumer credit

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<sup>23</sup> It is argued that this issue have been progressively understood as an unavoidable development following the efficient reorganisation of branch networks according to French *et al.* (2008).

because the conditions or price are unsuitable. In this regard, self-exclusion is not a problem of lack of knowledge or confidence. It is the result of the pertinent appreciation by customers of the inappropriateness of the services provided by banks (Gloukoviezoff, 2008).

Products are designed not only to deter some customers, but to entice other customers who are viewed as potentially more profitable. This is done in different ways. For example, some providers design “packages” of products, even though most customers only use some of them while paying for all of them. Some providers apply extra cost to products that are widely consumed by customers (e.g. charge for cash withdrawal at the bank’s counter or for incidents that are more likely to occur for poorer customers than for more affluent customers). These extra charges for incidents would be potentially negotiable for more affluent customers while poorer customers would have to pay them.

The last practice is lack of personal contact. “Undesirable” customers do not have access to a dedicated banker who would try to accommodate their needs within the banking norms and rules. This very costly aspect of the service is only accessible for the most profitable customers as their satisfaction is a key element of the commercial relationship. The least profitable are commercially interesting only if they pay a high price for the service, a service that has not been designed to suit their needs in the first place.

These practices cannot be criticised *per se* because financial services are commercial institutions which have to make a profit. Nevertheless, the extent of these practises can be criticised as it concerns a significant number of people who cannot gain access or who suffer from use difficulties that can lead to overindebtedness.

#### **1.4.2.2 An imperfect competition**

It is common knowledge that the financial sector experienced a huge structural change during the past three decades. As a result, less and less of their profit came from their role as an intermediary between companies who needed funds and households who had savings. At the same time, the elections of Reagan in the USA and Thatcher in the UK witnessed the start of the neo-liberal wave. One of the manifestations of this new wave was deregulation which was supposed to increase competition and make financial institutions more efficient.

As a result, the attitude of banks towards customers changed. Customers remained a source of deposits for loans; however, they also became a target for profit-making. In the mid-1980s, financial institutions began to develop commercial strategies to achieve this goal, based on the segmentation of customers and the differentiation of services provided.

Given that low-income consumers are less profitable, banks placed all their efforts in meeting the needs of more affluent customers. The focus on these customers is seen as “cherry picking” (Kempson et al., 2000; Devlin, 2005) or a “flight to quality” (Leyshon, Thrift, 1995). Consequently, the more profitable customers are on the verge of “super-inclusion” (Leyshon, Thrift, 1996), while others suffer from access and use difficulties because products are inappropriate to their needs. Competition to attract “supposedly” more profitable customers is so strong that, in the USA, the conditions offered to high-income customers for credit cards are subsidised by low-income customers (Ramsay, 2003). Even though competition is seen as a way of improving service quality, it has reinforced the process of financial exclusion (Carbo *et al.*, 2005; Gloukoviezoff, 2006, 2008).

This description of the effects of deregulation is broader than that proposed in the recent report on financial exclusion for the European Commission which states that “liberalisation of financial services market [...] has, in turn, led to increases in the number and complexity of financial products and providers. While this has widened access, the confusion that arises makes it difficult for some people to engage with financial services” (RFA, 2008a, p.40). Obviously the effects of competition are more far-reaching than mere “confusion”.

Financialisation can be used to explain why competition is not beneficial for all consumers. Firstly, even though the process of financialisation has made it necessary for every citizen to use financial products in order to lead a normal life, competition only focuses on a profitable cohort of the population. Secondly, financial institutions have experienced the constraints of financialisation and have been directly affected by financial market logic:

- their incomes from their subsidiaries and their investments in financial assets have grown;
- their transfers to financial markets in the form of interest

payments, dividend payments and stock buyback have risen.

Consequently, the profitability ratio expected by shareholders has grown quickly (Lordon, 2000, 2008; Dembinski, 2008). This reduces the proportion of “desirable” customers and increases the proportion of excluded or inappropriately served customers.

This development, which has increased financial exclusion, is the normal result of market logic operating on the process of financialisation. Even the structures of the banking market have changed remarkably. Building societies, credit unions or cooperatives banks which are driven by logic closer to reciprocity than market exchange, have suffered severely from this change. Since the mid-1980s building societies have experienced demutualisation in the UK, and in Ireland they have lost a large part of their specificity and influence since the reforms of the late 1980s and early 1990s. In France cooperative banks are still the main financial providers but they have seen their distinguishing features largely weakened under the influence of financialisation (Gloukoviezoff, 2010).

Similar to households, financial institutions (even co-operatives) have witnessed a change in the way they operate as a result of the intensification of financialisation due to the constraints of the financial markets. They too have played a role in the development of financial exclusion.

The causes of access and use difficulties have developed at two different levels which closely interact. The first level is the relationship between households and financial providers (demand and supply side causes). There are numerous factors that can lead to difficulties, e.g. lack of information, misunderstanding, opportunism, moral judgements, etc. Economists focus on market failure related to asymmetric information, while sociologists underline the inherent difficulties of social interactions. The second level of causes corresponds to the influence of the institutional context within the financial services relationship. It can mainly be characterised as market-led financialisation. It is extremely important to take into account these two levels when designing appropriate policies to tackle financial exclusion. This prevents a narrow approach that focuses on market failure. For some households, the problem is market logic itself, as these households are not profitable enough to have appropriate access.

### 1.5 Government responsibilities and financial inclusion policies

The institutional context, within which financial institutions and households evolve, is anything but a natural one. It is the result of political decisions. Of course, technological improvements have changed the way money is kept and used. Nevertheless, they do not constrain the norms and rules of access and use of financial products in a way which would explain financial exclusion.

The increasing need for households to make use of financial services is a direct result of political decisions. It is true for current accounts and modern means of payment (i.e. the mandatory payment of wages and social benefits through a current account) as well as for consumer credit (i.e. the increased flexibility of labour market and the reduced role of the welfare state both of which pressurise household budgets). These decisions reflect the growing influence over the past thirty years of a market-led financialisation and the implementation of neo-liberal policies. However, they are not by themselves sufficient to generate such levels of difficulty in accessing financial services or such high levels of overindebtedness.

These difficulties occur because market-led financialisation and neo-liberal policies (i.e. deregulation) have also impacted on financial services providers. As long as the intensification of financialisation is not mainly led by market logic, it does not generate significant financial exclusion. For years, the cooperative banks and the postal banks in France, the postal bank in Belgium, and the cooperative banks, building societies and credit unions in the UK and Ireland have limited the difficulties that the intensification of financialisation can create for low-income households. The financial sector therefore was mainly under the influence of the logic of redistribution and/or of reciprocity. These institutional arrangements (the mixed logics of redistribution and reciprocity) have proved to be favourable to greater financial inclusion.

It is essential to keep in mind that this shift from public intervention<sup>24</sup> to market logic was implemented by governments themselves. It was presumed that financial markets would be more efficient (supply-side economics) and would offer solutions to finance state expenditure as well as to improve the way companies were financed. More deregulation was needed to allow their development. These decisions were seen as pragmatic answers to

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<sup>24</sup> However, a financial sector which would be 100% public would not necessarily be the panacea. Public action as well as private action can be inefficient in relation to financial inclusion (World Bank, 2008), and it can also privilege private interests over collective ones (Galbraith, 2008).

concrete needs. Nevertheless, they increased the intensification of a market-based financialisation and acted as a catalyst for financial exclusion.

Even though governments have partly withdrawn from the economy, they still have to address social issues. It is therefore not surprising that they have been constrained to tackle financial exclusion (in different ways, depending on the government). Among the four countries under examination, France was the first to intervene on financial exclusion. Although the actual concept of “financial exclusion” was not mentioned for the first time until 1998, in 1984 a legal right to a bank account was implemented and in 1989 a non-judicial procedure was put forward to deal with overindebtedness. In 1992 MABS was established in Ireland to help people deal with financial difficulties. In 1998 in Belgium a non-judicial procedure to deal with overindebtedness was introduced and in 2003 a universal banking service, following a charter for access to basic banking services in 1996, was implemented. Finally, the UK started to develop a non-legally binding strategy to deal with access difficulties and overindebtedness following the electoral victory of Labour in 1997.

There are several explanations for this temporal proximity of political interest in the two main dimensions of financial exclusion (lack of access to basic banking services and overindebtedness). The main one is probably the fact that there was a delay between the deregulation of the financial sector (1980s) and the consequences for households (late 1990s). The different pace of intervention between these countries could be related to variations in levels of financialisation and in political traditions of intervention.

## **1.6 Conclusions**

This chapter has shown that financial exclusion is not only an issue of access to financial products but is a process where access and use difficulties are intertwined. It also demonstrates that access to a bank account is one aspect of the process of financial exclusion, while overindebtedness is another.

The process of financial exclusion is the result of the intensification of financialisation which makes financial services socially unavoidable for every citizen, while these services are sold by commercial institutions. It is the social role played by financial products and the difficulties citizens face in establishing a

relationship of good quality with financial service providers which has led to the prevention of financial exclusion becoming a major policy issue in Europe.

When financial exclusion is understood as a social phenomenon rather than as a result of weaknesses in the market the variety of causes increases dramatically. It is not only a technical problem that bankers and customers face but also the result of institutional developments which constrain the practices of both actors. For example, overindebtedness is partly explained by the fact that consumer credit has been used to complement low or irregular wages or insufficient social protection. Similarly, when a government decides to make wages or benefits accessible only through a bank account, it does not directly increase financial exclusion but it increases financialisation. This intensification leaves citizens with no other choice than to access a bank account even if its conditions are not appropriate to their needs.

In order to comprehensively develop a financially inclusive society, it is necessary to consider the process of financial exclusion as a result of a market-led financialisation which constrains households to use financial products, while providers are constrained to be as profitable as possible. Today, financial exclusion and financial inclusion policies are still viewed as technical rather than societal issues.

## **PART TWO**

### **Combating Financial Exclusion and Overindebtedness**



# Introduction

The move from merely conceptualising financial exclusion as difficulties accessing financial products to an understanding of the process of financial exclusion which links access and use difficulties has consequences regarding the policies implemented to tackle this phenomenon. The first part of this report identified the causes of these difficulties.

The framework that has been elaborated takes into account the demand and supply side factors which contribute to access and use difficulties as well as institutional factors such as the intensification of financialisation. Being able to take into account these different factors helps to assess the strengths and weaknesses of the responses available to tackle financial exclusion.

Firstly, a global answer to financial exclusion should consider the social role given to banking products. For instance, access to consumer credit is often seen as a necessity because no other solution is available to meet those financial needs. Therefore, in order to tackle access difficulties, as well as overindebtedness, it is necessary to explore the possibilities of providing higher levels of income, better levels of social benefits, and better public services. Despite their importance, these elements will not be specifically assessed in this report.

Secondly, in order to tackle financial exclusion in an efficient way, it is necessary to consider interactions between access and use difficulties. It is useless to promote access to basic banking services if these services are not designed to suit the needs of the customers. Similarly, tackling overindebtedness by restraining access to consumer credit implies that alternatives are available to compensate for lower access.

Thirdly, two sets of responses are needed to both prevent and address the consequences of access and use difficulties. The first set of answers targets the causes of the process of financial exclusion while the second set acknowledges that it is impossible to completely suppress these difficulties and their consequences.

This second part of the report assesses the different policies implemented to promote appropriate access to basic banking

services and responsible credit in the four countries studied. This assessment pays particular attention to the institutional context in order to identify the causes of the efficiency or inefficiency of those policies. Based on this assessment, it will therefore be possible to define some key recommendations to promote a more financially inclusive society in Ireland.

## Appropriate access to basic banking services

Tackling access difficulties to basic banking services is a paradoxical target. When the level of access is very low, it means that the intensity of financialisation is low too and that people without access to banking services are still able to live a normal life even if they face some negative consequences. However, if societies have low levels of access, this is usually only temporary if they are connected with other modern societies. This situation leads to a dual society where those with access can enjoy more opportunities and save money in their financial transactions. But if the level of access improves, it increases the intensity of financialisation which means that those remaining outside the banking system face higher negative consequences and are unable to lead a normal life.

Consequently, improving access to basic banking services requires taking into account wider social norms. First, those left outside the banking system face increasing difficulties. Therefore, even when there is a low level of unbanked, these people still need to be given appropriate access. Second, the appropriateness of the access changes with the level of access and intensity of financialisation. A bank account could be sufficient initially but adding modern means of payment quickly becomes unavoidable as these become the norm.

In order to outline a potential Irish strategy to promote access to basic banking services, the strengths and weaknesses of the strategies adopted in the UK, France and Belgium will be assessed.

### 2.1 Access to basic banking services in Ireland

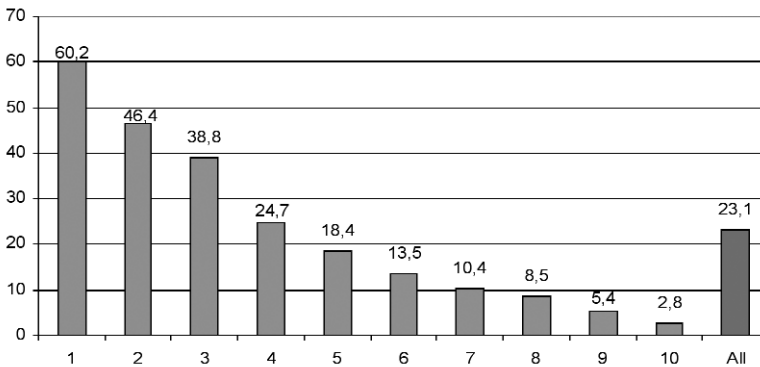
Ireland has not yet developed a strategy to promote access to basic banking services, even if this issue is now part of the political discourse since the publication of the Combat Poverty report in 2006 (Corr, 2006). It is nevertheless an ambitious target to develop access in Ireland as the country has one of the highest levels of banking exclusion in Western Europe.

### 2.1.1 Exclusion from banking services

In Ireland, financialisation is less intense than in other similar economies. One of the reasons for this is that there is no legal constraint to receive wages or social benefit through a bank account. Therefore, it is still possible to manage one's finances in cash even if it makes it more difficult to get a job or to rent accommodation (Corr, 2006). On the supply side, only retail banks offer current accounts as they are part of the clearing system. Building societies and credit unions only offer saving accounts, some of which can receive wages and benefits, but only very few credit unions are piloting current accounts. In 2010 An Post announced the closure of its bank (Postbank) which was set up in 2007 in partnership with the Belgian bank Fortis (and then the BNP-Paribas when it bought Fortis). Before the decision was made to close it, Postbank had announced that it was looking to provide a current account for Irish people outside the banking system. Such an effort was needed given the high levels of unbanked in Ireland.

The latest figures from 2008 show that 16.8% of Irish people have no access to a current account (EU-SILC).<sup>25</sup> Similar to other Western European countries, the main barriers to a bank account are low income and being in receipt of social welfare (pensioners, lone parents, unemployed, etc.) (Corr, 2006). The influence of these elements is illustrated by the fact that, in 2008, 32.4% of people at-risk-of poverty had no access to a current account (EU-SILC). It can also be seen in the following figure which shows the percentage of people without access to a current account by income decile for 2005.

Figure 19: People without a current account by income deciles (% , 2005)

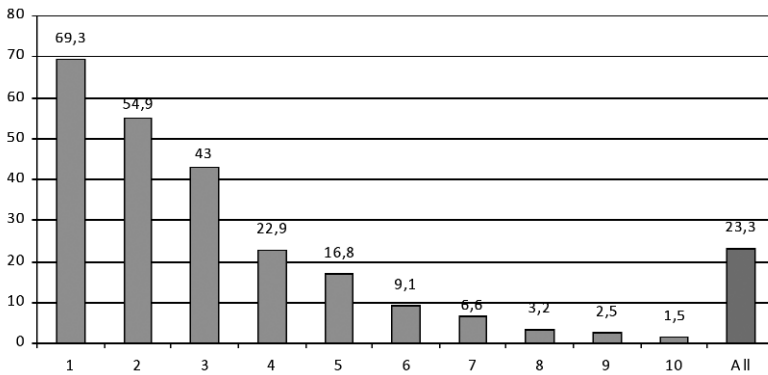


Source: Household Budget Survey, 2004/2005

<sup>25</sup> Based on data from 2005, Corr (2006) shows that 10% of Irish people have no access to a bank account while around 23% have no access to a current account.

Those with a low income are also more likely to be excluded from access to debit cards. While there is almost the same global level of people without access (around 23%), it is interesting to note that the absence of a debit card is even more polarised than for a current account (Figure 20). This probably underlines the fact that a bank account in itself is not enough and that a debit card is needed to optimise the benefits of a bank account. However, the barriers are higher for those on a lower income.

Figure 20: People without a laser card (debit card) by income deciles (% , 2005)



Source: Household Budget Survey, 2004/2005

The high numbers of people without access to current accounts and to debit cards can be explained by a lack of trust in banks, a lack of banking knowledge and also a preference to manage money outside the banking system, in cash (Corr, 2006).

However, it is necessary to be careful interpreting the preference for people on a low income to operate in cash. A quick interpretation could be that their “exclusion” from a bank account is not a problem as they prefer cash. This interpretation ignores the negative consequences they already face and which will increase with the intensification of financialisation. Such an interpretation also overlooks the fact that the unbanked may prefer cash because no appropriate banking service is provided. In order to understand this group of people with no access, it is essential to consider the supply side causes.

Among the numerous difficulties faced by the unbanked in

attempting to open a bank account, the first one is the inability to provide appropriate documents to prove their identification (passport, driving licence, utility bills, etc.). Despite the guidelines produced by the Money Laundering Steering Committee in 2001 and 2003 to address this issue, difficulties remain.

Another difficulty is the lack of bank branches in disadvantaged areas, where many unbanked people live. Even though these areas are served by ATMs, often people need direct contact with their bank in order to open a bank account and manage their budget. Furthermore, the unbanked are often less comfortable with internet or telephone banking.

Finally, and despite the move to “free banking” in Ireland, some people do not access bank accounts because of the charges that can occur. These charges are mainly for “out-of-course” transactions which occur when customers break a term of their contract (e.g. unauthorised overdraft, failed standing order, bounced cheque, etc.) (Corr, 2006). Often “free banking” is only accessible if certain requirements are met that are sometimes not suitable for the unbanked (i.e. minimum account balances, requirement to carry out a number of transactions via the internet, etc.).

### **2.1.2 Ireland’s strategy to promote access to basic banking services**

Until recently, financial inclusion was not part of the policy discourse in Ireland (Carbo *et al.*, 2005; Corr, 2006). However, in the past few years there has been a number of significant developments. In 2004 the Financial Regulator asked the Combat Poverty Agency to carry out a study on this topic (Corr, 2006). At the same time, it set up a Stakeholder Forum bringing together industry and government representatives in order to facilitate dialogue on this topic and to inform the research study.

One of the results of this effort was that financial inclusion was included for the first time, in the *National Action Plan for Social Inclusion 2007-2016*. However, basic banking services were still not seen as a policy priority and the emphasis was placed on the role of the Financial Regulator (the responsibility has now moved to the National Consumer Agency) regarding financial capability and that of the Money Advice and Budgeting Service (MABS) regarding overindebtedness.

Another result was the integration of some aspects of financial

inclusion into the *Consumer Protection Code* of 2006, in two different ways:

*A regulated entity must ensure that in all its dealings with customers and within the context of its authorisation it [...] without prejudice to the pursuit of its legitimate commercial aims, does not, through its policies, procedures, or working practices, prevent access to basic financial services. (p.10)*

And more precisely:

*A regulated entity must take into consideration the provisions of the relevant anti-money laundering guidance notes issued with the approval of the Money Laundering Steering Committee, and in particular any guidance in such notes on how to establish identity, in order to ensure that a person is not denied access to financial services solely on the grounds that that person does not possess certain specified identification documentation. (p.12)*

Nevertheless, these specific provisions cannot be considered as a proper strategy to promote better access to basic banking services.

In 2005 the Irish Banking Federation (IBF) recommended developing cooperation between banks and An Post in order to create accessible basic banking services. A similar approach was adopted in the UK. Nevertheless, this proposal focused on the payment infrastructure provided through a type of electronic purse (like the Post Office Card Account in the UK) but without a proper current account (IBF, 2005; Corr, 2006).

A significant commitment to addressing access to basic banking services was developed through the National e-Payment Strategy. One of the aims of this strategy was to “significantly improve access to banking products and services for the traditionally under-served segments of the Irish population and also contribute towards greater technology adoption by these segments” (Accenture, 2003, p. 35). The National Payments Implementation Programme (NPIP) was established in 2005 with the goal to change payment behaviour in Ireland in order to make it more secure and cost-efficient. One of its objectives is to increase financial inclusion.

The current financial crisis has increased the involvement of the government in relation to access to basic banking services. As a result

of the guarantee scheme for Irish credit institutions announced in September 2008, the Credit Institution (Financial Support) Scheme 2008 brought into law, in paragraph 45, that:

*Each covered institution shall procure that the Irish Banking Federation, on behalf of all covered institutions, submits a bi-annual report to the Minister on goals and targets laid down by the Minister in relation to Corporate Social Responsibility, including the goals and targets with respect to the objectives of this Scheme, the delivery of the national payments strategy, the promotion of financial inclusion, the development of financial education and the implementation of the next phase of the Government's Social Finance Initiative (Underlining added)*<sup>26</sup>.

A few months later, in December 2008, following their recapitalisation, the banks concerned were committed to broaden the provision of basic or introductory bank accounts and to promote these accounts to socio-economic groups where the holding of bank accounts is less prevalent and to those who find that a current account does not suit their basic banking needs.

The most recent development was the establishment of a Steering Committee on Financial Inclusion in September 2010. It is made up of key stakeholders from government departments, state agencies and the financial services industry. The aim of the group is to carry out a review of the options available to achieve financial inclusion in Ireland, while the domestic banking sector will be required to support and promote the availability of a basic bank account.

Therefore, access to basic banking services is slowly becoming a priority for the Irish government. There are existing elements which could favour this access. Commercial banks, An Post and credit unions have shown in different ways and at different times some interest in the question of access to basic banking services.

Along with the idea of a “universal banking service” inspired by the British experience, the involvement of the banks through their professional association (IBF) is limited to the promotion of financial education and the provision of information regarding banking services. The hypothesis is that displaying information will help people develop their financial capabilities and will make them better able to engage with financial services. The information provided is made available through MABS as education resources targeted either

<sup>26</sup> <http://www.finance.gov.ie/documents/publications/statutoryinstruments/2008/si4112008.pdf>

at the whole population or specifically targeted at people experiencing financial difficulties.

Finally, the main actor which could support greater financial inclusion and, more precisely, access to basic banking services is the credit union movement (building societies are also a pertinent potential actor). Around 3 million people are members of a credit union,<sup>27</sup> approximately 70% of the population. This movement, which is based on values complementary to financial inclusion, is on the whole not involved in promoting access to basic banking services, except for a few initiatives (Corr, 2006). Some credit unions provide accounts linked to basic transactional services. However, these services are limited as credit unions have no access to the clearing system. One example of their action is the “Budget Account” provided by 50% of credit unions to MABS customers. People can make weekly payments to their local credit union and then payments are made to their various creditors in accordance with the budget defined in collaboration with a MABS advisor (Corr, 2006).

There is a real need in Ireland for access to basic banking services which could improve the efficiency of the Irish economy and prevent the development of a dual society. This issue is becoming a real policy question and Ireland has the components of a successful strategy (i.e. An Post network, credit union movement, building societies, etc.). Nevertheless, significant work remains to implement such a strategy. In this regard, British, French and Belgian experiences are instructive sources of information.

## **2.2 The UK market answer: government as facilitator**

The most informed debates on access to basic banking services have taken place in the UK. The large number of studies and reports produced there has meant that the phenomenon has been well quantified and the strategy evaluated. This strategy relies on market-based financial inclusion policies.

### **2.2.1 Course of action**

The interest in financial exclusion followed the election of the Labour Party in 1997. However, despite a wide range of research studies on the topic and the setting up of a Policy Action Team dedicated to this topic (Policy Action Team 14), progress was slow. In 2004, in order to improve the effectiveness of this strategy, the government published a document *Promoting Financial Inclusion* which identified three main

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<sup>27</sup> <http://www.ilcu.ie/publisher/index.jsp?re=0&re=0&pID=93&nID=594>

priorities including access to basic banking services.<sup>28</sup> In 2005 the government established a Financial Inclusion Fund (£170 million stg) and an independent Financial Inclusion Taskforce whose role is to monitor progress and to make recommendations.

The Financial Inclusion Fund is not used to specifically fund basic banking services. Nevertheless, public money is used to finance a large number of research studies which inform the Taskforce about levels of banking exclusion and the effectiveness of basic banking services. The heart of the strategy was to define shared goals with the financial services industry and to facilitate their implementation. Between 2004 and 2008, it was decided to halve the number of people without a bank account.

The Taskforce is the cornerstone of the strategy of financial inclusion. Members participate in a personal capacity and do not represent their employers – banks, insurance companies, not-for-profit lenders, not-for-profit advice agencies, consumer bodies, community and voluntary organisations and academic bodies (PFRC, 2007). In 2007 the government established a cross-departmental ministerial working group to evaluate policy options on financial inclusion because in the UK an issue cannot be restricted to one area of expertise or authority.<sup>29</sup>

In order to achieve the shared goal, the government acted as a facilitator, in two ways (PFRC, 2007). In 2003 the government made it compulsory to receive social welfare payments electronically. Such a decision was not directly related to increasing financial inclusion. In itself it created more difficulties for people without a bank account to receive social welfare payments. Nevertheless, it did create an incentive to get a bank account by making these payments only accessible electronically (i.e. through a bank account or a prepaid card). While it did increase access, the motivation for the government was cost savings rather than financial inclusion. Having increased the demand side (i.e. motivation to access a bank account) the government also acted on the supply side through the Basic Bank Account (BBA) and the Universal Banking Services.

Given that transaction banking is free in the UK as long as the account is in credit, the BBA was introduced to try to avoid charges

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<sup>28</sup> Provision of affordable credit and availability of face-to-face debt advice are the two others.

<sup>29</sup> This working group is chaired by a Treasury Minister and includes Ministers from the Department for Work and Pensions, Department for Business, Enterprises and Regulatory Reform and the Ministry of Justice (Personal Finance Research Centre, 2007).

linked to unauthorised overdrafts and other irregular transactions. However, making this product available proved problematic. In order to solve this problem,

*the Chancellor (the UK's finance minister) issued an ultimatum that all the major banks should have a basic bank account by October 2002. All met the ultimatum. There were no sanctions for failing to comply, although banks understood clearly that the Government would take further steps if they did not comply voluntarily. (PFRC, 2007, pp 6-7)*

Having satisfied the government's expectations, no constraints have been applied to British banks. Therefore the BBA is self-regulated through the Banking Code which defines it as follows:

*A basic bank account will normally have the following features:*

- *Employers can pay income directly into the account.*
- *The Government can pay pensions, tax credits and benefits directly into the account.*
- *Cheques and cash can be paid into the account.*
- *Bills can be paid by direct debit, by transferring money to another account or by payment to a linked account.*
- *There is no overdraft facility.*
- *The last penny in the account can be withdrawn. (PFRC, 2007, p.12)*

This definition indirectly recognises the necessity for a buffer zone,<sup>30</sup> but no details are given of the different features of the BBA (i.e. cash card, debit card, etc.).

Regarding the way the BBA is delivered, the Financial Inclusion Taskforce states that "it is essential that FSA should ensure that the attitudes and practices of frontline staff at bank branches are regularly and effectively tested as a part of their monitoring program." (FIT, 2009, p.12)

Besides the BBA, the other main initiative introduced to contribute to financial inclusion is the Universal Banking Services (UBS). This is a result of joint action between the Treasury, the Post Office and the banks. The UBS has several components:

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<sup>30</sup> A "buffer zone" allows customers to withdraw the "last penny" from an ATM without incurring charges if the minimum amount available from the ATM leads to a small overdraft.

- All holders of a BBA with a major bank can use local post offices for their routine transactions. A small number of banks have extended their agreement with the Post Office to all their account holders.
- The Post Office has developed the Post Office Card Account (POCA), a store value card into which welfare benefits and pensions can be paid. Over 4 million have been opened and many of the users are pensioners with a bank account. The contract ended in 2010.

Through the UBS, the British government addresses the issue of geographical exclusion. Cognisant of the fact that some areas have no bank branches, post office branches have been seen as the solution to making financial services physically accessible. Nevertheless, using the infrastructure of the Post Office to deliver banking services does not make the Post Office a bank, as the POCA is not an individual bank account; it is more like an electronic wallet or purse.

### **2.2.2 Evaluation of the appropriateness of service provided**

In an evaluation of basic bank accounts, Devlin and Gregor (2008) found that the majority of BBA customers appreciate them (75% use them frequently) and using them increased these customers' self-confidence. Nevertheless, "low financial capability, particularly concerning knowledge or understanding of BBA features, prevents customers from making the most of their BBA's financial inclusion benefits" (Devlin, Gregor, 2008, p.7). A quarter (25%) of BBA holders use other banking services (including debit cards, savings accounts, etc.). This higher level of access is probably explained by the fact that 60% of them are in employment (as opposed to 40% for the whole population of BBA holders).

A second result is that access difficulties remain, even if accessibility has slightly improved (Talati, Kinloch, 2008). But the main weakness with the BBA lies in the fact that it is often too "basic" (PFRC, 2007; Devlin, Gregor, 2008; Talati, Kinloch, 2008). Among the major banks providing BBA, only very few offer the ideal package including a debit card (with real-time authorisation) or a "buffer zone".

Talati and Kinloch (2008) observe that 4 out of the 11 major providers offer a "buffer zone" and 9 out 11 offer a debit card but the transaction is not real-time and only 2 out of 9 offer Maestro (the most widely accepted debit card); others offer solo or electron. BBA users are often frustrated by the lack of products provided (mainly

a mainstream debit card). This is seen as a barrier to full financial inclusion (Devlin, Gergor, 2008).<sup>31</sup>

Talati and Kinloch (2008) observe that this high level of inconsistency between providers cannot be explained by market or policy forces. Instead they have been guided by internal drivers. Moreover, some providers have tried to go further and provide more appropriate products but have given up. For instance, Bank of Scotland and Woolwich piloted a bill-payment service which was deemed more suitable than direct debits for low-income households who manage their budget weekly. They provided a linked account where weekly payments were made and where bill payments were managed by the banks. "A small fee was charged but this was much less than the cash savings for paying bills by direct debit. Neither scheme still exists." (PFRC, 2007, p.11)

Regarding Universal Banking Services, the cooperation between the banks and the Post Office seems to be satisfactory but there are some questions about the POCA as its contract which ended in 2010 has still not been renewed, revisited or altered in September 2011. The POCA, which was set up to make pensions and social benefits accessible electronically for those without a bank account, appears to be too expensive for public finances. According to Allen (2008), paying benefits through the POCA is 100 times more expensive than through a bank account. As well as the problem of cost, it also appears that despite its success (4.25 million customers), a POCA deters people from accessing a proper bank account and other banking services (FIT, 2009). In addition, the Financial Inclusion Taskforce has highlighted that cards similar to the POCA (such as prepaid cards) are popular among people with no access to a bank account but they do not offer adequate protection (loss of funds stored on cards due to fraud, physical loss, etc.) (FIT, 2009)

### 2.2.3 Economic model and quality of access

There are some data available which allow for the assessment of the cost of a BBA. According to Talati and Kinloch (2008), since the BBA has been set up more providers are charging customers for failed direct debits, and the level of those charges has increased. Only HSBC was not charging for failed direct debits in 2008, and for the others the cost varied from £15 stg to £38 stg.

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<sup>31</sup> PFRC (2007) emphasises that "some credit unions now offer transactional bank accounts, through a pilot initiative between ABCUL (the main credit union trade body) and the Co-operative Bank. The account offers an ATM card for cash withdrawals, a debit card and access to direct debits and standing orders to make payments. For the most part, these are credit unions that have also received support from the Financial Inclusion Growth Fund."

While transaction banking in the UK is free, a report carried out by the Office of Fair Trading gives a clearer picture of the situation regarding these fees. The report states that

*... there seems to be a substantial cross subsidisation from those consumers who incur insufficient funds charges to those who do not; and to a significant extent from "vulnerable", low income and low saving consumers, to higher income, higher saving ones. (OFT, 2008, p.2)*

More precisely, it shows that

*... insufficient funds charges have increased by an average of 17 per cent in real terms between 2003 and 2007. The average daily unarranged overdraft balance over the year in 2006 was £680 million but involved some £1.5 billion in paid item and maintenance fees. This is a return of over 220 per cent on the balances. (OFT, 2008, p.4)*

Knowing that insufficient fund charges represent over 30 per cent of banks' revenues and that those charges are typically paid by low-income/ low-saving consumers (OFT, 2008), it seems that while banks are progressively opening their doors to low-income customers (including BBA's holders), they make them pay a very high price for it indirectly.

The Office of Fair Trading underlines that this strategy works because bank staff do not display information about these fees or advise on how to avoid them:

*Some consumers are not even aware that some fees exist. Even where they are aware of the existence and level of fees, consumers find it hard to judge when and how these fees will be incurred. Indeed, only seven per cent of consumers who exceed their arranged overdraft limit said it was a deliberate decision. Research also showed that 19 out of 22 banks themselves gave out wrong cheque clearance time or were unable to offer practical advice on this to consumers. (OFT, 2008, p.5)*

It appears that the costs of the service provided by banks are clearly inappropriate for those customers. The lack of information and advice makes it even worse, given that financial inclusion requires the establishment of a trustworthy relationship between customers and providers. The Financial Inclusion Taskforce is aware of this difficulty and is wondering if an alternative charging

model should be considered rather than the current one which is supposed to be “free banking” (FIT, 2009). Based on research carried out by Jones (2008) among low-income customers, the Financial Inclusion Taskforce considers that those customers generally prefer a small regular fee to paying higher charges in cases of misuse (71% of respondents). Among these respondents, 83% of credit union current account holders and 72% of those who had previously been unbanked would be satisfied with a regular fee (FIT, 2009, p.14).

It appears that the financial inclusion strategy implemented in the UK has obtained poor results regarding quality of access. A variety of products is being offered with the BBA which is too restrictive regarding the needs of the consumers. Furthermore, the information and advice displayed by bank staff are inappropriate to the need of those customers.

#### **2.2.4 Results**

Given that the qualitative results of the British Financial Inclusion Strategy are not totally satisfactory, what about the quantitative results? This issue is at the heart of the British Financial Inclusion Strategy. The shared goal was to halve the number of people without a bank account between 2003/04 and 2007/08.

In 2002/03 2.8 million adults were living in 1.8 million households without access to any type of bank account. In 2006 the Financial Inclusion Taskforce stated that real progress had been made as the number of adults had been reduced to 2 million living in 1.3 million households. Nevertheless, the following year was characterised by a slowdown or cessation in this decrease. Consequently, the attention of the Financial Inclusion Taskforce was drawn to the growing proportion of people who were classed as unbanked in statistical studies but who “did not state” whether or not they had an account. Paying more attention to their specific characteristics, it appeared that they were a different group in comparison with those who stated not to have a bank account. Those who “did not state” seemed to be older and to have a higher level of income. Following this analysis, it was decided to consider as a reference the people who stated they did not have a bank account.

They were 3.57 million adults in 2002/03, representing 8% of the population, and they were 1.75 million in 2007/08, representing 4% of the population. The shared goal has been met according to this method of calculation.

Table 2 shows these developments for adults and households regarding both methods of calculation, while Table 3 presents results for those who are without access to any kind of account.

*Table 2: Unbanked (without access to transactional account)*

<b>Year</b>	<b>Households without transactional account (including "did not state")</b> 000, % of total	<b>Households without transactional account – Positively affirmed no account</b> 000, % of total	<b>Adults without access to transactional account (including "did not state")</b> 000, % of total	<b>Adults without access to transactional account – Positively affirmed no account</b> 000, % of total
<b>2007/08</b>	1,820 (7%)	1,280 (5%)	2,710 (6%)	1,750 (4%)
<b>2006/07</b>	2,000 (8%)	1,410 (5%)	3,000 (6%)	1,920 (4%)
<b>2005/06</b>	1,910 (7%)	1,370 (6%)	2,850 (6%)	1,880 (4%)
<b>2002/03</b>	3,020 (12%)	2,570 (10%)	4,380 (10%)	3,570 (8%)

**Source:** Financial Inclusion Taskforce (2009)

*Table 3: Unbanked (without access to any account)*

<b>Year</b>	<b>Unbanked households (including "did not state")</b> 000, % of total	<b>Unbanked households – Positively affirmed no account</b> 000, % of total	<b>Unbanked adults (including "did not state")</b> 000, % of total	<b>Adult living in unbanked households – Positively affirmed no account</b> 000, % of total
<b>2007/08</b>	1,249 (5%)	690 (3%)	1,850 (4%)	890 (2%)
<b>2006/07</b>	1,370 (5%)	780 (3%)	2,090 (5%)	1,010 (2%)
<b>2005/06</b>	1,300 (5%)	760 (3%)	1,970 (4%)	1,000 (2%)
<b>2002/03</b>	1,840 (7%)	1,390 (6%)	2,830 (6%)	2,020 (4%)

**Source:** Financial Inclusion Taskforce (2009)

Even though the shared goal has been achieved, it has to be emphasised that there still remains between 4 and 6% of adults (depending on the base) without a transactional account and between 5 and 7% of households in the same situation. This level of financial exclusion is relatively high in a society where electronic banking and the electronic economy are growing following the process of financialisation.

Furthermore, the pace of reduction of the proportion of the population outside the banking system has been zero since 2005/06. Consequently, the Financial Inclusion Taskforce is wondering what could explain it. The main hypothesis is that the remaining people without a bank account could be “more resistant to opening one or have greater difficulties in doing so” (FIT, 2009, p.10); and that there remain some barriers to accessing bank accounts.

Even if it is possible to argue that the remaining proportion of people outside the banking system is lower than in some other European countries<sup>32</sup> and that the remaining barriers to access cannot be easily overcome, the two shortcomings cited above really question the effectiveness of the strategy that has been implemented.

The hypothesis of the current text is that the British strategy based on voluntary action is limited due to the cost of including the remaining people without access. The analysis of financialisation showed that financial services providers face profitability constraints. These constraints deter them from serving in an appropriate way a part of the population that is seen as not profitable enough. Therefore self-regulation is unable to achieve financial inclusion of the entire population as it has to comply with profitability constraints. In addition, with the weaknesses of the British strategy already outlined, two other elements support this hypothesis.

The first element is that while the banks have included more citizens in their services, they have increased the level of charges by 17% in order to make this population more profitable. Clearly, a higher level of financial inclusion in a self-regulated context is achieved at the cost of the poorest. The second element is related to the pace of financial inclusion since 1997. It has to be remembered that the banks’ effort to include unbanked people followed the ultimatum of the Chancellor in 2002 threatening them with a more

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<sup>32</sup> In the EU-15, the average proportion of people without access to current account was 5.9% in 2008 against 2.1% in the UK, according to EU-SILC data.

constraining regulation. If they made such an effort against the constraint of profitability, it is only because they were thinking that proper regulation would be costlier. Unfortunately for those without access to a bank account, the threat has not been enough to produce effective results since 2006.

In Labour's last Budget (2010) – the context of the election could have had an influence – the Chancellor announced that a proper right to an account will soon come into force. The Budget 2010 stated:

*... the government believes that it is possible to make further reductions in the number of adults without access to banking services, potentially by up to half over the next five years, and that one step towards achieving this would be to introduce a new right to open a basic bank account. The Government intends to introduce a new "universal service obligation", giving people the right to a basic bank account under certain conditions, and will consult on the details (p.46).*

Along with this development, the Budget also announced that the British Post Office will become a proper bank. This should help to bring this right into reality as the Post Office network and the confidence people have in this institution are the source of its success.<sup>33</sup>

The British example is characteristic of the strengths and weaknesses of a self-regulated approach. The strengths of this approach are the large numbers of research studies which assess the progress obtained as well as the high level of involvement of key stakeholders. Nevertheless such a strategy reaches its limits due to profitability constraints. The service provided is insufficient, heterogeneous and characterised by high indirect costs; and the progressive inclusion of unbanked people cannot be extended to the overall population.

### **2.3 The French "quasi-regulatory" answer**

The French approach to financial exclusion is paradoxical: regulation was implemented when there was no proper financial inclusion strategy, while self-regulation has recently been promoted when financial inclusion became a political issue.

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<sup>33</sup> Both projects seem to have been abandoned by the conservatives–liberal democrats' coalition.

### 2.3.1 Course of action

The French approach to basic banking services has been mainly pragmatic. The French population saw a massive migration to the banking system during the 1970s when it became compulsory to pay social benefits (1978) as well as wages through a bank account (this developed between the mid-1960s and 1973). While only 17% of the population had access to a current account in 1962, this increased to 25% in 1966, 62% in 1972 and 92% in 1984. This population was mainly catered for by publicly-owned or cooperative banks. Nevertheless, the increase in up-take did not occur without difficulties. One such difficulty was linked to the use of cheques (free in France). This modern means of payment was risky, and bounced cheques were an on-going occurrence. Customers who faced those difficulties often had their bank account closed and faced difficulties opening another one in another bank as they were listed in the *Fichier Central des Chèques* (bounced cheques centralised file).

In 1984 an in-depth reform liberalised the banking sector. Aware of the difficulties some customers faced in opening bank accounts and anticipating that those difficulties may increase, the government implemented the “right to an account”. This right stipulated that if a person without a current account was refused by three different banks, he/she was entitled to ask the *Banque de France* to designate a bank where a free current account would be opened. This right applied to every citizen, including those who were listed in a centralised file because of a bounced cheque.

It soon became apparent that having a bank account was not enough to lead a normal life and that basic banking services were also necessary. In order to avoid regulation, the industry adopted a non-compulsory professional charter in 1992 (*la charte des services bancaires de base*). This charter stated that some services should be accessible for customers accessing a bank account through the “right to an account”:

- a cash card;
- the possibility to set up direct debit and money transfers;
- monthly account statements;
- and, if the bank is willing, a limited number of cheques.

Despite the supervision by the industry association (*Association Française des Banques (AFB)* now known as *Fédération Bancaire*

*Française (FBF)*), this charter had almost no effect on improving the quality of services accessible for people who benefited from the “right to an account”, as it has been very poorly implemented by providers.

Taking into account the lack of effectiveness of this professional charter and the fact that the procedure related to the “right to an account” was too complex, the government decided to modify it in 1998.<sup>34</sup> It simplified access to the “right to an account” (one bank refusal was enough to contact the *Banque de France*) and the principle of a basic banking service was adopted. This free package of services which had to be offered with the “right to an account” was defined in 2001. It includes:

- a current account;
- the possibility to set up direct debit and money transfer;
- account statements on demand and at least monthly;
- the possibility to lodge cheques;
- a card to withdraw money from ATM;
- 2 cheques per month;
- And if the bank is able to provide it, a debit card with real-time authorisation before payment. (This card became compulsory in 2006.)

At the start of the 2000s, a right to a free basic banking service became the cornerstone of French financial inclusion policy. Nevertheless the complexity of the procedure led to several modifications during the past decade.

In 2003 the *Comité Consultatif du Secteur Financier (CCSF)* (financial sector consultative committee) was established to assess the quality of the relationship between the financial industry and its customers and to make recommendations for reform. The *Comité* is composed of stakeholders representing industry and consumers. Although financial exclusion is not its main subject, it is one of its terms of reference.

In 2004 consumer associations initiated an intense debate to increase the accessibility of the right to an account. They advocated for it to be replaced by a “universal basic banking service”, understood as the same package of products included in the basic banking service but accessible through every bank and which could

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<sup>34</sup> Probably partly following the British interest in it, the concept of “financial exclusion” appeared in the law to tackle exclusion (*loi de lutte contre les exclusions*).

not be refused. In order to avoid such a restricting development in the regulation, the industry agreed to two voluntary action plans under the control of the CCSF. The first one in 2004 was dedicated to improving information about the right to an account and in 2006 the second one was supposed to facilitate access to this right since the banker was entitled to apply on behalf of the person.

In 2008 the elements of these two action plans were included in a law. However, the law explained that the conditions for the provision of information to citizens and for the procedure around the right to an account would be defined by a professional charter. Therefore, the law is based on a charter.

French policy on financial inclusion regarding basic banking services is a mix of self-regulation and regulation. Nevertheless, until the late 1980s the self-regulated banks were either public or cooperative. This situation made financial inclusion easier. Since the early 1990s public banks have been privatised, cooperative banks have seen a decrease in the influence of the state, and only *La Poste* (the French post office which is a real bank with the exception of consumer credit<sup>35</sup>) is still mainly publicly owned. The status of the different banks has to be taken into account as it still makes a difference in the way an issue like financial inclusion is recognised. In relation to regulation, the lack of evaluation as well as the lack of incentive or sanction to make the regulation respected has to be underlined. Far from the frequent caricature of the French tendency to frenetically legislate, it appears that regulation has only followed the failure or the insufficiency of self-regulation. Nevertheless, the effectiveness of the regulation implemented is still in question.

### **2.3.2 Evaluation of the appropriateness of service provided**

In terms of research, financial inclusion has not seen the same level of interest in France as it has in the UK. There are only a few pieces of research and none of them has tried to assess the quality of the service provided by the “right to an account”.

Nevertheless, on the basis of research examining financial exclusion (Gloukoviezoff, 2004), it is possible to assess qualitatively whether the package of services included in the “right to an account” is appropriate. In a country like France where cheques still play an important role, it is very pertinent that the plan was to offer a limited number of them to customers. Similarly, the compulsory inclusion

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<sup>35</sup> Since 2011 *La Poste* is entitled to offer consumer credit.

of a debit card with real-time authorisation allows people to make a payment and to withdraw money without any risk of becoming overdrawn. Another positive point is that the legal definition of this package avoids a range of packages being offered by different providers.

Despite the quality of this package, it has to be noted that no buffer zone is offered, which means that people may be unable to withdraw the last euro from their bank account given that fewer and fewer banks give access to coins at their desk.

Besides the “right to an account” and the 2006 action plan, banks have made some efforts to offer alternative means of payment for people with no access to cheques (i.e. people listed in a file for bounced cheques). Those means of payment are mainly money transfers, direct debits and debit cards with real-time authorisation. At the same time, local public authorities (schools, dining halls, day nurseries, swimming pools, social landlords, etc.) have made an effort to accept these means of payment.

Regarding debit cards with real-time authorisation, 4.9 million were held in 2004 and this increased to 8.32 millions in 2007 (an increase of 70%). This includes people listed for bounced cheques, as 70% of them had this kind of card in 2007 (1.7 million people are listed) while they were only 50.2% in 2006 (CCSF, 2009).

Finally, and indirectly related to financial exclusion, a law passed in 2002 protects from seizure the income of people in their account. It states that when a seizure is made, the customer is entitled to ask the bank to give him/her access to the minimum social benefits (€450 per month on average, although the amount asked is usually €350 (CCSF, 2009)). However, this amount needs to have been available on his/her account before the seizure. Such a law ensures that social benefits are protected from seizure, but this can convince people that their money is safer in their account than at home. Nevertheless, this law does not protect against a potential overdraft.

The basic banking service seems to be appropriate to the needs of people facing severe financial difficulties, as it is meeting their basic financial needs. However, it should be pointed out that no buffer zone has been put in place though this could be particularly useful.

### **2.3.3 Economic model and quality of access**

The “right to an account” as well as basic banking services is free for customers. As this procedure is used by the poorest, it was decided

that they would not have to incur any costs to use it. Making basic banking services free could have been an incentive for banks to offer access to mainstream bank accounts, given that there are annual fees for these accounts, but there is no evidence of this.

Despite the absence of annual fees, bank accounts could lead to other kinds of costs related to difficulties like bounced cheques or charges for failed direct debits. Knowing that people who are more likely to face financial exclusion are also those who are more likely to experience those charges, the maximum amount for these charges has been capped.

Since 2007 fees for a bounced cheque cannot exceed €30 for a cheque of an amount under or equal to €50, and cannot exceed €50 for a cheque over €50. All other insufficient funds charges cannot exceed €20. Even if this measure limits the individual cost of each payment with insufficient funds in the account, it does not help to deal with the situation where people are accumulating fees because they cannot face their charges anymore. In this situation, banks have agreed to have a close look at the situation, but no specific action has been defined or followed-up.

### 2.3.4 Results

According to the latest statistics, less than 1% of households were without a current account in 2009 (Jauneau, Olm, 2010).<sup>36</sup> In comparison with the previous study funded by the CCSF, the situation has remained stable since 2001 when the level of households without a bank account was already less than 1% (Daniel, Simon, 2001).

Between 2001 and 2010, some positive developments can be noted. Regarding social welfare recipients, 8% were without a current account in 2001 compared to 4% in 2010, while 36% were without cheques or debit card in 2001 compared to 14% in 2010. Even if the level of access difficulties remains high, the focus on access to a bank account during the past decade has had some positive effects for the poorest.

However, these positive results need to be considered carefully. The implementation of the “right to an account” has led to the legal definition of a basic banking service which includes a current account, direct debits, transfers, some cheques and a debit card with real-time authorisation. Regarding this definition under which people would be considered financially excluded, it appears that in

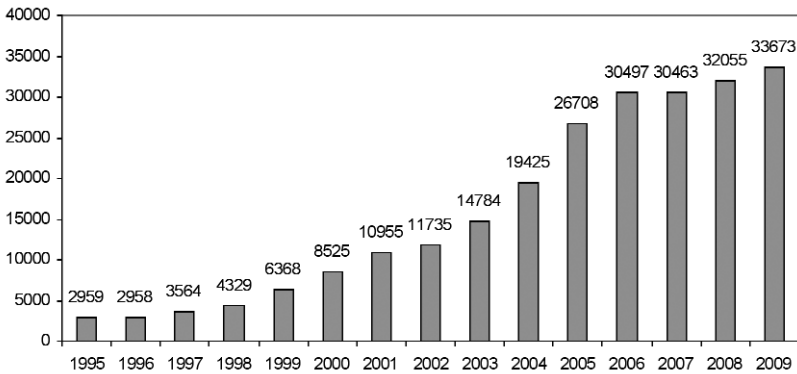
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<sup>36</sup> According to EU-SILC, only 0.3% of people were without a current account in 2008 in France.

2001 between 3% and 4% of households were financially excluded, as opposed to approximately 2% in 2010 (Jauneau, Olm, 2010).

The question is therefore to assess the extent to which financial inclusion policies have led to greater levels of inclusion. Given that the CCSF estimates that around 500,000 adults remain without bank accounts, it seems that the “right to an account” has had a very limited influence, as Figure 21 shows.

*Figure 21: Number of accounts opened through the right to an account*



Sources: Data Banque de France

First, these figures show that very few people apply for the “right to an account” in relation to the number excluded (500,000). For instance, in 2009, 33 thousand people applied for a right to an account (6.7% of those excluded). But the figures also show that the number of bank accounts opened during this period through this procedure increased by 1100%. Such an increase is surprising as the right to an account has existed since 1984. It seems that this development is related to the debate in 2002-2004 animated by consumer protection associations about the implementation of “universal basic banking services”. If this procedure became more popular, it is widely due to the involvement of the banking sector in order to avoid a tighter regulation. It should be noted that only in 2004 did the banks really start to implement the law voted in 1984 – 20 years earlier.

If we consider more precisely two specific measures related to the action plans of 2004 and 2006, they appear to give mixed results. In 2004 the banks agreed to voluntarily improve access to alternative

means of payment to cheques. Besides direct debits and money transfers, the main alternative means of payment is the debit card with real-time authorisation. This payment card is not risky for the providers and allows the customer to lead a normal life in a modern economy. This effort has been effective as 14% of households were without a debit card in 2001 and this decreased to 7% in 2009. The second measure was to make the procedure of “right to an account” more accessible. The banker is entitled to apply on behalf of the person refused. It appears that only 4% of procedures to a “right to an account” are processed in this way.

Despite its “technical” limits, the “right to an account” seems in theory to satisfy the requirements of financial inclusion. However, the high level of financial inclusion in France should be considered in more depth.

The first element is that banks have no interest in informing refused customers about the right to an account as this product is free. They potentially even have an interest in opening another bank account with the related annual charge without giving debit cards or any other facilities.

The second element is that access to basic banking services is the results of efforts by certain financial institutions like the bank of the French post office (*La Banque Postale*) and the cooperative banks like the French saving banks or the *Crédit Mutuel* (conversely to the UK or Ireland, these banks are mainstream banks in France). For example, while *La Banque Postale* has 4-5% of the market share for bank accounts of the general population, its market share is over 30% for people receiving social benefits (Gloukoviezoff, Monrose, 2004). Despite the liberalisation of the French banking sector, therefore, it is cooperative banks and the post office bank who play a vital role in terms of access to banking services.

Unfortunately, a lack of rigorous research and, most of all, of transparency makes it practically impossible to assess the role of different financial institutions as well as the role of the different charters and legislative procedures that have been implemented. For example, it is impossible to know if the procedure to the “right to an account” is used and if accounts have been opened as a result. Similarly, it is difficult to know which bank networks are more likely to cater for those who are financially excluded and those who are not. Finally, there is very little information about the cost of the banking relationship for less well-off people.

In conclusion, the French strategy to improve access to basic banking services is a pragmatic expression of the specific characteristics of the French banking sector and of the different tools available (charter or regulation). However, it is difficult to assess the effectiveness and respective role of each tool.

## 2.4 The Belgian regulatory answer, “solidarity based”

The Belgian approach to accessing basic banking services is very straightforward. Initially, this issue was tackled through self-regulation. However, this did not soften the effect of the financialisation market logic, so it was followed by proper regulation.

### 2.4.1 Course of action

Prior to the 1970s, households in Belgium accessed basic financial services mainly for the purpose of savings. Households only became a commercial target for banks in the late 1960s as a result of economic growth. Their access was mainly ensured by public and cooperative institutions like the *Caisse Générale d'Épargne et de Retraite*, the post office or the *Crédit Communal* which were specialised institutions (savings or credit).

Since 1975 savings banks were authorised to provide all banking services, but the focus on financial inclusion did not start until the passing of a law in 1986 which made it compulsory to have a bank account to receive wages. Households then became a real market, and therefore liberalisation of the banking sector has been seen as the best way to meet their needs. The 1990s saw the decline of almost all public and cooperative financial institutions and the development of access difficulties to a bank account (RFA, 2002).

The first signs of access difficulties to a bank account appeared in the late 1980s, when social welfare recipients and the unemployed were refused by banks and directed towards the post office which became a proper bank in 1995 (RFA, 2002). Nevertheless, these problems were not a political issue. They were raised as an issue in the general report on poverty in 1994 (*Fondation Roi Baudouin*, 1994) and in a more dedicated study in 1996 (Collard, Dejemepepe, 1996). However, none of these reports quantified the phenomenon (the questionnaire was addressed to communal social services).

Following these two studies and the public debate about improving access to a bank account, the Belgian bank association (*Association Belge des Banques*) developed a charter at the end of 1996

in order to facilitate access. The “basic banking service charter” stated that banks should provide a bank account for customers without an account. They were free to refuse potential customers with a history of fraud but not those who had been listed in a negative file following repayment difficulties. The account allowed deposits, direct debits and transfers, but no other services were part of the charter. The price was the usual one for this kind of service.

In 2001 the consumer association *Test Achat* evaluated the effectiveness of the charter and found that difficulties opening a bank account persisted at a high rate for poor people and that the quality of the service provided was poor. This evaluation stimulated the Minister for the Economy to commission a study in 2001 to assess difficulties in accessing a bank account in Belgium (RFA, 2002).

The conclusions of this report were that difficulties in accessing a bank account were on the increase for a growing number of people. Using the same methodology as the study of 1996 (Collard, Dejemppe, 1996), the report stated that the number of communal social services stating to have known someone who had experienced difficulties opening a bank account increased by 113.8% between 1996 and 2001 (RFA, 2002). The study was also able to estimate that there were at least 40,000 unbanked adults in Belgium. Therefore it could be estimated that there was, at least, 0.5% of the adult population without a bank account. This is similar to figures from the EU-SILC which found that 0.6% of the adult population in Belgium was without a current account in 2008.

Given that access difficulties to a bank account were increasing (probably related to the intensification of financialisation) and that approximately 0.5% of the adult population was without a bank account, the Belgium government decided to establish a “Universal basic banking service”, implemented by law in March 2003.

In order to tackle financial exclusion the government, in collaboration with charitable associations, did not want to implement a discriminatory scheme. To avoid this risk, it decided that every bank would have to offer a basic banking service to any person who did not already have one in another bank or who already had a savings account or credit for a cumulative amount of €6,000.<sup>37</sup> When someone requests a bank account, he/she can specifically ask for the basic banking service, or the bank can offer it. The customer just has to fill out an application form and the account is opened. If the bank

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<sup>37</sup> These conditions of access were widened in 2007 following difficulties met by some people (e.g. overindebted people) in accessing basic banking services.

refuses to open the account, it has to define its decision through the application form which is kept by the customer and can be used to contest this decision with the financial ombudsman.

The universality of the basic banking service is ensured by the fact that this procedure is not specifically targeted at poor people but is supposed to be a guaranteed first step for people into the banking system.

#### **2.4.2 Evaluation of the appropriateness of service provided**

The basic banking service is composed of several elements:

- a current account;
- the possibility to lodge cheques and to make deposits;
- the possibility to make direct debits and transfers;
- a monthly account statement;
- and potentially a card to make withdrawal from ATMs (without a card, the customer is entitled to 72 withdrawal of cash at the counter; with a card he/she is only entitled to 36; subsequent transactions have to be paid for – between 20 cents and 50 cents).

The Belgian basic banking service offers the absolute minimum even if the cash card provided by 93% of the banks is included (RFA, 2008b). It does not include a debit card whereas this means of payment is widely used in Belgium (cheques are almost unused). No buffer zone is offered, and only some specific social benefits are protected from seizure, which is a concern for people without a bank account (RFA, 2008b). When services are provided they are not totally appropriate as the withdrawal card usually only works in the bank's own ATM.

The range of services provided through the basic banking service appears very limited in comparison to the social account provided since 2000 by the financial institution Dexia to social welfare recipients. This account, opened through the communal social services, is free for the customer and he/she can be advised to manage his/her budget by a social worker. This account comes with a withdrawal card which can be used in every ATM, a stored-value card (*Proton*), a protection against seizure from the bank, and a buffer zone of €20. A social welfare recipient can open this account even if he/she already owns another current account.

The Belgian basic banking service is mainly focused on the account and it fails to provide important services which are absolutely necessary in order to be able to use the account in an appropriate way and to be financially included.

### **2.4.3 Economic model and quality of access**

The basic banking service is not free and its cost is capped at €12.80 per annum. Only two banks offer it at a lower cost – €8.68 and €6. Another bank offers a free bank account but it is linked to a savings account with a minimum deposit requirement. As the customer base of the basic banking service is generally poor, many customers cannot meet this requirement and therefore do not have access to this free account (RFA, 2008b).

There is no regulatory framework established to deal with insufficient funds in an account to cover a payment. Each bank applies its own fees. The annual fee and the “incidental fees” contribute to fund the basic banking service. However, the original proposal made in the law of 2003 was that the scheme would be funded through a compensatory fund. This mechanism could have been an incentive for banks but was never applied as the decree was not signed by the Belgian King. The proposal was for each bank to support the fund in relation to its market share. Banks would also be granted funding from the fund, depending on the number of accounts opened through the basic banking service.

### **2.4.4 Results**

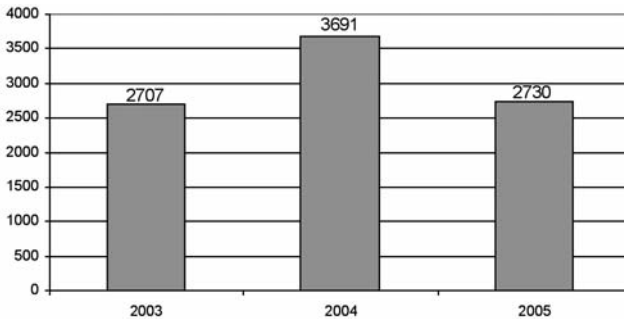
According to the RFA (2008b), the number of adults outside the banking system dropped from 40,000 (0.4%) in 2001 to 10,000 (0.1%) in 2005. Even if these figures underestimate the number of adults without a current account (0.6% in 2008) (EU-SILC), the results show that the introduction of the basic banking service has strongly contributed to a decrease of 75% in 4 years of the number of people without access to a bank account.

Nevertheless, this result cannot be explained solely by access to a basic banking service. Between 2001 and 2005, 30,000 adults gained access to a bank account but between 2003 and 2005 “only” 9,128 basic banking services were opened (Figure 22).

Two complementary hypotheses can explain what the basic banking service cannot directly explain. The first hypothesis is the role of the social account provided by Dexia (see 2.4.2 for

description). Provided since 2000, in 2005 there were almost 51,000 accounts in use. Of course people who already have a current account can open one but it could have played a role in improving access to a bank account for people receiving social welfare as its characteristics are more interesting than those of the basic banking service.

*Figure 22: Number of basic banking services opened (2003-2005)*



**Source:** RFA (2008b)

The second hypothesis is that the banks have been encouraged to give access to their products without necessarily offering the basic banking service first. With a cost of €12.80, the basic banking service is not profitable enough for providers. They may prefer that potential customers open a current account with an average cost of between €15 and €20 per year. Even if this access to a current account rather than basic banking services is a positive result, it has to be pointed out that its higher cost may be problematic for some of those customers.

The strategy to promote access to basic banking services implemented in Belgium has had impressive results as it has reduced the number of unbanked by 75%. Such a result underlines the pertinence of an approach based on a law implementing a universal service. Its effectiveness lies in the articulation of constraint for the providers and easy access for the consumers. Nevertheless, the Belgian example is not perfect.

The first limitation is that the products attached to a basic bank account are really too restricted (lack of a debit card). A second limitation concerns the lack of information about financial

exclusion and the lack of supervision of the banks regarding the implementation of the basic banking service (impossible to assess the role of various providers). The third and final limitation is linked to the promises set out in the law. It is very disappointing that the compensatory fund has not been implemented since it could have played a significant role in encouraging banks to play their part.

## **2.5 What could be learnt for Ireland?**

The will to improve access to basic banking services is a paradoxical one. On the one hand, this target is explained by the intensification of financialisation which creates difficulties for people outside the banking system and can lead to a more dual society. On the other hand, improving access to basic banking services intensifies financialisation, making it even more difficult to be outside the banking system. In order to solve this apparent paradox, it is important to favour an “equal” financialisation, i.e. a financialisation that is characterised by an equal access to appropriate banking services in order to lead a normal life.

An example of this paradox is making receipt of social welfare through a bank account compulsory. Such a decision intensifies financialisation and obviously increases access to a bank account because people would not have another choice. However, this higher level of access to basic banking services could be seen as contributing to greater financial inclusion only if appropriate basic banking services are provided to those new customers.

Without this appropriate provision, the financialisation would be unequal and would not lead to greater social cohesion. It would also contribute to the impoverishment of a large section of the population. Therefore, there is a need for an ambitious strategy that would improve access to basic banking services as well as adopting a global understanding of the consequences for the target group. This implies taking into account the characteristics of the basic banking services provided and their cost (e.g. business model), and ensuring that they are accessible to everyone.

Based on the lessons from the British, French and Belgian experiences and the strengths and weaknesses of the Irish situation, the following broad guidelines of a potential Irish strategy to promote access to basic banking services are outlined.

### 2.5.1 Characteristics of the basic banking services

Firstly, it is crucial to define the exact characteristics of the basic banking services that should be provided homogeneously by all banks, without preventing banks adding other services if they wish. It is also essential that the target audience can access the basic banking services easily. Such an obvious target involves several elements.

As Corr (2006, p.172) underlines, it is necessary to include “flexible account opening requirements around identification in adherence with the anti-money laundering guidelines”. Such an issue does not apply to France or Belgium, where it is compulsory to have an ID card. Nevertheless, some difficulties have been observed for migrants because their temporary papers are often considered by bankers as difficult to assess. In Ireland specific attention should be paid to other groups who could face similar barriers.

Another aspect is the potentially negative credit history of a customer. As basic banking services do not involve credit,<sup>38</sup> this element should not prevent access for such customers. In the UK, France and Belgium, the issue has been addressed in the same way: only customers with a history of fraud can be excluded by a bank.

Along with these direct practices of selection, other “screening” practices are used. Providers define the characteristics of their products in a way that is calculated to deter undesirable customers. To avoid such practices, it is important to avoid a minimum opening or monthly balance (Corr, 2006) as well as compulsorily linked products that would not be explicitly part of a package of basic banking services.

Secondly, the experience of France, Belgium and the United Kingdom shows that some potential solutions should be avoided. In that respect it appears that cards to store money, e.g. POCA, should be avoided as they prevent access to a bank account. It seems that overdraft facilities should also be avoided as these are too risky for low-income customers.

Thirdly, it is necessary to define precisely which products would be part of the basic banking services. This choice should be based on the norms of the country. For Ireland, a package of basic banking services would require, as a basis, a current account with a monthly (at least) account statement. This account should entitle people to receive

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<sup>38</sup> When debit card are not real-time, it can be considered as a form of credit. However, it would be an excessive interpretation of “credit” as the customer does not request or need this “credit”.

money transfers, lodge cheques and make deposits in cash. It should be possible for people to access their money easily. This implies giving them a cash card that could be used at every ATM at no cost. As ATMs usually give a €20 note as the smallest note, it is important to have a buffer zone of €20 to allow every cent to be accessible.

As seen in France, Belgium and the United Kingdom, an account by itself is not enough. It is very important that a modern means of payment is accessible. Direct debits and money transfers are essential although they are not enough to lead a normal life. In Ireland, as in France, debit cards are very popular. The difficulty is that this means of payment may be risky for providers. The French solution has been to provide a debit card with real-time authorisation. Such a debit card prevents payment when funds are insufficient. This card has been a great success in France and the possibility of providing such in Ireland could be carefully assessed by the National Payment Implementation Programme. Regarding cheques, this option may be disregarded as this kind of payment is becoming less common for personal use.

Fourthly, the British experience and some Irish studies highlight the usefulness of taking into account the fact that people on a low income often manage their budget on a weekly basis. In order to make the transition from management in cash to management through a bank account easier, it would be helpful to offer the possibility of having a “budget account” – similar to that used by the Credit Unions with MABS – linked to the basic bank account. This would help prevent people from falling into arrears and to progressively adapt themselves to banking rules.

Making sure that the characteristics of the service provided are appropriate to the needs of people without access is key not only to improve access but also to avoid use difficulties. For example, it could limit the fact that some customers self-exclude themselves by withdrawing all their money from their account as soon as they receive it and continue to manage their finances in cash (Corr, 2006, p.77).

The transition from managing money in cash to a bank account also raises the question of the financial capabilities of customers. In every European country, financial education is promoted as the cornerstone of financial inclusion, even though there is no scientific evidence to show that it has positive impacts.<sup>39</sup> Nevertheless, it is obvious that the target audience of basic bank accounts need:

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<sup>39</sup> See the work of the Personal Finance Research Centre ([www.pfrc.bris.ac.uk](http://www.pfrc.bris.ac.uk)).

- information about its existence and characteristics;
- advice about the way to make the best of this offer.

The first dimension (information) could include leaflets, websites, and other media messages, while the second one implies a face-to-face relationship. A key question is, Who has responsibility for this advice? Certainly the financial provider should have part responsibility. However, for the more complex cases, it would be better to have access to an independent adviser. In order to meet this need, the UK has made an effort in terms of budget advisors. In this respect, Ireland has a successful “tool”, with MABS providing such advice. Nevertheless, the capacity of MABS would need to be increased to face the demand and to provide good quality advice.

Finally, in order to favour the establishment of trust between the target group and the banks, the question of the protection of their resources should be evaluated. In France a defined amount considered as a social minimum cannot be seized. In order to make this right real, it was decided that when a creditor obtained the right to make a seizure on the account of a debtor, the debtor is entitled to ask the bank to make available, in cash, the defined amount (if it was available before the seizure). Such a protection – which also needs to be extended to bank charges – could foster a relationship of trust between the banks and their customers.

### **2.5.2 The cost of basic banking services**

Appropriate access to basic banking services implies having access to products which make it possible to satisfy people’s needs as well as ensuring that the cost does not impoverish those people. Regarding this issue, the UK, France and Belgium have made different choices.

In the UK access to a basic bank account is free, a debit card is provided but the cost is potentially very high if difficulties occur (i.e. failed direct debit). In Belgium the basic banking service costs around €1 per month, fees are those usually applied by the bank and no debit card is provided. In France there is the right to an account, the basic banking service is free, fees are capped, and a debit card is provided.

This comparison poses the question regarding the cost for the customer and the provider. It could be argued that customers should

pay for the price of the service provided. It could also be argued that this cost should be appropriate (e.g. inferior to the potential monetary gain for people to switch from cash to banking management). In the same way, it is important that the potential cost of the basic banking service is clear for those people in order to help them integrate it to their budget. Finally, another effect should be taken into account: the incentive effect for the provider. The basic banking service should be the first step in the banking system, so it would be interesting if banks were encouraged to offer wider access to their services in order to make the relationship more profitable (but still appropriate to the needs of the customers).

According to the results obtained in the three countries studied and to the movement towards free banking in Ireland, a basic banking service, as defined in the previous paragraph (2.5.1), with a debit card with real-time authorisation (without stamp duty), could be provided free of charge.

Along with this offer, it would be pertinent that the fees which occur when customers break a term of their contract (e.g. unauthorised overdraft, failed standing order, bounced cheque, etc.) would be capped as has been done in France. This is an important issue because when people manage their money in cash and are not able to face a bill they are in trouble with their creditor, but when they manage their budget through a bank account and experience a similar problem, they are in trouble with their creditor and with their bank. It doubles the costs.

For those who face difficulties with cumulative penalty fees, it would be interesting to orientate them to MABS advisors who could help solve (as much as possible) their difficulties and help reduce the banking costs.

If the services provided are free and if the charges are capped, there is a real threat that basic banking services become an unbearable cost for the providers who are the most welcoming. How can this be avoided? Several possibilities exist.

The first possibility is related to the fact that providing basic banking services is recognised by the European Commission as a Service of General Economic Interest (Art. 86 of the EC Treaty). Such recognition allows for a public compensatory financing system. A second possibility is a compensatory fund like that proposed by the Belgian government but which was never implemented. Each financial institution would receive money from the fund or

contribute to it depending on the comparison between its overall market share for banking products and its market share regarding the basic banking service. Such a system would make the cost of providing basic banking services sustainable for the providers who would most welcome low-income people, and would create an incentive for all members of the industry to promote access to basic banking services.

This way of funding basic banking services is led by a different logic than the market one: reciprocity. Each stakeholder (citizen, bank, state) provides part of the funding in accordance with its capacity. Such a provision is justified by the fact that all stakeholders benefit from a more financially inclusive society.

### **2.5.3 Making access to basic banking services effective**

One of the main lessons from the assessment of the British, French and Belgian strategies is that voluntary charters or codes of practice are not effective. In the UK the industry's code of practice was applied only when the Chancellor threatened a more rigorous regulation in 2002. However, those efforts did not last and the proportion of unbanked people ceased to decrease by 2005. In France the basic banking services charter of 1992 was replaced by a law in 1998 as the charter had no effect. And in Belgium the charter of 1996 promoting basic banking services was substituted by a law in 2003 for the same reason as in the French situation.

The ineffectiveness of voluntary codes of practice could be explained by the fact that access difficulties to basic banking services result from the insufficient profitability of those customers vis-à-vis profitability requirements. The commitments of the industry cannot really go against this constraint. However, a law is not by itself the appropriate answer, as is shown by the French example. The right to an account and to basic banking services was highly confidential for 20 years until the pressure from government on the industry increased in 2004.

A law is necessary as it is the only tool that can act as an effective opposition force to the constraint of profitability. Nevertheless, to be effective it needs to be appropriately defined. In that regard, several elements need to be respected.

Firstly, the content of the law should be the result of consultations with the key stakeholders as their involvement is a key element of the success of such legislation. This was the case in Belgium, and in

the UK the Taskforce looks like the perfect body to lead these consultations. In Ireland the new Steering Group on Financial Inclusion could possibly do the same.

Secondly, it is essential that providers are obliged to supply a detailed reporting of their activities regarding access to basic banking services. This obligation could be consistent with the requirement of paragraph 45 of the Credit Institution (Financial Support) Scheme 2008.<sup>40</sup> With this obligation, providers should display figures related not only to basic banking services but also figures related to access to banking products of people on low income; this would enable an assessment of the actual level of access of this public to banking services, not only to basic banking services. Such a tool was planned in the Belgian legislation although it was not applied, and was advocated for in a broad range of research from the Taskforce in the UK as well as independent research carried out in the UK. France is particularly poor in that respect. This partly explains the lack of effectiveness of the “Right to an account”.

Thirdly, it is very important that the legislation allows for incentives and constraints. The cost of not committing to the provision of basic banking services should be significantly higher than for committing. Without this element, the profitability constraint will underpin the whole legislation.

These principles can be applied to every type of legislation dedicated to improving access to basic banking services. However, it is possible to develop further guidelines for potential Irish legislation.

Regarding foreign experiences, it appears that the most effective way to provide basic banking services is the Belgian approach. Every bank should be constrained to provide basic banking services to customers who do not have access to similar banking products. Such an approach would prevent the risk of administrative difficulties which deter people from applying for this right, like in France. It means that customers without a current account could apply for the basic banking service in the bank branch of their choice, which could not refuse them unless they have a history of fraud.

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<sup>40</sup> “Each covered institution shall procure that the Irish Banking Federation, on behalf of all covered institutions, submits a bi-annual report to the Minister on goals and targets laid down by the Minister in relation to Corporate Social Responsibility, including the goals and targets with respect to the objectives of this Scheme, the delivery of the national payments strategy, the promotion of financial inclusion, the development of financial education and the implementation of the next phase of the Government’s Social Finance Initiative.”

In order to make this legislation even more effective, it would be important to provide the credit union movement (as well as building societies) with the possibility of becoming part of the clearing system. Such a development would build on the strength of the banking sector in Ireland, as it did in France for the cooperative banks which are more likely to welcome financially excluded customers – customers who are more likely in return to trust them more than private banks. A move of this importance for credit unions would however require some modernisation.

Although An Post announced the end of its banking activity, the possibility of using the An Post network to provide basic banking services for other providers in a similar way to the British universal banking service should be assessed.

## **2.6 Towards an Irish basic banking service**

The potential Irish basic banking service could incorporate the responses implemented in the UK, France and Belgium. This is because the Irish banking sector shares common points with these three countries.

The provisions of an Irish basic banking service could be characterised as follows (very close to the recommendation of Corr, 2006, p.172):

- a current account;
- flexible account opening requirements around identification;
- no exclusion with possible exception of a history of fraud;
- no minimum or monthly balance;
- a monthly account statement;
- the possibility to lodge cheques and to make deposits in cash;
- direct debit and standing order facilities;
- a €20 buffer zone;
- no overdraft facility;
- a debit card with real-time authorisation without stamp duty;
- a weekly bill payment account;
- financial advice and information (when banking difficulties occur, contact with a MABS advisor should be facilitated).

The basic banking service should be provided at no cost and the charges that occur when customers break a term of their contract (e.g. unauthorised overdraft, failed standing order, bounced cheque, etc.) should be capped.

In order to encourage people to make use of their account and not to withdraw all their money from it, a minimum amount should be protected from seizure in the account.

The basic banking service should be provided by every financial service provider. Therefore customers could apply for it in a bank branch of their choice. It would be pertinent to include credit unions and building societies as potential providers, although they would need to be part of the clearing system. The An Post network could be used by other providers to provide a basic banking service when customers would prefer to have access through the Post Office or when there is no bank branch in a locality.

In order to finance the basic banking service, a compensatory fund supported by banks and by the state as a Service of General Economic Interest should be set up. Such a fund should ensure solidarity within the industry. Those providers who welcome a bigger market share of the target group than other providers should be compensated for their extra costs. Conversely, those who do not contribute to the improved access of this target group should be penalised.

Because codes of practice are ineffective, the basic banking service should be implemented through law. Its legal definition would prevent a heterogeneous provision of services among providers. In order to be effective, such a law should be preceded by a large consultation of key stakeholders; their involvement is crucial. Such a consultation should identify a group to oversee the implementation of the law – possibly the Steering Group on Financial Inclusion. It is very important to involve different government departments (e.g. Department of Finance, Department of Social Protection, etc.) as such an issue is clearly cross-cutting.

It should be based on two principles:

- scientific evaluation of quantitative and qualitative results in terms of access to and use of basic banking services;
- incentives and sanctions based on the scientific evaluation in order to ensure that the law is effective.

The popularity of basic banking services would be reinforced if it were compulsory to pay social welfare and wages into a bank account.

## Towards fair credit

### 3.1 Introduction

The intensification of financialisation has meant that consumer credit became more than just a simple commodity. It now plays an essential role in the lives of an increasing number of people. Appropriately provided, it can protect people as it helps them face unexpected expenses or changes in their income. It can also help them to improve their situation as it allows them to finance their projects (i.e. training, equipment, etc.).

However, in order to play such a positive role, consumer credit needs to be widely accessible and appropriate. This is a difficult aim to reach as credit is a risky service for the debtor as well as for the creditor.

There are therefore two main issues which challenge financial inclusion:

- difficulties accessing consumer credit;
- overindebtedness.

Difficulties accessing consumer credit is a problem for people who may have the ability to make repayments but are ignored by lenders mainly because their level of risk is too difficult to assess (e.g. generally because of a lack of information) or because they are considered not profitable enough. Conversely, if access is too easy it can also be problematic. If there is an accumulation of credit or if the characteristics of the credit are not appropriate, and not adapted when necessary to the financial needs of the borrower, financial difficulties will arise and subsequently a situation of overindebtedness where the borrower will be unable to repay his/her debts.

In order to promote responsible access to credit – an appropriate access which increases or preserves the autonomy of the borrower – numerous countries have adopted different kinds of regulations which could be adapted to the needs of Irish society. This chapter describes how Ireland, the UK, France and Belgium deal with access

to credit and with the risk of overindebtedness during a period where financialisation has intensified.

### 3.1.1 Measuring access to credit, and overindebtedness

Because of a dearth of data, a detailed assessment of the effectiveness of different regulatory regimes is difficult. For instance, statistical indicators have not yet been developed which allow for the quantification of the number of people excluded from consumer credit (i.e. they have a need for credit and the ability to repay it but have no access to it) or how many people face financial difficulties which can be understood as overindebtedness (i.e. they cannot face their debts without depriving themselves of essential items for day-to-day living).

Data are also unreliable in relation to access difficulties, as surveys (e.g. Eurobarometer, EU-SILC) do not consider forms of credit such as home credit or other kinds of subprime which are very important in the UK and in Ireland.

The processes that lead to financial difficulties are the same as those that lead to overindebtedness. Overindebtedness is usually measured by the indicator measuring arrears on at least one payment in the previous 12 months (EU-SILC). In 2005, 5% of people were in this situation in France, 6% in the UK, 7% in Belgium and 8% in Ireland (OEE, 2008). However, this indicator does not actually measure overindebtedness but rather financial difficulties. Overindebtedness is a more serious situation where people are no longer able to face their financial commitments.

Another way to try and measure level of overindebtedness is through administrative figures collected by structures set up to deal with financial difficulties. Again the result is not satisfactory as the figures are not comparable due to the differences between these procedures. It reflects more their effectiveness than the reality of overindebtedness. Nevertheless, this indicator shows that the financial crisis is having and will have a huge impact regarding financial difficulties and overindebtedness for households. In 2009 France saw an increase of 14.8% of new applications for the administrative treatment of overindebtedness,<sup>41</sup> while Belgium faced a 23.3% increase (BNB, 2010). In the UK an increase of 27% between 2008 and the second quarter of 2009 was observed for people who were granted a bankruptcy, Debt Relief Order or Individual Voluntary Arrangement.

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<sup>41</sup> Banque de France website: [www.banque-france.fr](http://www.banque-france.fr)

As Ireland does not have debt settlement procedures or bankruptcy procedures, it is difficult to compare, but the increasing number of people contacting MABS could be an indicator. Between 2008 and 2009 the number of new customers rose by 20.6%.

In addition to these indicators, the household debt/disposable income ratio, which is related to the risk of overindebtedness of the overall population,<sup>42</sup> is much higher in Ireland (176%) and in the UK (173%) than in Belgium (75%) and France (72%). The risk of overindebtedness is also increased by the influence of growing negative equity for numerous debtors, a phenomenon weaker in Belgium and France where the housing market did not experience a “bubble” like in Ireland.

### **3.2 Ireland: to promote responsible access to credit**

The Irish population is highly indebted. Moreover, its indebtedness rate has risen during the past two decades. The Irish responsible lending strategy is centred on the Consumer Protection Code 2007.

#### **3.2.1 Quality of access and overindebtedness**

Until recently credit was easily accessible in Ireland. The Irish credit market is characterised by a low level of regulation which favours this access as there is a prime market, a subprime market, and even an informal market. As a result, it is possible for low-income households to borrow up to 8 times their average income (Daly, Leonard, 2002; Corr, 2006). However, the quality of this access is really unequal. Furthermore, Collins (2006) shows that “29.4% of ‘mildly deprived’ households, and 64.7% of ‘severely deprived’ households, reported they could not raise €1,000 if an emergency arose” (Corr, 2006, p.18).

Corr (2006) explains that there are 3 main sources of credit for low-income households:

- informal credit from relatives or neighbourhood;
- subprime market, in particular moneylenders;
- formal credit from credit institutions.

However, informal credit sources only provides a solution for 10% of low-income households (Byrnes *et al.*, 2005). Such households usually borrow from relatives or neighbourhoods when they have no other solution.

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<sup>42</sup> See the first part of this report.

In relation to formal sources of credit, it is necessary to distinguish between banks and credit unions. Credit unions are very popular in Ireland, with almost 3 million members. They are even more popular among low-income borrowers as between one-fifth and one-quarter of such borrowers are borrowing from a bank while two-thirds are borrowing from a credit union. The preference for credit unions as opposed to banks can be explained by higher accessibility (criteria of selection) and the opportunity to borrow smaller amounts at a lower price. However, the necessity to have a good credit and a good savings history to apply for a loan can deter some low-income borrowers (Corr, 2006; LRC, 2009). Another issue is that credit unions seem to “have begun moving towards a middle-income market, which would raise concerns as to access to credit for those on low incomes due to the recent reduction in credit supply” (LRC, 2009, p.19).

This development could reinforce the popularity of money-lenders, despite their high cost (one-third of low-income households are currently borrowing from a moneylender (Byrne *et al.*, 2005)). Various factors explain this popularity: their informality, their convenience, the fact that they are easy to access, loans are granted immediately, repayments are weekly, no collateral is needed, and in case of repayment difficulties the loan can be renegotiated at no extra cost to the customer (Byrne *et al.*, 2005; Conroy, O’Leary, 2005, Corr, 2006; LRC, 2009). Despite all these benefits, moneylenders are so expensive that they often impoverish the borrowers (Byrne *et al.*, 2005). Illegal moneylenders or loan sharks, without a licence from the Financial Regulator, operate in some extremely disadvantaged areas.

Finally, the Law Reform Commission (2009) emphasises that one of the main sources of debt for low-income households is arrears on utility bills. “Delaying the payment of bills is the primary manner in which low-income families tend to borrow in times of need” (LRC, 2009, p.18). For higher income households, debts are less related to utility bills and tend to be personal bank loans and credit card borrowings.

As noted earlier, Irish households are heavily indebted and their indebtedness has grown quickly over the past 15 years. This central role given to consumer credit within Irish society increases difficulties for people who cannot gain access to credit and for those who gain inappropriate access (or see their situation changing

making it more difficult to repay their debts). Such difficulties are even more important given that the most common reasons among low-income groups for accessing credit are for child-related expenses, consumer goods, emergency situations and changes in personal circumstances (Conroy, O'Leary, 2005; Daly, Leonard, 2002).

The growth of Irish consumption is mainly fuelled by credit which makes the situation of most Irish households very fragile. As a result of the burst of the housing bubble, many home owners were left in negative equity, while many borrowers were at risk of overindebtedness given that an unexpected change (e.g. unemployment) could make their financial situation untenable. A recent research study by the White Horse Mortgage Service (2010) shows that mortgage arrears are explained by economic reasons (unemployment and a reduction in income) in 78.14% of cases, while personal reasons (ill health and relationship breakdown) explain only 12.44% and lifestyle reasons (under the direct control of borrowers) account for 9.42%.

As highlighted in the introduction, there is no agreed definition of overindebtedness and there is no way of measuring this phenomenon.<sup>43</sup> It has been estimated that there were probably between 7 and 10% of overindebted households in Ireland before the financial crisis, and this could have risen to between 12 and 15% in 2008 (Stamp, 2009). The increase is due to the development of credit and mortgages in the past decade as well as the recent drop in employment and house prices.

Some of the consequences are a growing number of new clients contacting MABS (14,551 in 2006/ 22,962 in 2009), a growing number of debt-related high court execution orders (1,208 in 2007/ 1,601 in 2008) and the rapid growth in the number of mortgages in arrears for more than 90 days (3.6% in December 2009, 4.1% in March 2010, 4.6% in June 2010 and 5.1% in September 2010).

These difficulties raise the question of the appropriateness of a financial inclusion strategy regarding credit in Ireland. Such a policy framework would have to deal simultaneously with access and use difficulties and should neither prevent lenders from lending nor favour irresponsible behaviour from either lenders or borrowers. Therefore the question is: Does Ireland have a policy framework that

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<sup>43</sup> See OEE (2008) for an outline of the key factors that should be taken into account when defining overindebtedness.

favours appropriate access to consumer credit and that allows for the efficient management of financial difficulties?

### **3.2.2 Appropriate access to credit**

The quality of access to credit and the way to promote it are European concerns (OEE, 2008). These issues are usually referred to as “responsible credit” which has two derivatives: “responsible lending” and “responsible borrowing”.

In line with mainstream economic theories, the promotion of “responsible credit” implies ensuring that markets are working properly. It means that information has to be accessible and understandable for both lenders and borrowers and that prices should be fixed regarding the level of risk.

#### **3.2.2.1 Better informed borrowers and lenders**

An important piece of Irish policy is to promote appropriate access by developing responsible borrowing through financial education and the provision of reliable information to consumers. Interest in this issue started in 2004 with a consultation paper by the Financial Regulator. Consequently, the Financial Regulator set up a National Steering Group on Financial Education which published its first report in 2009 (NSGF, 2009).

Financial education is provided through the educational system, in several ways. It is incorporated in the Junior Certificate through the business studies course and in the Leaving Certificate through the Home Economics – Scientific and Social syllabus. A financial education programme is also provided for students in Transition Year through a joint initiative supported by MABS and the Financial Regulator (LRC, 2009).

Adult financial education is targeted in two different ways. The National Consumer Agency’s website ([www.itsyourmoney.ie](http://www.itsyourmoney.ie)) provides information to assist people in making pertinent financial choices. That information is also available through leaflets and handbooks. During the past few years the National Adult Literacy Agency (NALA) and EBS Building Society have developed their financial literacy programme through leaflets that explain financial vocabulary using simple definitions (LRC, 2009).

The basic assumption of such a strategy is that many consumers have too low a level of financial skills to make the best of the available information. Therefore, without these skills, they would

not be able to make informed, rational decisions. However, to be effective, such a strategy needs to make sure that lenders provide fair and complete information regarding the services they offer.

The requirements that have to be met by lenders are mainly – as in other EU countries – the implementation of successive Credit Directives of the European Union. The Consumer Credit Act 1995 as well as the Consumer Protection Code 2007 make clear that in their advertisement as well as in their offers (leaflets, contracts, etc.), lenders have to provide all the necessary information so that the potential borrower fully understands his/her commitments as well as the full cost of it (including cost in case of repayment difficulties). The Consumer Protection Code also prohibits unilaterally raising credit limits and pre-approved unsolicited credit. It encourages lenders to develop a better knowledge of their customers and changes in their situation in order to offer them suitable services. Such a regulation bound most of the lenders but left out moneylenders and credit unions.

Moneylenders and credit unions are both regulated in specific ways. The Consumer Protection Code for Licensed Moneylenders issued by the Financial Regulator in 2009 emphasises that moneylenders have to clearly outline the high cost of the credit they provide, and the consequences of default. There is no mandatory code of conduct for credit unions, which are supervised by the Registrar of Credit Unions.

As well as providing information to borrowers, European research (OEE, 2008) also underlines the importance of lenders having access to information about their potential customers through files containing positive information (about indebtedness of customers and sometimes about their economic and social situation) and/or negative information (about arrears and judgement of borrowers who have defaulted). Such files can be managed by public credit registers and commercial credit bureaux. The information provided helps lenders assess the level of risk of a potential borrower through credit scoring tools.

In Ireland the Irish Credit Bureau (ICB) is the main credit reporting (positive and negative) database. It is a private company with 80 members (50% financial institutions and 50% credit unions). Members provide data voluntarily on a monthly basis. There are also other credit reporting agencies operating in Ireland like Experian Ireland Ltd which claims to be the largest business information

provider in Ireland (LRC, 2009, p.90). The sharing of information through the ICB and the Irish credit reporting “system” is non-compulsory and lenders have no obligation to consult it before lending to a potential borrower.

### 3.2.2.2 The right price

There is no statutory interest rate ceiling in Ireland. Despite this, the level of interest rate is regulated in two different ways by the Consumer Credit Act 1995 (LRC, 2009, p.93):

- Section 93 provides that lenders who charge more than 190% per year may not be granted a licence when applying to renew it.
- Sections 47 and 48 allow the Court to reopen a credit agreement if the conditions are considered excessive.

Regarding moneylenders, the Moneylenders Act 1900 provides also that the Court can reopen a loan agreement when the transaction is “harsh and unconscionable” (LRC, 2009, p.95).

Regarding credit unions, their interest rate is limited at 12% per year by the Credit Union Act 1997. While moneylenders are allowed to charge a very high price, credit unions succeed in giving access to people on a low income, who are a supposedly higher risk, charging them only 12% per year. In these conditions, the fact that credit unions balance their budget shows that a personalised way to assess the risk and a personalised relationship is an efficient way to really reduce the risks.

Apart from the case of the credit unions, in Ireland interest rates are not regulated *ex ante* but are rather regulated *ex post*, as the Court is able to reopen usurious loans.

### 3.2.2.3 Alternative appropriate credit providers

Cognisant of the social role of consumer credit, it is essential that people have access to other sources of credit when they have been refused by mainstream lenders. The subprime market is one possible answer. Despite some very appropriate characteristics, the cost of those providers makes them widely inappropriate as means of helping people develop their autonomy and escape or avoid poverty.

Credit unions are the other possible alternative. However, their requirements (to build up a savings history) make them partly

inappropriate despite their low interest rate (no more than 12% per year). In order to address this, some credit unions have a “social fund” which allows them to lend to people referred by MABS with no savings history. However, the effectiveness of the “social fund” is limited as there is a risk that MABS could be perceived as a cheap emergency credit provider by low-income people. Such a development would have a negative influence on the service provided by MABS.

Despite the strength of the credit union movement, alternative credit providers do not produce all their potentially positive impacts due to the lack of an appropriate regulatory framework.

### **3.2.3 Dealing with financial difficulties and overindebtedness in an efficient way**

The management of repayments by credit providers is based on the same mainstream economic theories that inform the implementation of responsible credit strategies. Basically, mainstream economics teaches that once the credit is granted the lender has to set up conditions that prevent the borrower taking more risk than initially announced. In order to prevent difficulties, it has to be very costly for the borrower to default. Such an understanding of financial difficulties treats debtors facing difficulties and people who refuse to repay their debt (i.e. can't pay vs. won't pay) in the same way.

Lenders take into consideration potential arrears when lending, as a borrower who might face difficulties repaying his/her debt is not necessarily a problem for the lender. If the debtor is able to make up for any missed payments, the credit will be reimbursed and its profitability will have increased due to the fees the debtor would have paid as a result of his/her arrears. However, it is never profitable for the lender to let the borrower accumulate an unmanageable amount of arrears. Therefore it would be beneficial for both the lender and the borrower to have a regulatory framework that favours arrears avoidance as well as arrears handling and responsible debt recovery. Unfortunately the Irish regulatory framework is particularly weak on these points.

#### **3.2.3.1 Managing arrears**

The management of arrears is regulated by the Consumer Protection Code and by the Code of Conduct on Mortgage Arrears. However, the requirements of these codes are mainly limited to the obligation

on lenders to inform their borrowers that a payment has been missed and to explain to them what are the available sources of advice as well as the potential consequences if no solution is reached. None of the codes defines any precise procedure for reaching an agreement with the debtor, even if the principle of considering the situation in a personalised way is underlined.

Basically, arrears are managed within the framework of a commercial relationship between provider and customer. The example of the energy and renting domains could however inform the credit sector, as they are both guided by codes of conducts that emphasise the importance of a holistic approach to debt, and disconnection or expulsion is seen as a last resort (LRC, 2009).

Another weakness is the lack of regulation of private debt collection agencies (e.g. agencies buying debts or collecting them on behalf of the creditor), some of whom are engaged in “deceptive and unfair practices” (LRC, 2009, p.107).

As with the strategy to promote responsible access to credit, the main constraint on providers is to provide information to customers. The emphasis is again placed on financial education as well as the provision of personalised financial advice.

In recent years various private bodies have started providing debt counselling. Some provide it for free, e.g. charitable organisations, while others are commercial companies. These companies charge fees to their customers and are not regulated. The Law Reform Commission has expressed concern “in relation to certain misleading practices engaged in by private commercial debt advice agencies” (LRC, 2009, p.110). The Irish debt counselling services (MABS) is considered a model of best practice at European level (Korczak, 2004).

MABS was founded in 1992 by the Department of Social and Family Affairs. It provides, on a national basis, services to try to prevent overindebtedness as well as to rehabilitate the people concerned. The services provided include financial education and information (the programme *Smart with Your Money* has been developed in partnership with the Financial Regulator).

MABS mainly provides independent, free and confidential debt counselling, money advice and budgeting assistance to people facing financial difficulties and overindebtedness. Through the personalised advice provided, it supplies concrete and pragmatic financial pedagogy which helps people develop their financial

autonomy. MABS also negotiates on behalf of the debtor in order to reach an agreement to facilitate dealing with his/her financial difficulties. The intermediary role played by MABS often facilitates the rescheduling of the debt and the adoption of a monthly repayment. This is beneficial to both the debtor and the creditor as it allows the debtor to repay his/her debt, whereas without it it may have been impossible.

In 2009, aware of the effectiveness of MABS's role as an intermediary, the Irish Banking Federation and MABS set up an operational protocol to manage debt on a personalised basis. This protocol, which relies on the principle of good faith full disclosure, is ambitious, as "debt settlement or partial debt discharge are fundamental to the Protocol" (LRC, 2009, p.123).

Creditors, who are members of the IBF, must respect the protocol and must therefore welcome any applications from MABS on behalf of a debtor in financial difficulties. The creditor and MABS try to establish a more appropriate repayment plan to the situation of the debtor in order to find a "mutually acceptable, affordable and sustainable" solution. This plan is reviewed every 6 months and can be adapted if necessary. The plan takes into account other existing debts but does not involve other creditors and therefore does not change their terms and conditions. The necessity to involve all the creditors in order to find a sustainable solution when debtors are facing overindebtedness is the main challenge for MABS. Some creditors can be reluctant to agree to reschedule the debt and their opposition can make it impossible to reach a solution.

Finally MABS also intervenes to provide support when clients are already facing debt enforcement procedures. Fifty-one per cent of MABS's clients contact the service at this stage (LRC, 2009). The success of MABS's intervention depends on the role of the Judge who may welcome it or not. When welcomed, MABS helps people to prepare for examination hearings or to draw up a statement of means (LRC, 2009).

The management of arrears in Ireland mainly relies on the debtor. Lenders have to provide information regarding consequences and procedures, while the debtor has to be able to use this information to decide what to do. In that respect the role played by MABS (as well as some other organisations such as Saint Vincent de Paul, Free Legal Advice Centres, etc.) is absolutely essential, although it may not be sufficient to avoid financial problems damaging the debtor's autonomy.

### 3.2.3.2 Remedial measures for overindebtedness

As with arrears management, remedial measures – when debtors are unable to repay their debt anymore – do not take into account the reality of overindebtedness.

The debtor is considered as someone who refuses to pay, while most of the time he/she is unable to repay. When people are in arrears and no agreement has been found between the debtor and the creditor, the creditor usually instigates legal action to recover the debt. The legal enforcement system is supposed to threaten the debtor and make him/her repay the debt.

Another weakness results from the fact that the legal system considers single debt while overindebtedness can be the result of multiple debts. Therefore multiple procedures could be processed at the same time for the same debtor. The Law Reform Commission (2009) considers such an approach as an inappropriate way of dealing with difficulties in repaying debt as the legal system has not the human and financial resources to handle all the cases in an appropriate period of time.

Some debtors are unable to appropriately engage with the process (e.g. due to the intimidating procedure, difficulties in understanding the process or lack of solutions offered to debtors to reimburse what they owe) and therefore to satisfy the requirements of the decision of the Court. This can lead to imprisonment (FLAC, 2009; LRC, 2009). The Law Reform Commission “believes that the imprisonment of debtors for failing to comply with an instalment order is unjustifiable” (LRC, 2009, p.173).<sup>44</sup>

Finally, when no solution is found the last possibility is, in theory, bankruptcy. Personal insolvency law is ruled by the Bankruptcy Act 1988 and the Rules of the Superior Courts 1986. The procedure can be implemented either by the debtor or by a creditor and all the debtor’s belongings are managed by an Official Assignee in order to generate income for the creditors. The family home and some essential goods can be protected. However, the procedure is extremely costly for the debtor, who has to pay all the costs and who has to wait 12 years to be totally discharged. “These conditions for discharge mean that it is quite possible that a bankrupt may never become eligible for discharge under Irish law, and may remain subject to a bankruptcy order for the remainder of his or her life” (LRC, 2009, pp 113-114).

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<sup>44</sup> Between 2001 and 2007, about 200 people were imprisoned in connection with debt. In 2008, 276 people were imprisoned (FLAC, 2009; LRC, 2009).

The bankruptcy procedure is extremely expensive, overly punitive regarding the main cause of overindebtedness and prevents the debtor from making a fresh start. Therefore the procedure is hardly ever used – only four bankruptcies were declared in 2007 and eight in 2008.

The Irish regulatory framework appears unable to provide effective remedial measures. However, a pilot project highlighted how other ways of dealing with the issue were possible.

In 2002, as a response to the failings of the judicial debt settlement scheme, the legal system in relation to debt enforcement and the statutory bankruptcy regime, MABS and the IBF, with the support of FLAC, launched a *Pilot Scheme for Alternative Debt Settlement*.

This pilot was a voluntary out-of-court arrangement which led to the establishment of a repayment plan that could include partial write-off of the debt in order to allow a fresh start for the debtor. The plan adopted a holistic approach and took into account the basic needs of the debtor's household and tried to protect his/her principal private residence. Part of the plan is that a conciliator approves the agreement and helps to solve any eventual disputes. Although no evaluation has been carried out, the Law Reform Commission considers that this pilot was beneficial for all stakeholders: debtors, creditors and the state. However, the aim of the pilot was to simply provide an example for law reform and ceased to operate after a number of years.

Since then, many cases of overindebtedness are solved through voluntary debt settlement which involves, on an informal basis, MABS or fee-charging debt management companies. The Law Reform Commission considers that "informal plans are however a poor substitute for a statutory debt settlement" (LRC, 2009, p.126) as those plans are not legally binding and there is usually no debt relief.

In conclusion, "while the Pilot Debt Settlement Scheme was largely successful, the Commission feels that responsibility for organising extra-judicial debt settlement schemes should not be left to private initiatives" (LRC, 2009, p.127).

### **3.2.4 Strengths and weaknesses of the Irish strategy to develop responsible credit**

Even though Ireland has had one of the highest levels of growth in consumer credit in the EU, the regulatory framework has not

followed this development. It remains a framework for a pre-“credit society”, mainly based on the premise that it is better to let the credit market work with as little intervention as possible. There are therefore very few constraints for lenders.

Most of the constraints pertain to credit unions (i.e. capped interest rate) and should favour the provision of appropriate credit for low-income households. However, despite the popularity of credit unions, their action is limited by the necessity to save before borrowing as well as by the competition of moneylenders who are able to provide credit on the doorstep with high flexibility, even if the benefits cost the borrowers dearly.

Regarding information, the Irish framework respects the minimum standards set by the European Commission through its successive Credit Directives. Nevertheless, in relation to the social role of consumer credit in Ireland, this standard is too low to really ensure responsible credit practices.

Given that the decision-making process not only involves basic financial skills (informed by financial education and information provided by lenders) but is also affected by emotions, advice from a specialist is essential (Gloukoviezoff, 2008; LRC, 2009). Therefore, financial education – without discussing the quality of the training provided – and information cannot be considered as a substitute for advice. It is doubtful that these efforts will enable low-income households to accurately assess their financial situation as well as the appropriate features of the credit.

Regarding advice, the fact that credit scoring deprives the borrower of a potential relationship with the lender puts lenders in a situation that does not allow them to properly inform their borrower about the personal consequences of borrowing. Therefore, even though requirements regarding information provided by potential borrowers are of course welcome, it is doubtful that this information will be sufficiently useful for people at risk of overindebtedness.

It appears that the Irish strategy to reinforce the quality of information on the consumer credit market is valuable but too limited to achieve a fair access to credit. Likewise, the Law Reform Commission’s report concluded that there were

*... considerable doubts as to whether the provision of information to consumers may by itself be effective in preventing overindebtedness.*

*This suggests that an information based approach to consumer credit regulation must be combined with other preventative measures in adopting a thorough approach to preventing overindebtedness. In particular, lender-side measures must be adopted which seek to ensure responsible lending practices are observed to counter-balance the above difficulties in ensuring responsible borrowing practices (LRC, 2009, p.84).*

Among the shortfalls that the Law Reform Commission points out is the lack of effective information-sharing through the Irish Credit Bureau and other suppliers. It is questionable whether it really helps lenders to assess the level of risk of their customers. The main weaknesses are that the databases are incomplete, since information-sharing is not compulsory and is fragmented between several providers.

However, even if these weaknesses were addressed, the high level of interest applied to lending would remain a disincentive for lenders to assess accurately the level of risk of each borrower (Stiglitz, 2010). A lender does not mind if a borrower fails to finally repay his/her debt as long as:

- the borrower has already made the lending profitable by paying fees on arrears until being unable to repay;
- the overall lending activity of the lender is profitable, taking into account all its customers.

When lenders assess risk through credit scoring, it is the global portfolio of borrowers rather than that of the individual borrower which is the pertinent issue (Gloukoviezoff, 2008). These observations are similar to the conclusions of the Law Reform Commission:

*Commercial lending is based on maximising profit, not eliminating risk. This means that commercial lenders may accept that certain borrowers will default, and charge higher rates for this. Also, fiercely competitive consumer credit markets and sales-related remuneration systems may mean that disincentives exist for lenders to engage in responsible lending practices. Thus while a certain number of defaults may be simply the cost of doing business for a lender, each case of overindebtedness can result in personal tragedy for debtors and their families. This provides a*

*further justification for the law to contain measures requiring responsible lending practices to be observed (LRC, 2009, p.86).*

Considering that “a certain number of defaults may be simply the cost of doing business for a lender”, the fact that the Irish system to deal with overindebtedness is totally out-of-date is an extremely serious issue.

There is almost no constraint in Ireland to framing the way financial difficulties are taken into account. Lenders have only to inform the debtors, while the debtors have to negotiate with their creditors and to make the best decisions possible, based on the information available. There is no legal framework to allow for all debts to be taken into account simultaneously nor for a global solution for rescheduling the debt – which may include potentially writing-off part or all of the debt.

Basically, the present framework sees the solution in the commercial relationship between a service provider and a customer. It implicitly considers that when difficulties occur, it is the responsibility of the debtor. Therefore the whole system is structured so that pressure is put on the debtor to make him/her repay what is owed. Such an understanding of causes of financial difficulties can only lead to inappropriate answers.

Overindebtedness cannot be explained solely by the lack of financial capabilities of the debtor or his/her unwillingness to repay his/her debts. Debtors’ difficulties have also to be linked to the service provided by lenders, as it could be argued that the latter should have an expertise that allows them to assess the risks they take and therefore assume. Even though the debtor has a responsibility, overindebtedness is a social phenomenon which is the result of the widespread use of consumer credit and the fact that unexpected events occur which make the repayment of loans impossible.

Debtors who can pay but won’t repay are not overindebted and should therefore not be able to access any specific procedures. However, for the vast majority of debtors who face real financial difficulties, as well as for creditors, it would be beneficial to develop procedures addressing initial problems such as missed payments right up to cases of overindebtedness. This would require debt settlement procedures that take into account all the debts as well as an insolvency procedure that would be easily accessible and really allow a fresh start.

Despite these weaknesses, Ireland could build on its valuable assets like the credit unions and MABS. But both these organisations would work more effectively within a regulatory framework that makes better use of their strengths.

In order to achieve a more responsible credit sector, irresponsible practices have to be costlier for lenders than responsible practices. Currently, it is the opposite. A more appropriate regulation is needed as

*... the law currently places all the costs of overindebtedness on debtors and on the State's social welfare system, despite at least partial contribution from creditors to the causes of overindebtedness. While sections 47 and 48 of the Consumer Credit Act 1995 provide some protection against irresponsible or predatory lending, this protection is quite limited (LRC, 2009, p.99).*

Regarding arrears, some pilot projects which have been carried out in partnership with the IBF show that financial service providers understand that it is also in their interests to manage debt in a more efficient way. Even though the involvement of multiple creditors makes it difficult to reach an agreement which includes the global debt, it is necessary to find a way to constrain all lenders (even the most reluctant) to collaborate. In other words, a regulatory intervention is needed in order to neutralise the competition effect of the free market and to allow a more cooperative search for a solution. Such issues have been partly addressed by the UK, France and Belgium.

### **3.3 Consumer credit in the UK**

In many respects the UK consumer credit sector seems to be very similar to the Irish one. However, there are some real differences both in the structure of the sector as well as the regulatory framework implemented to improve appropriate access to credit.

#### **3.3.1 The British way to promote fair credit**

As in Ireland, consumer credit plays a significant role in the daily life of households. The ratio of indebtedness compared to disposable income is extremely high (173%), and it is clear that consumer credit helps to deal with emergency and unexpected expenses. It can play such a role because the consumer credit market is very developed

and gives access even to the highest risk borrowers including those with an adverse credit history, the overindebted, the unbanked and even those who are bankrupt (Collard *et al.*, 2006).

The British consumer credit market is structured in the same way as the Irish market. There are mainstream credit providers (including credit cards companies), third sector lenders (credit unions, community development financial institutions), subprime lenders (moneylenders, home credit providers, etc.) and illegal lenders. It is a continuum from the mainstream prime credit providers to the alternative subprime credit providers. The top end of the subprime market is very similar to the lower end of the prime market except that interest rates are higher and conditions are more punitive.

Not surprisingly, among the 75% of the population who have a loan or a credit commitment of some kind, non-mainstream sources of credit are more commonly used by people with low income such as lone-parent households (BIS, 2010b). As in the Irish situation, it also appears that even low-income households use different sources of credit and appreciate the services provided by non-mainstream lenders (Jones, 2001; Collard, Kempson, 2005). However, this apparent similarity hides some differences.

First, the British credit union movement is not comparable at all to that in Ireland. With only 500,000 members it is not as widespread as in Ireland. This is mainly the result of restrictions implemented by the 1979 Act<sup>45</sup> as well as competition from other lenders.

Second, in the UK there is no limit for interest charged except for credit unions. Licensed moneylenders charge between 100% and 500% a year while home credit companies provide loans charging sometimes more than 400%.

Despite having three levels of credit provision, access to affordable credit is more and more difficult to achieve. In 2008, 73% of credit unions reported an increase in demand for loans, but for 50% of them this increase came not only from people on low income but also from people on medium and high incomes (FIT, 2008). However, a greater number of applications had to be turned down due to a lack of capacity to repay. Such a situation is of concern for the Financial Inclusion Taskforce which stated that “a continuing or worsening lack of access to financial services will hinder people’s ability to recover from a significant change in circumstances and

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<sup>45</sup> For more details see Edmonds (2011).

therefore hinder the UK's ability to recover from a recession" (FIT, 2008, p.2).

More recent studies carried out by the Department of Business, Innovation and Skills (BIS, 2010a, 2010b) show clear signs of those difficulties for households. It appears that 9% of households are in structural arrears while 15% considered that keeping up with bills and credit commitments is a heavy burden. These studies also note that one out of five households has already used one or more of their current loans or credit, to refinance or pay off other borrowing.

Such difficulties emphasise the importance of the strategy implemented by the British government to develop access to affordable credit especially for low-income households and to prevent overindebtedness. This strategy became a real priority for the British Government in 2004 when the lack of access to affordable credit was identified as contributing to child poverty and social exclusion as well as imposing additional costs on the state benefit system (McDonald, 2005). The strategy, which is monitored by the Financial Inclusion Taskforce, is increasingly important due to the consequences of the financial crisis.

### **3.3.2 Access to affordable credit**

The British strategy to promote access to affordable credit is mainly based on two hypotheses. The first is that credit is an appropriate answer to satisfy the needs of all segments of the population. The second is that market mechanisms are appropriate to provide credit to everybody. The aim of the British strategy is therefore to improve the way market mechanisms work.

#### **3.3.2.1 Better informed borrowers and lenders**

Quality of information is essential to inform appropriate access. Therefore the British government has widely promoted the provision of clear and fair information to borrowers as well as developing financial education.

The provision of information is taken into account in multiple ways. It is part of the Consumer Credit Act 2006 which is an update of that of 1974 and which sets the basic legal requirement of lending activity. More detailed guidelines for good practice are given in the Lending Code (former Banking Code) – a voluntary code of conduct which applies to members of the British Bankers Association, Building Societies Association and UK Cards Association. This Code

covers 63% of the unsecured credit sector. Basically, its requirements regarding customer information are related to the cost of the credit, its consequences if difficulties occur and its repayment conditions. In order to promote responsible lending, it also requires that its members

*... check both positive and negative data held at a credit reference agency and take into account one of the three sources of data on the customer's financial circumstances. These are: income and financial commitments; how the customer has handled existing accounts and the lender's internal credit scoring techniques (OEE, 2008, p.67).*

In order to help the lenders assess the level of risk of the borrower, three main credit agencies provide information: Callcredit, Experian and Equifax.

The requirements of the Credit Consumer Act 2006 and of the Lending Code will be improved with the implementation of the Consumer Credit Directive which was laid down on 30 March 2010 and comes into force on 1 February 2011. If the Directive does not radically transform the lending practices, it will at least make them more homogeneous.

Along with the requirements for lenders, the Government has developed numerous resources to help potential borrowers to assess the cost and the appropriateness of the credit provided. For example, regarding home credit companies and following the Home Credit Market Investigation Order 2007, the Competition Commission has set up a website allowing customers to check the real cost of such credit ([www.lenderscompared.org.uk](http://www.lenderscompared.org.uk)). Similarly, the Office of Fair Trading, which gives licences to lenders and controls fair practices, has set up a website which helps consumer to assess the quality of services provided ([www.consumerdirect.gov.uk](http://www.consumerdirect.gov.uk)). Charitable organisations are also involved in developing resources like websites, leaflet and handbooks to promote financial education. For example, the Personal Finance Education Group is helping schools and was posited as an example of best practice in the OEE report for the Commission (OEE, 2008).

These initiatives to inform customers through websites and leaflets were led by the Financial Service Authority (in conjunction with various government departments and key stakeholders) until April 2010, and responsibility changed with the launch of the

Consumer Financial Education Body (CFEB). This new body leads the National Strategy for Financial Capability, bringing together interested parties from industry, consumer bodies, voluntary organisations, government and the media. Its aim is to favour and promote the development of efficient supports for financial education and also to support the development of face-to-face advice. This is the second element of the British strategy to improve the population's financial capability.

The Financial Inclusion Fund, which has been extended until 2011, spent £45 million stg between 2005 and 2008 on the provision of face-to-face money advice as well as another £6 million stg "to pilot mechanisms of money advice outreach aimed at those who do not normally present themselves to debt advisers" (PFRC, 2007, p.8).

There are numerous providers of face-to-face advice; some are commercial while others are free. Interestingly, a pilot scheme set up by Independent Financial Advisers and Citizen's Advice Bureaux was evaluated in 2007 which led to the examination of the feasibility of a new, sales-free national money guidance service (Thoresen, 2008). Consequently, a pilot – "pathfinder" – has been established in the east and north-east of England, to be rolled-out across the UK during 2010. The Money Guidance Pathfinder provides free advice delivered face-to-face, on the phone and online. It works in partnership with organisations like Citizen's Advice or Manchester Credit Unions. The different features of the pilot would suggest it has been influenced by the MABS experience in Ireland.

The British strategy of promoting better quality information follows the same logic as that in Ireland. The main difference is the level of public money spent in promoting and structuring financial education and money advice. The constraints placed on the lenders to inform their customers are similar.

### **3.3.2.2 The right price**

The British approach to credit is to make it widely available by allowing the lender to fix the price in conjunction with its assessment of the level of risk of the borrower. Therefore there is no maximum interest rate limit, unlike in Ireland where a licensed moneylender cannot lend at an interest rate beyond 190% a year.

Legislation in the UK controls the level of interest rate by allowing courts to reopen credit agreements when the terms are considered

usurious. In this respect, the Consumer Credit Act 2006 widened the definition of extortionate credit to include terms and conditions along with the price. It also brought this issue under the remit of the Financial Ombudsman Service. This facilitated making a complaint easier for low-income households as court procedures are avoided. Such a development is positive as few borrowers were willing to take creditors to court (OEE, 2008).

However, this does not prevent very high interest rates. Such practices maintain people in poverty because a large part of their income is dedicated to paying the interest on their loan, though it could be used in a more productive way. These loans are also seen as a source of impoverishment for the whole community as this money is not invested in the local economy (Thiel, 2009). Therefore, on one side of the debate about the introduction of an interest rate ceiling are those thinking that lower levels of interest rate will exclude riskier borrowers from gaining access to credit, while on the other side are those who think that borrowers will become impoverished without an interest rate ceiling. The question is whether a more affordable source of credit could be provided on a sustainable basis to low-income borrowers.

### 3.3.2.3 Alternative affordable sources of credit

Given that providing consumer credit through market mechanisms has led to some difficulties due to the extremely high cost of these loans or even to borrowing from illegal lenders with even greater negative consequences, the aim of the British strategy has been to tackle illegal lending and to promote access to affordable credit.

The first step of this strategy is to try to eliminate – more realistically, to reduce – illegal lending. In 2005, 165,000 households were borrowing from illegal moneylenders. This represents 0.44% of the total population but 3% of low-income households and 6% of households living in the most deprived areas (Policis, 2004; Collard *et al.*, 2006). In comparison, 2.3 million households borrowed from high cost licensed home credit lenders; this represents 6.15% of the population. Illegal lending could seem like a small-scale problem but “because it occurs in pockets of deprivation, it is likely to be as widespread as are deprived micro-communities” (Collard *et al.*, 2006, p.9). The concern about these practices is also highly understandable as the average interest rate of these loans is 825% per year (FIC, 2010).

The Department of Trade and Industry set up in 2004 two pilot

enforcement projects in Birmingham and Glasgow with the aim of looking for evidence on illegal lending practices, in order to take action against lenders as well as raise the awareness of potential borrowers. They also helped victims to make transitions to legal credit sources and other financial services. Between 2004 and 2007 more than 3,000 customers of illegal lenders had their loans cancelled (FIT, 2008). In 2007 the government set up a national network of trading standards teams<sup>46</sup> which has helped 10,000 more people. However, a lot remains to be done as the number of people borrowing from illegal moneylenders grew by 22% from 2007 to 2010 (FIC, 2010).

Despite their limits, these pilots have shown that “the most effective strategies for tackling illegal lending will balance enforcement [important role of enforcement and deterrence through collaboration with the police] with alternative credit supply but also wider efforts to tackle financial inclusion” (Collard *et al.*, 2007, p.8).

The development of alternative affordable sources of credit is therefore the cornerstone of the UK financial inclusion strategy regarding credit. However, the challenge is that these alternatives have to appeal to customers of high cost moneylenders as well as to those who have been refused by these lenders and borrow from illegal moneylenders.

The Social Fund is a potential source of affordable credit for those considered risky by lenders. Set up in 1988 and operated by the Department of Work and Pensions, it offers interest-free loans to people claiming social assistance. Over one million loans are made each year (PFRC, 2007). However, despite the benefits, there are many drawbacks to the Social Fund. It is perceived as inaccessible for some groups. For instance, pensioners and households headed by a member of an ethnic minority are less likely to get a loan (Legge *et al.*, 2006). Furthermore, the Social Fund has not prevented the development of illegal lending to a target group that is wider than social welfare recipients.

The main criticism of the Social Fund is that it does not help to reduce poverty. Commentators cite that applications are often refused or only partially granted and that the impact of having loan repayments deducted from benefits means that people have to survive on a smaller income (Legge *et al.*, 2006).

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<sup>46</sup> [http://www.direct.gov.uk/en/MoneyTaxAndBenefits/ManagingDebt/DebtsAndArrears/DG\\_10035958](http://www.direct.gov.uk/en/MoneyTaxAndBenefits/ManagingDebt/DebtsAndArrears/DG_10035958)

The Growth Fund is the main policy that has been introduced to promote affordable credit among not-for-profit lenders. Between 2005 and 2008 credit unions and the Community Development Financial Institution (CDFI) received £36 million stg in funding.

Credit unions have used these funds to target people who are financially excluded, and to favour lending decisions based more on people's ability to repay rather than on the amount they have saved (PFRC, 2007).

The CDFIs have used their fund to develop their services targeted at people who are refused loans from prime lenders. Unlike the credit unions, they do not require a savings history.

Funds provided by the Financial Inclusion Fund have included loan capital to increase the ability of third sector lenders to lend to low-income borrowers, as well as for investment in capacity building (PFRC, 2007). More recently, the Financial Inclusion Fund has examined the possibility of developing financially sustainable organisations. Some banks such as Barclays Bank and the Co-operative Bank have also provided financial support to help third sector lenders to extend their services and to move towards financial sustainability (RFA, 2008).

Despite these efforts and real results having been obtained, the Financial Inclusion Taskforce has stated that significant time was needed to build adequate capacity and coverage among third sector lenders (FIT, 2008). Moreover, the consequences of the financial crisis have led to an increasing demand for credit. Anticipating this development, the Financial Inclusion Taskforce proposed doubling the Fund in order to be able to grant 150,000 more loans (FIT, 2008). It was thought that this could be achieved with public money and/or further financial support from mainstream banks. Finally, while the Growth Fund was £42 million in 2007, in December 2007 a further £38 million was allocated from the Financial Inclusion Fund, and in Budget 2009, the Chancellor announced an extra £18.75 million, bringing the total to almost £100 million.

However, the development of third sector activity in the UK remains uncertain. Firstly, its development is highly dependent on public money, the availability of which is uncertain in the current economic climate. Secondly, another consequence of the financial crisis is the increasing demand for credit from riskier borrowers. Thirdly, third sector lending institutions are supposed to become sustainable while competing with high cost moneylenders whose

services are in many ways well adapted to customers' needs. Such a goal is a real challenge. For example, in order to develop a sustainable not-for-profit home credit organisation three main elements are required: "home collection; a single price underpinned by cross subsidy (both between customers and over an individual customer's life cycle) and flexibility with regard to payment and debt recovery for people who can't rather than who won't pay" (Kempson *et al.*, 2009, p.4). Considering the potential costs of delivering such services, a sustainable not-for-profit home credit organisation should charge more than 100% APR and also succeed in attracting "good" customers from existing home credit providers (and not only the riskiest borrowers who face difficulties in borrowing from existing lenders).

Even though it is not necessary for not-for-profit lenders to lend at 100% APR, the difficulties in becoming sustainable without public money are real. The British credit market is already well developed, and despite the high cost of their services moneylenders are extremely efficient competitors for alternative affordable lenders.

### **3.3.3 Dealing with financial difficulties and overindebtedness in an efficient way**

The British way to deal with financial difficulties is concurrent with the way access to credit is supported: market mechanisms are at the heart of the strategy. Therefore there are very few regulations regarding arrears management, while remedial solutions often rely on the action of commercial providers.

#### **3.3.3.1 Managing arrears**

According to the OEE (2008), there is almost no regulation in the UK organising arrears avoidance and arrears management. When they do exist, they are related to water and energy provision. They mainly require the provider to inform its debtor through a standardised sheet about his/her rights and responsibilities as well as how to obtain independent debt advice. Obligations regarding information for lenders introduced by the Lending Code as well as the Consumer Credit Directive are very similar.

Although there is no proper regulation in this respect, lenders are strongly encouraged "to be flexible in arrears management and debt recovery and to reach repayment arrangements outside the jurisdiction of the court" (OEE, 2008, p.89). In 2002 retail bank

members of the British Bankers Association were obliged to accept a repayment offer designed by a debt advisor. Such an offer is provided through a standardised “financial statement form”. This “partnership” was set up following a pilot which showed that the cases assessed by advisers were treated more efficiently for the borrower as well as the lender (OEE, 2008).

Apart from this specific partnership there are no other procedures which help to deal with financial difficulties in a more comprehensive way. Basically, the main answer for borrowers in difficulties is to seek help from free or fee-charging debt advisors in order to find a solution and to negotiate with different creditors in a more efficient way. The effort made by the government to recruit and train new money advisers is in this respect crucial. According to the Financial Inclusion Taskforce, over 500 new money advisers were recruited and trained between 2006 and 2008 and over 193,000 clients were assisted with their debt problem. However, its future effectiveness relies entirely on the continuation of the funding; the Taskforce was concerned that two-thirds of it will run out in 2010 (FIT, 2008).

Finally, borrowers facing an unforeseen deterioration in their financial circumstances and who have a reasonable prospect of improvement in the short term (6-12 months) can be eligible for an enforcement restriction order. Such an order prevents creditors taking any enforcement up to 12 months as well as cutting off the supply of energy. It ensures that people who are facing severe but temporary difficulties do not see their situation deteriorate by enforcement procedures while they have the possibility of reimbursing in the near future (OEE, 2008; LRC, 2009).

### **3.3.3.2 Remedial measures for overindebtedness**

The British way of dealing with overindebtedness tries to reconcile the social role played by consumer credit with the choice of self-regulation by the market. Therefore, given that this is an efficient way to deal with overindebtedness and recognising that a high level of access to credit can sometimes result in borrowers being unable to repay their debt, the British system has taken into account the possibility of a “fresh start” through the bankruptcy procedure. However, the bankruptcy procedure (designed primarily for businesses) is out of reach for most debtors due to its cost (deposit and fees) (LRC, 2009). In order to provide a

solution to people facing overindebtedness, a range of solutions has been established.

Firstly, the Administration Order or County Court Administration Order applies to borrowers with a total debt of less than £5,000 stg. The court assesses the budget of the borrower and if possible organises the repayment of the debts by instalment. The repayment can last a maximum of 5 years and the frequency and amount of repayments are calculated by the court (LRC, 2009). However, it appears that administration orders have a high level of default mainly because participants are too poor to manage a repayment plan (OEE, 2008).

If the creditor owes more than £12,000 stg, he/she is eligible for an Individual Voluntary Agreement (IVA). This is a legally binding agreement set up by local insolvency practitioners. It becomes binding when over 75% of the creditors (in value of the global debt) have approved the proposal. The debtor contributes a significant proportion of his/her assets, as for a bankruptcy procedure, but his/her property is not automatically sold (LRC, 2009). There is also a period of contribution (repayment from debtor's income) which lasts between 3 and 5 years before the debtor is discharged. The IVA is very popular as it is less costly than the bankruptcy procedure and also because it has been widely advertised by fee charging insolvency practitioners. However, the involvement of those private companies has been criticised by both not-for-profit debt advisers and creditors.

*As a consequence a Code of Practice is being compiled that will create industry standards to regulate how responsible debt practitioners market and advertise their services. The standard will also cover the quality of advice customers receive from IVA providers on the register as well as the transparency of charges and fees will be made [compulsory]. (OEE, 2008, p.97)*

The other possible solution is a debt relief order which is designed for people who have no assets, a very low income and a low level of debt. Introduced in 2007 following a consultative paper in 2004, it is a low-cost debt relief mechanism. A debtor must first participate in debt counselling before applying for the relief order. There is a reasonable fee for the procedure which is mainly administrative and it does not require court intervention. "The order prevents creditors

from enforcing their debts and discharges the debtor's obligation after a period of one year" (LRC, 2009, p.261).

### **3.3.4 Strengths and weaknesses of the British strategy to develop responsible credit**

The two pillars of the British responsible credit strategy are: access to consumer credit, given the central role credit plays in British society, and allowing market mechanisms regulate supply and demand. On this basis, the British strategy is largely coherent.

In order to facilitate access to credit, there is no interest rate ceiling. Lenders are allowed to price risk and to serve the most risky borrowers. On the other hand – and to avoid where possible bad practice – information is provided to customers in order to help them make an informed choice. Such information should help them to avoid the most expensive offers and to favour the more reasonable ones. In that respect, the Financial Inclusion Fund has invested money in a complementary way to support the development of not-for-profit lenders which gives a real choice to borrowers, while illegal lending has been targeted by several pilots.

In relation to responsible credit, the British government has funded numerous debt advisers in order to develop face-to-face and telephone advice for people facing difficulties. Along with these personalised sources of advice, websites and leaflets have been promoted and it is compulsory for lenders to display information about solutions available to debtors when payments are missed. Some partnerships between retail banks and debt advisors have been set up on a voluntary basis to improve the efficiency of dealing with arrears.

Finally, when arrears are accumulating and the borrower is becoming overindebted, it is possible to choose from various bankruptcy procedures, depending on the debtor's situation.

Overall, the implementation of the British strategy and the work of the Financial Inclusion Taskforce have involved a large number of studies assessing the reality of the difficulties as well as the efficiency of the responses set up. In this regard, the British strategy is outstanding. However, this strategy has failed in numerous ways.

Firstly, it has not been able to develop real alternatives to high cost credit providers. Although third sector lenders have experienced real growth, they are still dependent on public funding which is uncertain. More importantly, they also face difficulties competing

with high cost lenders who, even though their services are expensive, offer certain features that suit low-income borrowers. Therefore they face difficulties attracting borrowers other than those who have been refused by high cost lenders. Credit unions and CDFIs also seem to be reluctant to welcome these very high risk borrowers.

Secondly, the strategy to develop financial capabilities is really effective regarding face-to-face advice but those providers cannot meet the demand. Such a situation fuels the development of fee charging debt advice providers whose services are not always appropriate for customers.<sup>47</sup>

Another limit of this strategy is that these elements rely on the initiative of the borrowers. Commercial agreements, debt advice and even bankruptcy procedures are only available once the difficulties have started to develop. Knowing that borrowers will first try to find a solution themselves, debt advisers are frequently contacted only when remedial procedures have started.

Thirdly and finally, notwithstanding the benefits of having the option of bankruptcy and a fresh start, there is no opportunity for a collective rescheduling of debt except for those with a very low level of debt. A procedure allowing collective rescheduling of debt would help to find an early solution to situations that would have had ended up in bankruptcy. Such a procedure would allow for coordinating the interest of the different creditors in a coherent way and for protecting the autonomy of the debtor.

These failures and shortcomings are explained by the prevalence of the belief that the free market can ensure appropriate access to credit. Unfortunately, the free market can offer access to credit but at a price that makes it inappropriate:

- Despite the high prices, borrowers accept these loans as they desperately need credit to face their daily expenses.
- The ability of borrowers to make the most appropriate financial decisions is undermined by the lack of choice, the complexity of the characteristics of the credit (the overall costs), and the influence of emotions on their skills (which legitimises the need for advice from an expert).

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<sup>47</sup> In a recent report the Office of Fair Trading stated that “the findings from this review shine a spotlight on a market where poor practices appear to be widespread. While degrees of non-compliance range from very serious matters to matters of less direct concern, it is clear that standards across this market are not as high as should be the case” (OFT, 2010, p.7).

Therefore, in order to promote a really responsible credit sector in Britain, there is need for appropriate regulation and appropriate alternatives to credit (like more public services and benefits), since credit cannot always be the answer to the needs of every household.

### **3.4 Consumer Credit in France**

The French way of promoting responsible credit is significantly different from the Irish and British approaches. This difference is mainly due to the less important role given to market mechanisms in France.

#### **3.4.1 The French approach to responsible credit**

The social role of credit cannot be compared with that in Ireland and in the UK as household indebtedness is far lower in France, as indicated earlier. However, even though the role of credit in French society is not so important, it still plays a role.

The credit market in France has no subprime market but there are two types of actors: the “global players” who provide all types of financial services (retail banks) and the “pure players” who only provide consumer credit (credit card providers, supermarkets, car dealers etc.). Many of these are also owned by retail banks. For example, BNP Paribas and Crédit Agricole represent (with their subsidiaries) more than two-thirds of the revolving credit market (Athling, 2008).

Regarding access, 51% of the French population had a loan in 2009 (61% if bank overdrafts are included). However, only 31% of households at-risk-of poverty (e.g. having less than 60% of the median income (€910 per month)) have a loan (55% with overdraft). Among those without any credit, 1% has been refused, while 8% of households at-risk-of poverty are in the same situation (Jauneau, Olm, 2010). These figures illustrate that access to credit is difficult in France as there is no subprime market due to the existence of an interest rate ceiling.

This is an essential element of the French approach to financial inclusion, in particular credit: an increased access to credit is not seen as positive if the quality of this access is poor.

When they do access credit, low-income households usually use the most expensive source of credit: revolving credit (e.g. credit cards). This kind of credit has a maximum interest rate of 20% (while instalment loans have a maximum interest rate of 10%), making them

the most profitable for lenders. Among households accessing consumer credit, 40% of households at-risk-of poverty have access to revolving credit compared to 28% of the general population.

Regarding the use of credit, households at-risk-of poverty are more likely than the general population to borrow in order to face budget shortfalls (28% vs 12%). This has been increasing since 2001 (from 22% to 28%) while it has been decreasing for the general population (from 21% to 12%) (Jauneau, Olm, 2010). The overdraft (a costly form of credit) is often used to face financial difficulties (30% of households at-risk-of poverty are in this situation vs 15% for the general population). The use of overdraft in that respect leads some of the borrowers to exceed the limits of their overdraft (18% vs 12%) and to increase their difficulties (Jauneau, Olm, 2010).

However, revolving credit is more common among overindebted households than are overdrafts. According to the Banque de France, 70% of overindebted applications were using revolving credit, with six of them on average per application (Banque de France, 2008).

There are a number of indicators used to identify the population at risk of financial difficulties, although none of them is totally satisfactory:

- 2.5 million people are listed in the FICP (a file of borrowers who have missed three instalments in a row), an increase of 12% since 2005;
- 4.4% of households are considered to be in severe financial difficulties because of credit use (Observatoire des crédits aux ménages, 2010);
- over 770,000 households are currently overindebted (e.g. they have been through the debt settlement procedure of the Banque de France), which represents 3% of households; this is consistent with the proportion of the general population who consider themselves overindebted (the proportion rises to 6% for households at-risk-of poverty) (Jauneau, Olm, 2010).

In comparison with Ireland or the UK, there is a lower level of access to credit in France but also a lower level of financial difficulties. However, even though people without access to credit face difficulties, it does not mean that all them would be better off accessing credit as it is provided in Ireland and the UK. It is

important to note that some of the needs which are satisfied by credit in Ireland and the UK are met by other means in France, e.g. through public services, social benefits, etc. However, this situation is not satisfactory. Therefore, the question is how to increase access to credit while at the same time reducing the number of people facing financial difficulties.

### **3.4.2 Policies promoting access to affordable credit**

Along with the promotion of quality of access, the fact that consumer credit has become a key element of household consumption and economic growth has decided the French government to liberalise this sector and to implement laws that emphasise quality of information. Such an effort has been characterised by a law every other year since 2000.

#### **3.4.2.1 Better informed borrowers and lenders**

Since 1978 and the so-called “Scrivener law”, information provided in adverts and contracts is regulated. This regulation increased consistently over the years. Hence, when the European Consumer Credit Directive was introduced in 2010, most of the requirements were already met by the French credit industry.

The Consumer Credit Law of 2010 introduced two main innovations regarding the regulation of consumer credit activity. Firstly there is the “dialogue form” which summarises information about the income and charges of the borrower. Such a form is supposed to form the basis for the assessment of solvency of the borrower. It is supposed to be periodically reviewed in order to help the debtor and the creditor to take into account potential changes in the debtor’s situation. However, the information provided does not have to be justified (no written proof of income is needed) and the document will not be considered as evidence to judge whether the credit has been sold in an appropriate or inappropriate way. Therefore, the emphasis placed on avoiding any constraints for lenders, in order to prevent the selling of credit becoming more difficult, or costlier, has totally neutralised the potentially positive impact of this law.

The second main innovation of the law is the future introduction of a “positive credit register” regarding the indebtedness of households. Despite the opposition of some lenders, consumer associations, as well as the private data protection body the *Conseil*

*National Informatique et Liberté* (CNIL), the Ministry of Finance has decided that a committee will be set up to prepare the creation of a “positive credit register” before the end of 2011.

For the moment, lenders can only consult the FICP (*fichier des incidents de payment des credits aux particuliers*) which is a register containing the name of borrowers who are in arrears for more than 90 days. It also contains the names of people who have been through the public scheme to deal with overindebtedness. However, even though lenders should always check the FICP before granting credit, they often do not.<sup>48</sup>

Even though there is no legal constraint regarding the provision of financial education, the financial sector has been keen to set up different structures to provide it. Financial education is seen as a very effective way to promote financial inclusion and it is highly supported by the *Comité consultatif du secteur financier* (CCSF).

The two main financial bodies provide financial education through: *Les clés de la banque*<sup>49</sup> for the *Fédération Bancaire Française* (FBF) (the retail banks association) and *La finance pour tous*<sup>50</sup> for the *Autorité des marchés financiers* (AMF) (the financial markets authority). The respective websites provide basic information about budget and financial services (including microloans) as well as offering pedagogic support to social workers, teachers or volunteers in charitable associations. However, financial education is not a compulsory topic at any stage of the educational cycle.

Financial education is also provided by dedicated associations. The oldest one is *Finances & Pédagogie*,<sup>51</sup> set up by the saving banks in the late 1950s. Apart from its website, its main activity is training programmes organised in partnership with charitable associations, social workers and schools as well as private companies or the army. *Finances & Pédagogie* is represented in every French region, with at least one employee able to provide this training. Although the association can charge fees for its services, it is free for organisations such as charities. In 2009, 3,840 training programmes were organised for 55,000 people.

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<sup>48</sup> If repayment difficulties occur, the court can prevent the lender from recovering its debt if it has not checked the FICP while the borrower was registered in it. However, this risk is quite limited as the borrower has to bring the lender to court and has to demonstrate that it did not consult the FICP.

<sup>49</sup> <http://www.lesclesdelabanque.com/>

<sup>50</sup> <http://www.lafinancepourtous.com/>

<sup>51</sup> <http://www.finances-pedagogie.fr/>

Even though financial education is seen as one of the key components of the French financial inclusion strategy, none of these programmes has been evaluated.

#### 3.4.2.2 The right price

Interest rates are capped in France. There are three different levels of usury rates regarding the amount and type of consumer credit.

When the amount lent is under €1,524, the maximum APR that could be charged is 21.41% (July 2011). When the amount lent is over €1,524, the usury rate changes depending on the type of credit. If the credit provided has no fixed monthly repayment plan (overdraft or revolving credit) the usury rate is 19.37%, but if there is a monthly repayment plan (personal loan) the usury rate is 11.22% (July 2011).

Setting the interest rate caps in such a way has limited the level of overindebtedness, as it limits the level of risk that lenders can take in a profitable way. Simultaneously, it reduces the potential profitability of lending to the riskiest borrowers, and hence creates access difficulties for these borrowers. However, no scientific study has been carried out analysing the impact of interest rate caps on financial difficulties and access difficulties.<sup>52</sup>

While no lender is advocating for a complete suppression of the usury rate (except the association ADIE which provides microcredit), most lenders are lobbying for an increase of this limit. Through the Consumer Credit Law of 2010 the government decided to modify those levels but not exactly in the way that the providers were expecting. In order to encourage the provision of instalment credits rather than revolving credits, the interest rates caps will be progressively set up at the same level for both type of credit between April 2011 and April 2013. There will be only three levels of interest rate caps regarding the amount borrowed: €3,000, between €3,000 and €6,000, and over €6,000. However, it is not certain that this reform will favour greater access to instalment loans for riskier borrowers as the profitability of revolving credit is not only based on its price but also on its features.

#### 3.4.2.3 Affordable alternative sources of credit

The French credit sector is characterised by access difficulties as the interest rate is set too low to make riskier borrowers profitable enough for lenders. Furthermore, there is a reluctance to increase the level of the usury ceiling in order to avoid an increase in financial

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<sup>52</sup> Conclusions of Policis (2004) are contested in France.

difficulties and overindebtedness. Consequently, in 2005 the government decided to promote personal microcredit.

Personal microcredit involves instalment loans between €300 and €3,000 with an interest rate between 4% (*Caisse d'épargne*) and 13% (ADIE), targeted at borrowers refused by mainstream lenders. These loans are granted by a lender (retail bank or credit card provider) in partnership with a structure (charitable association, social workers, etc.) responsible for evaluating the request and supporting the borrower during the repayment. These microcredits differ from professional microcredit as they cannot be used to set up a business. However, the emphasis is still linked to professional goals, such as maintaining employment through repairing or purchasing a car or increasing the likelihood of getting a job through the funding of a driving licence or training. Nevertheless professional purposes are not the only ones. Personal microcredit can also be used to improve or maintain the quality of every aspect of life (housing, health, social or family life, etc.).

Before the introduction of personal microcredit, small loans were granted to people with no access to banking credit by the *Caisses d'allocations familiales* (state body which pays family benefits). These loans were granted to improve people's living conditions (e.g. equipment for or refurbishing of their accommodation). They are interest-free loans and can be reimbursed within four years maximum. However, their two main weaknesses are that they have strict conditions and are only accessible to people with children who are receiving family benefits.

Cooperative banks were also active in the early 2000s. The *Crédit Agricole* of the North East region set up a pilot called *Points Passerelle* which gave small emergency loans to people in difficulties while the *Crédit Mutuel* of the South West region was working in partnership with Caritas France to give small loans to households from Toulouse who suffered from the AZF catastrophe.<sup>53</sup>

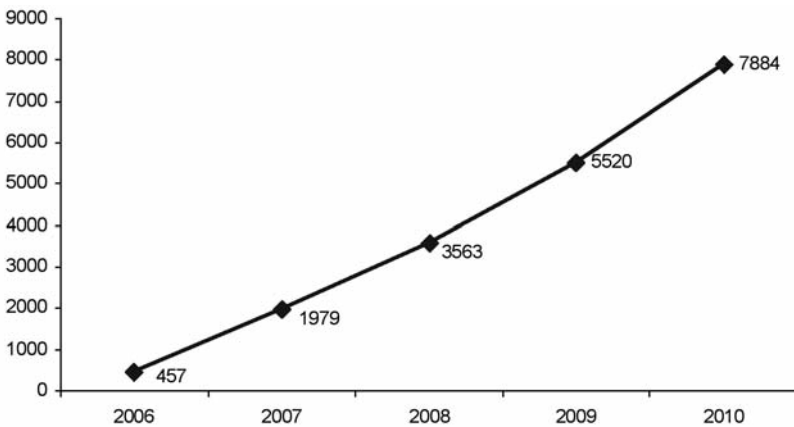
Based on the positive results of these pilots, the government decided in 2005 to set up the Social Cohesion Fund, granted with €75 million over 5 years, to guarantee 50% of professional and personal microcredit. Its purpose is to reduce the cost of the risk for lenders and to encourage banks to become involved in the provision of microcredit.

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<sup>53</sup> A chemical factory exploded in 2001 and the victims were unable to repair their accommodation as insurance companies were too slow to reimburse the damages. *Crédit Mutuel* and Caritas France decided to give microcredits to these people so that they could deal with the most urgent needs (e.g. windows).

On a quantitative basis, the provision of personal microcredit is limited as only 19,403 personal microcredit loans have been granted over five years, with only 7,884 in 2010. However, such a result is not a negative one in itself. Establishing this new tool required complex social engineering as it is supposed to facilitate bankers and volunteers or social workers working together despite their different working cultures. Encouraging signs are given by the strong annual growth rates of personal microcredit: more than 330% in 2007, 80% in 2008, 55% in 2009 and 40% in 2010 (Figure 23).

Figure 23: Growth of personal microcredit in France



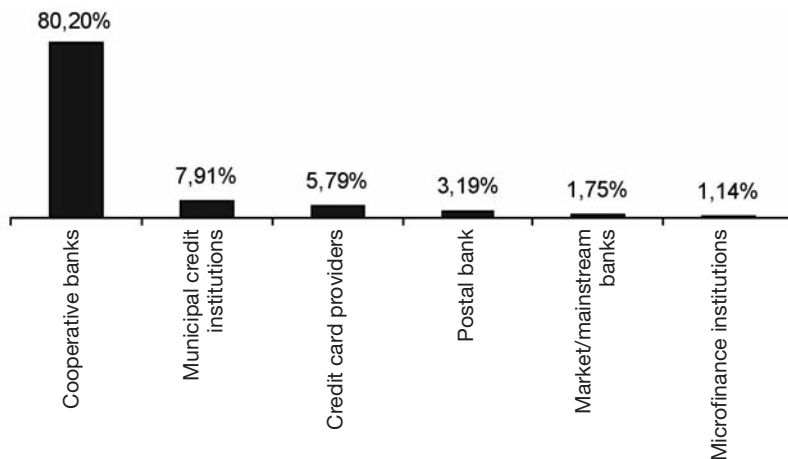
Sources: Based on Caisse des dépôts data

However, this apparent strong growth is not the result of a global effort of the lending sector. The *Caisse d'épargne* is the main lender, providing more than 40% of the microcredit loans.<sup>54</sup> It is followed by the *Crédit Coopératif* and the *Crédit Mutuel*, with 22% and 15% of the market share respectively. Overall, cooperative banks are the main providers of personal microcredit, providing 80% of the market share (Figure 24). This demonstrates that there is a real potential to develop personal microcredit as the more committed banks who lend microcredit, e.g. the cooperative banks, obtain good results.

<sup>54</sup> It is important to highlight that *Caisse d'épargne* had a legal obligation to spend a percentage of its profit on projects of general interest, including the provision of microcredit. This obligation was suppressed in 2008 but the *Caisse d'épargne* continues to provide these projects through its corporate social responsibility role.

Therefore, in order to involve all the banks it may be necessary to implement strong incentives or constraints.

Figure 24: Market shares of personal microcredit



Sources: Based on data from Caisse des dépôts

Personal microcredit has proven successful, with only 4% of borrowers defaulting. It has also had a positive impact as evaluations have shown that they have improved or protected the situation of the large majority of borrowers (Gloukoviezoff, Palier, 2008, 2009).

### 3.4.3 Dealing with financial difficulties and overindebtedness in an efficient way

The weaknesses of the soft approach to preventing difficulties for borrowers and the will to avoid “over-regulation” which could lead to even more difficulties with access have led to efforts being focused on reducing the consequences of financial difficulties.

#### 3.4.3.1 Managing arrears

There are very few legal rules regarding the way arrears are managed. “An organisation’s own policies provide the only grounds on which practice is guided” (OEE, 2008, p.76). The creditors have to inform their borrowers that they have missed a payment and explain the sanctions they may face as well as the solutions available.

A law in 2001 offered one solution which obliges every financial

institution to have an ombudsman service in order to deal with conflicts with their customers. However, decisions made by these services are rarely binding for the financial institutions. Another limitation is that the ombudsman can only intervene when difficulties are related to contractual dimensions. They cannot assess the appropriateness of a loan, for example.

Management of arrears is also taken into account by the law in another way – through respect for the private lives of debtors. When creditors, or companies working for them, try to recover debt there are rules to prevent inappropriate practices. For example, they cannot come to the house of the debtor before 6.00am and after 9.00pm, or contact relatives or colleagues about the debt. However, it seems that these rules are often broken.

When financial difficulties are the result of an unplanned change in the situation of the borrower but there is an expectation that the situation will improve, a legal possibility of “debt resting” exists. The judge can suspend the repayment or reschedule a debt over 2 years, depending on the borrower’s situation. This solution is different from those available for overindebted debtors but offers a temporary solution for people facing temporary difficulties with their credit.

Finally, the main weakness of the French system to deal with arrears is related to the lack of personalised advice. There is no specific service like that provided by MABS in Ireland. Social workers play a role in helping people to deal with their financial difficulties. However, they are not trained to deal with the complexity of financial products. Some help is provided on a local basis by generalist associations (e.g. consumer associations or charitable organisations) and specialised associations (e.g. Crésus). However, these associations cannot respond to the demand as they lack the required skills.

The industry has developed a specific answer on a voluntary basis only. One of the most interesting is the one set up by the *Crédit Agricole* from the North East region with the *Point Passerelle*. They receive debtors in difficulties for face-to-face interviews in order to find a personalised solution to their difficulties. These advisers use specific tools in order to make their action really effective. For example, they can restructure the overall indebtedness through a low-interest loan. This restructuring spreads the indebtedness over a longer period of time in order to reduce the monthly repayments,

and additionally each debt is renegotiated by the adviser. The aim of this approach is to take into account the global situation of the customer in order to secure an improvement in the situation as well as the repayment of the potential credit.

This pilot was set up in 2001 to reaffirm the cooperative dimension of the regional *Crédit Agricole*. Although there was no desire to make a profit, after several years it appeared that the *Point Passerelle* costs were matched by the savings made through avoiding costs such as lawyer fees which would have been incurred through the recovery of debts (Crosemarie, 2007). Even if the “profitability” of the *Point Passerelle* is very low, it shows that this alternative way of dealing with the difficulties of debtors is economically sustainable and that cooperative banks are still able to build on their specificities in order to innovate.<sup>55</sup>

Another financial institution which has developed some innovative ways to deal with financial difficulties is the *Crédit Municipal de Paris*. For example, it has developed a flexible loan which can be adapted depending on the borrower’s circumstances. It is used to restructure the debt of households who face difficulties with their monthly repayments. In addition, the *Crédit Municipal de Paris* has developed partnerships with firms like *La Poste* and *EDF* (electricity provider) in order to give personalised advice to their employees in financial difficulties. These two initiatives have not yet been evaluated.

#### 3.4.3.2 Remedial measures for overindebtedness

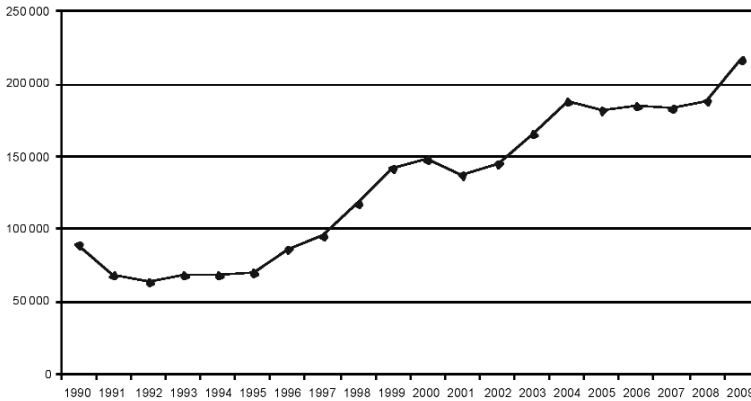
Since 1989 and the law “Neiertz”, overindebtedness is officially taken into account. This law has been updated several times (in 1995, 1998 and 2003). Today, the French debt settlement procedure is organised in several steps.

The first step is the *Commission départementale de surendettement* (overindebtedness commission presented in each *department*). When a borrower cannot meet his/her financial commitments anymore, he/she can apply to the *Commission* in order to find a non-judicial solution. This procedure has become increasingly popular since 1989, reaching 216,400 applications in 2009 (Figure 25).

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<sup>55</sup> The regional *Crédit Agricole* pilot was such a success that it was decided to extend the *Point Passerelle* on a national basis. However, each regional *Crédit Agricole* can change the organisation and services provided by the *Point Passerelle* which has led to a significant heterogeneity of the service and therefore to its efficiency.  
[http://www.creditagricole.info/fnca/ca1\\_843809/fr/initiative-pour-clients-fragilises?portal=esn\\_5744](http://www.creditagricole.info/fnca/ca1_843809/fr/initiative-pour-clients-fragilises?portal=esn_5744)

Figure 25: Annual number of applications for overindebtedness procedures



Source: Based on data from Banque de France

The *Commission* is hosted by the *Banque de France* which manages the overall scheme. It is composed of different stakeholders (six members representing the state, the creditors and the debtors). After having received the application of the debtor, the *Commission* tries to design a repayment plan, taking into account the debtor's circumstances and the characteristics of the indebtedness. This plan has to leave the debtor with a sufficient income to face current expenses (usually the level of the minimum social benefit). Several tools are available.

The *Commission* can propose "ordinary" measures which mainly involve rescheduling debts and reducing the level of interest due. If the debtors are unable to repay, "extraordinary" measures are proposed which include the possibility of a moratorium of two years maximum as well as a new assessment of the situation by the *Commission*, or a partial discharge of the debt. Mortgages can be reduced to the sale value of the home.

If the creditors or the debtor contest the plan designed by the *Commission*, it is the end of the non-judicial part of the procedure. The *Commission* makes a recommendation to the judge who bases his/her decision on the work already done by the *Commission*. The judge has the same tools as the *Commission* but his/her decision is binding.

If a debtor is unable to repay his/her debts and there is no

reasonable hope that his/her situation will improve, since 2003 the *Commission* can refer the debtor to the court for the *procédure de rétablissement personnel* (personal recovery procedure). This procedure requires that all non-exempt belongings of the debtor are sold to allow the judge to close the case for asset insufficiency. However, most of these debtors have no belongings, and goods necessary for work are exempt.

In 2008 the most common of these procedures was a repayment plan (58% of applications), while 20% of applications went to a judge, 16% ended with a personal recovery procedure and 6% with a moratorium.

The French way to deal with overindebtedness appears balanced and mixes non-judicial and judicial approaches as well as offering the possibility of repayment plan, moratorium or bankruptcy. However, its effectiveness has been questioned by a recent evaluation of the *Cour des comptes* (public body which controls public expenses) (*Cour des comptes*, 2010).

Almost 40% of applications are second time applications. Some of these are because people have reached the end of their moratorium while others have failed with their repayment plan. This questions the effectiveness of the work of the *Commission* to define the most appropriate answer. The difficulty seems to be because the approach adopted is too administrative (Crosemarie, 2007). The *Commission* has not enough time or resources to meet the debtor and to carry out an in-depth assessment in order to define a really suitable and personalised repayment plan. Another weakness is the lack of support for the debtor once the solution is agreed. Despite the fact that the law stipulates that a social worker should support the debtor during the repayment plan, no funding has been made available to provide this service.

#### **3.4.4 Strengths and weaknesses of the French strategy to develop responsible credit**

As in Ireland and the UK, the French strategy on responsible credit relies first on financial education and better information for borrowers. Such an approach is consistent with that promoted by the Consumer Credit Directive.

One of the key differences between France and the UK and Ireland is that France does not have a public credit register or a commercial credit bureau which provide information about the

existing indebtedness of potential borrowers. Recognising that more complete information could help lenders to lend more responsibly, a committee has been set up in France to prepare for the establishment of a public credit register which would collect positive and negative data. However, the impact of such a register on preventing overindebtedness is doubtful even though it may help to increase competition between lenders (Gloukoviezoff, 2008).

One of the key features of the French credit sector is the existence of a usury ceiling. As a result, the price that can be charged by lenders reduces the profitability to lend to riskier borrowers. Therefore lenders take less risk than they would without a usury ceiling. Hence there is a lower level of overindebtedness. However, a usury ceiling also restricts access to credit to a part of the population. For some, this is beneficial as access to credit could have driven them to overindebtedness. However, this can represent a real problem for others. Even if French people are less dependent on credit than their Irish or British counterparts, there is still a need for credit which is not met.

In order to address this problem, the French government has been promoting personal microcredit initiatives since 2005 through the guarantee of 50% of personal microcredit loans by the Social Cohesion Fund. Despite positive results in relation to the impact on the borrower as well as the level of repayment, personal microcredit loans are not an alternative for people without access to consumer credit as they are not yet mainstreamed. Such a weakness is due to a lack of commitment of most of the retail banks as well as credit card providers. In order to promote personal microcredit and to ensure that it becomes a real tool for financial inclusion, better regulation is needed to increase the involvement of credit providers.

Apart from the usury ceiling, regulation of the financial sector in relation to responsible credit is too weak to produce significant results. Similarly, the *Cour des comptes* concluded in its assessment of public policy regarding overindebtedness: "it intervenes to treat social problems caused by an insufficient regulation of credit provision"<sup>56</sup> (Cour des comptes, 2010, p.486). The report of *Cour des comptes* states that public policy regarding overindebtedness is unbalanced. It is more focused on providing a solution to people facing overindebtedness rather than trying to prevent it.

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<sup>56</sup> Personal translation

Cognisant of this major weakness, it appears that the response to the consequences of overindebtedness in France is well balanced, mixing non-judicial and judicial approaches, as well as providing a variety of tools that help to take into account the different situations of debtors (from repayment plans to bankruptcy). However, there remains a lack of personal support and advice. Before the debt settlement procedure starts, neither lenders nor charitable associations, consumer associations or social workers are able to meet the demand for advice. During the debt settlement procedure, people have no personalised support once the repayment plan is agreed, despite the law clearly stating that this support is compulsory.

In order to promote access to responsible credit, it seems that the main strength of the French strategy relies on the fact that consumer credit is not as necessary as it is in Ireland or the UK. It makes access difficulties less harmful than they would be in the other two countries – even if the consequences are real. This is a clear reminder that consumer credit is one possible answer to financial needs. Other responses are decent wages, social benefits, etc. However, the quality of access to credit in France needs to improve on two key aspects: the promotion of alternative forms of credit as well as the provision of free independent personalised support when people face financial difficulties.

### **3.5 Consumer credit in Belgium**

In numerous ways, the Belgian situation is similar to that in France. However, two differences are noticeable. First, there are almost no cooperative lenders in Belgium. The vast majority of credit providers are commercial lenders. Second, regulation is better designed to facilitate the promotion of responsible credit and to cope with the consequences of overindebtedness.

#### **3.5.1 The Belgian approach to responsible credit**

Consumer credit is less used by households in Belgium than in Ireland, the UK and even France. As noted earlier, consumer credit is almost three times less used in Belgium than in the UK. Credit providers cite a too tight regulatory environment to explain this situation (Athling, 2008). Furthermore, the social role of consumer credit is limited by the effectiveness of social protection and public services along with the level of wages compared to the level of living

costs. The second explanation is supported by the fact that policy issues regarding access to credit do not focus on broadening this access but on improving the appropriateness of credit offered to potential borrowers with low/average incomes (RFA, 2007).

There is a dearth of data on the level of access to consumer credit and the borrowing practices of households with low or average income. Most of the information is provided by the *Central des credits aux particuliers* (public credit register with positive and negative data), managed by the National Bank of Belgium since 2003. However, the *Central des credits* was not designed to be used as a statistical tool, so the information provided is quite limited. It can be used to understand key trends but provides no information on issues related to quality of access.

Data from the *Centrale des credits* show that 56.8% of adults over 18 years of age are registered as having a loan (mortgage or consumer credit), and more than 75% of people between 35 and 54 years (BNB, 2010). The most common type of credit is revolving credit (47.2%), followed by mortgages (29%) and personal loans (instalments, consumer credit) (18.8%). However, if the information is classified by new contracts granted in 2009, the hierarchy changes, with personal loans representing 35.6%, revolving credit 33.4%, and mortgages 19.7%.

Since 2004 the number of registered credit contracts has increased by 22.13% while the number of borrowers only grew by 11.78%. The lower level of growth means that the credit market is focusing on people who already have at least one credit. This development in the credit market is mainly fuelled by revolving credit which grew by 37% between 2003 and 2009. Mortgages saw the second largest growth rate during this period (30%), while personal loans only grew by 6%.

A growing number of borrowers with a growing number of loans usually results in an increase in financial difficulties. In 2009 the number of new contracts with one or more missed payment grew by 8.3% compared to 2008 when the total arrears' amount increased by 16.1%. This development is mainly due to mortgage defaults which increased by 6.5%, compared to 4.2% for revolving credits and 3.2% for personal loans.

The number of borrowers defaulting (having not cleared their missed payments) increased by 3.6% in 2009, representing 4.1% of the over-18 population. If borrowers who cleared their situation are

included, the increase of borrowers who defaulted in 2009 is 7.2%, and for 76.5% of them it was the first time they were defaulting.

However, this increase in defaults is not only related to the rise in indebtedness among Belgian borrowers, but is also a consequence of the financial crisis. This is confirmed by an evaluation of the number of people going through the procedure to deal with overindebtedness (collective debt settlement procedure).

The number of people participating in collective debt settlement procedures increased by 11.4% in 2009. This development was mainly fuelled by a massive increase in the number of new people going for the procedure in 2009: compared to 2008, they increased by 23.3%. However, participating in a collective debt settlement procedure does not always involve credit default: 29.4% of overindebted people in 2006 and 32.2% in 2009 participated in the procedure, without any credit defaulting. Their difficulties were focused on health expenses, utility bills and fiscal arrears.

### **3.5.2 Developing appropriate access**

Appropriate access is promoted in a similar way in Belgium and France. However, the availability of a public credit register, the *Centrale des crédits aux particuliers*, is a key difference.

#### **3.5.2.1 Quality of information**

Similar to France, and in line with the Consumer Credit Directive, the Belgian legal framework sets rules to prevent misleading information being provided through advertising. Therefore, it is forbidden to disseminate the message that anyone can gain access to consumer credit regardless of financial difficulties and that access to credit can be quick and easy. Contractual rules require providers to provide clear and easily understandable documents which must contain the amount and duration of the credit, the annual percentage rate and the global cost. All these constraints are similar to those of other countries.

Financial education is limited in Belgium, except for information posted on generalist consumer websites or the work of the Indebtedness and Credit Observatory.<sup>57</sup> Financial information in Belgium focuses on the tools available to lenders in order to assess the trustworthiness of a potential debtor.

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<sup>57</sup> <http://www.observatoire-credit.be/>

Until 2003 lenders could only access a register of borrowers who had faced difficulties repaying their credit. In 2003 the register was expanded in order to collect information regarding the indebtedness of every borrower. The aim was to help lenders assess the ability of their potential customers to reimburse a new credit and to promote the prevention of overindebtedness. In order to ensure its effectiveness, lenders are obliged to check the *Centrale des crédits* before granting a new credit, as well as providing information once they have granted a loan. The aim of such constraints is to ensure:

- that every lender is aware of the level of indebtedness of its customers and;
- that information is comprehensive and reliable.

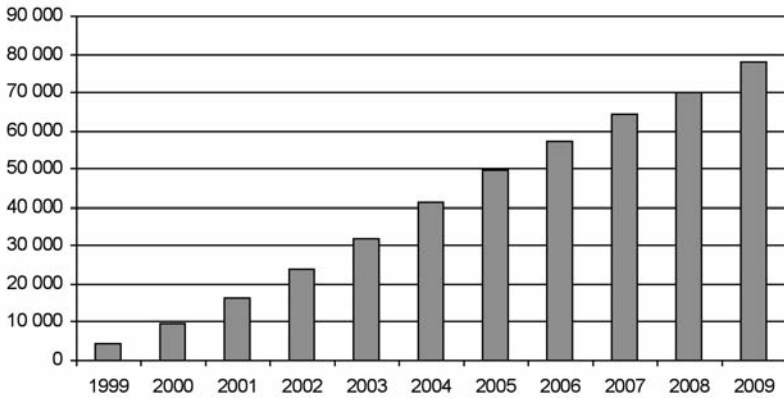
In theory, if credit providers do not consult the credit register a court can write off all or part of the money borrowed.

The register is publicly run by the National Bank of Belgium to prevent this information being used for commercial purposes. Such a use is strictly forbidden by law. Furthermore, only credit providers are entitled to consult the register. This is to ensure that the central credit register does not have damaging social effects for people already highly indebted or with a history of financial difficulties (inability to access housing, a job, etc.). Although the *Centrale des crédits* is publicly run, credit providers have to pay to consult it.

Has the *Centrale des crédits* achieved its aim of helping to prevent overindebtedness? It is very difficult to answer this question, for two reasons. First, in order to assess its impact a comparable situation without it would be needed. Such a comparison is not possible. Second, the *Centrale des crédits* is not the only element of the Belgian strategy to prevent overindebtedness. Therefore, there is no evaluation study available in Belgium to answer this question and the National Bank of Belgium as well as the Indebtedness and Credit Observatory are very careful when they have to give their opinion about its impact. However, some tentative conclusions can be drawn.

An examination of the data regarding the number of people registered under the collective debt settlement procedure indicates that the *Centrale des crédits* does not seem to have had any significant impact on reducing the number of people who are overindebted (Figure 26). The numbers have increased systematically since 1999 (the year the procedure was established).

Figure 26: Number of people registered due to overindebtedness procedure

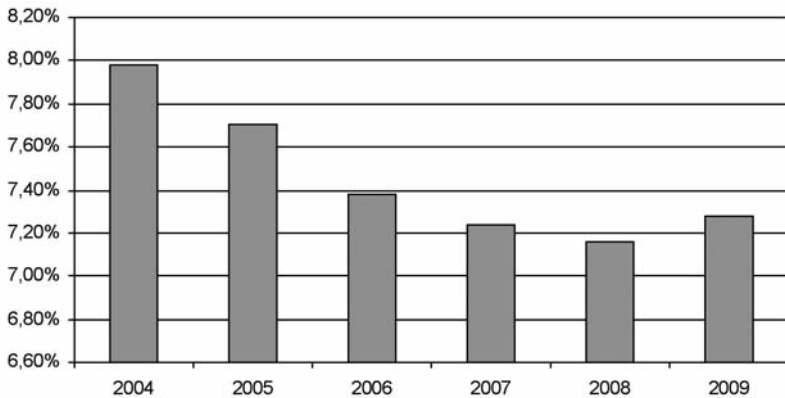


Source: Data from National Bank of Belgium

The data question the effectiveness of this tool in preventing overindebtedness. This lack of evidence may be explained by the fact that overindebtedness is a more complex phenomenon than just an accumulation of credit.

Nevertheless, the *Centrale des credit* has been effective in increasing access to credit in a less risky way. This can be illustrated by the ratio of “borrowers in arrears/ overall number of borrowers” (Figure 27).

Figure 27: Proportion of borrowers with one or more outstanding payment



Source: Data from National Bank of Belgium

The *Centrale des crédits* has contributed to the reduction of this ratio, from 7.98% in 2004 to 7.16% in 2008, while the number of borrowers increased by 9.7% and the number of credits by 18.3%. These figures show that while the *Centrale des crédits* favours access to credit, the focus is on borrowers who already have access to credit and who are considered relatively safe. According to the lenders' criteria, "good borrowers" may be targeted in order to increase their indebtedness and to sell them revolving credit. Such a hypothesis is supported by the fact that revolving credits increased by 22.7% between 2004 and 2008.

It is difficult to assess the impact of the *Centrale des crédits*. However, the evidence suggests that the register has probably had no real impact in preventing overindebtedness. Nevertheless it does seem to have had real effects in increasing access to credit. However, this increase seems to be focused on people who already have access to credit. As a result, people who have access to credit are more indebted than they were before the *Centrale des crédits* was established.

### 3.5.2.2 The right price

Similar to France, Belgium has a usury ceiling (several depending on the type of credit and the amount).

Table 4: Usury ceilings in Belgium

	<i>Instalment credit</i>	<i>Revolving credit with a card</i>	<i>Revolving credit without a card</i>
Less than €1,250	19.5%	15%	11%
Between €1,250 and €5,000	15%	13%	10%
More than €5,000		9.5%	

Source: Ministry of Finance – July 2010

The higher level is applied to personal loans which are the most appropriate for people with a low income as they are easier to manage (stable amount of repayment each month). This makes personal loans more profitable for lenders than revolving credit

(which is less appropriate for borrowers). However, more statistical analysis is needed on this subject.

Regarding the difficulties of access created by a usury ceiling, it seems that the *Centrale des crédits* provides an interesting answer as it reduces the cost of assessing the indebtedness of potential borrowers.

### 3.5.2.3 Responsible credit alternatives

Despite the positive effects of the *Centrale des crédits*, there still remains a group of people who need access to credit but are refused as they are too risky or not profitable enough.

In 2003, in order to provide appropriate access to small loans for those who need credit in an emergency, the association Credal Plus developed a microcredit pilot in partnership with the Walloon region and the Postal bank. Founded by the Walloon region, Credal was responsible for the assessment of the borrower's request and for the support (personalised advice, budget education, financial information, etc.) during the repayment period, while the Postal bank granted the loan. However, due to administrative difficulties, the partnership with the Postal bank ended in 2007. Since 2008, Credal has been lending directly to borrowers while the Dexia Foundation is providing funds to the association.

These microcredit loans are for people who cannot access appropriate consumer credit but whose needs are useful and necessary. Furthermore they cannot earn more than the limit related to their social situation (number of people in the households, rent cost, etc.). The amount of these microcredits varies from €500 to €10,000 with an interest rate of 5% (including the administrative costs).

The methodology is very similar to that of the social microcredit projects in France:

- An educational approach is developed along with a detailed budgeting plan.
- Solutions to solve possible financial difficulties are explored.
- An adaptable debt recovery method is provided.

The pilot is considered a success as it has met the needs of its borrowers. Moreover, despite the fact that these loans are granted to

“risky” people, very few have faced repayment difficulties (5.04% between 2003 and 2008) or have been lost (0.4% between 2003 and 2008). This emphasises that appropriate lending practices can significantly reduce the level of risk of these borrowers. However, the Credal’s pilot remains limited as only 529 microloans were granted between 2003 and 2009 (Credal, 2009).

The mainstreaming of these microloans is the key challenge for the pilot to really achieve its target. Such a goal is not unrealistic considering that the *Monts de piété* (municipal pawnbrokers) grant 120,000 loans per year and a large part of them are provided to the target group of microcredit.

### 3.5.3 Dealing with financial difficulties and overindebtedness in an efficient way

The Belgian strategy addresses financial difficulties through regulation as well as direct intervention.

#### 3.5.3.1 Managing arrears

Similar to other countries, when a borrower presents with financial difficulties, Belgian credit providers have to try and come to some agreement with the borrower. However, if these difficulties remain unsolved, the recovery of debt is highly regulated in order to avoid potentially inappropriate practices from creditors, or from companies who intervene on their behalf.

In 2003 a law was introduced which clearly defines the procedures around debt recovery. It forbids:

- all intimidating practices (e.g. false information regarding the consequences of non-payment, use of documents copying the style of official or legal documents, etc.);
- measures which exploit the debtors (e.g. making them pay illegal fees);
- harassment (i.e. phone calls and visits are forbidden between 10pm and 8am and the debtor is free to refuse or stop the visit).

The law also requires that debt recovery respects the confidentiality of the procedure. It is forbidden to make explicit on correspondence that the enclosed material is related to debt recovery procedures, or to contact people known to the debtor (family, relatives, neigh-

bourhood, work colleagues, etc.). All debt recovery companies have to be registered and cannot charge debtors for their action (only creditors have to pay for their services).

The law also requires that the debtor receives a letter outlining the reason for the debt recovery and the procedure that will follow. Once the letter is sent, no action can be taken during the following 15 days. This period is supposed to give the debtor time to find a solution. In this situation – but also in every debt situation – the debtor can be assisted by debt counsellors.

In 1991 another law created debt mediation providers. These registered public or private entities help debtors find solution to their indebtedness problems. They can:

- act as an intermediary between the debtor and his/her creditor(s);
- negotiate repayment extensions or interest reductions;
- elaborate a repayment plan;
- initiate a collective debt settlement procedure.

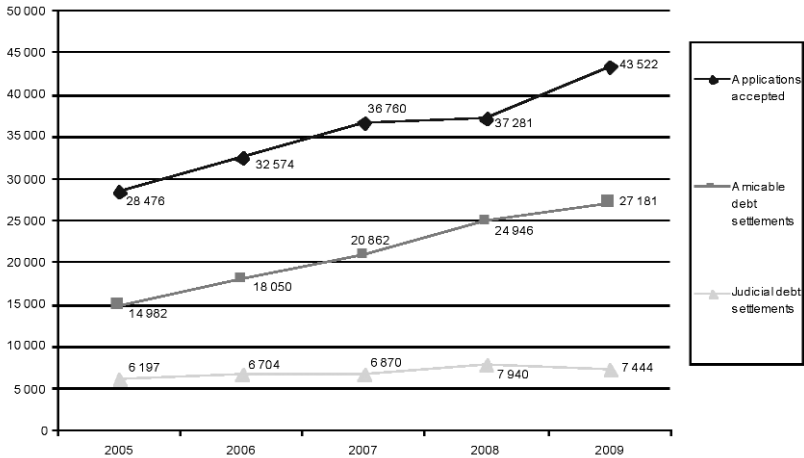
The main providers of debt mediation services are Public Social Action Centres (CPAS) which exist in every municipality. Debt mediation is not their core activity as they also provide social welfare and deal with the financial and social difficulties of social welfare recipients. Similar to other public entities registered as debt mediators, they do not charge fees for their services. Conversely, private debt mediators such as lawyers can be costly.

In 2007 debt mediation was extended to cover all types of debt. Hitherto it was exclusively dedicated to consumer credit arrears. Debt mediators can now deal with the global financial situation of the debtor, which makes their action more effective. However, they are only mediators: they cannot constrain creditors to accept a repayment plan or to modify their expectations. If no agreement can be reached, even with the support of debt mediators, the next step is the *règlement collectif de dettes* (collective debt settlement procedure).

### **3.5.3.2 Remedial measures for overindebtedness**

The collective debt settlement procedure is similar to that in France. The judicial procedure is only seen as a “last resort” if the non-judicial procedure has failed.

Figure 28: Number of collective debt settlements registered in the *Centrale des crédits aux particuliers*



Source: BNB, 2010

In order to begin a collective debt settlement procedure, the debtor has to submit an application of “good faith” to the court, which is either accepted or rejected. Then the court will designate a debt mediator who will oversee the procedure to reach an agreement as well as its implementation. The mediator may be the one who has previously helped the debtor to assess his/her situation and tried to help him/her find a solution.

The costs of debt mediators who charge a fee are regulated by law, their bills are validated by the judge and the fee can be taken into account by the “overindebtedness treatment fund” when debtors’ solvency is too low (the fund intervenes mainly when partial or total write-off of the debt occurs).

This fund is funded by creditors in relation to their level of involvement in the collective debt settlement procedure and their credit market share. This mechanism is supposed to motivate creditors to adopt more responsible lending practices. However, no evaluation of it has been carried out.

When the application has been accepted, the amicable phase of the procedure begins. There is no legal definition of the characteristics of the debt settlement except that it has to preserve a

disposable income necessary for a decent life. Apart from this requirement, the stakeholders are free to agree on any measure they consider appropriate (e.g. rescheduling of the debt, reduction of interest due, etc.) as well as on the length of the new repayment plan. The only condition is that all stakeholders agree to it. When this agreement is obtained, the judge validates the plan agreed.

Creditors have to give precise explanations if they refuse the plan that is submitted to the judge. If the judge considers these explanations invalid, the amicable plan is implemented. Similarly, if the negotiation lasts for more than two periods of 6 months, the amicable phase is interrupted and the plan becomes the responsibility of the judge.

When an agreement is not reached, the judge designs a repayment plan which is compulsory for all stakeholders. Contrary to an amicable one, the judicial plan is regulated by law and it cannot extend beyond 5 years.

Similar to the amicable process, the judge can reschedule the debt, reduce the interest rate, suppress fees and constrain the debtor to attend budgetary guidance or any other social supports that seem appropriate.

If it appears that the income of the debtor is too low, the judge can implement a partial or total write-off of the debt. In the case of a partial write-off, the plan cannot be shorter than 3 years or longer than 5 years and what is not reimbursed is written-off. A total write-off involves the selling of all the debtor's belongings except those considered necessary for a decent life. The bankruptcy is considered as definitive after 5 years. During these 5 years, if the situation of the debtor significantly improves a repayment plan is set up.

### **3.5.4 Strengths and weaknesses of the Belgian strategy to develop responsible credit**

The Belgian strategy to promote responsible credit relies more on regulation than does any of the other three countries studied. Moreover, this regulation has taken into account most of the key elements needed to tackle access and use difficulties. The Belgian approach also differs in several ways to that in the UK, Ireland and France, even though they have all implemented the requirements of the Consumer Credit Directive.

First, the question of the quality of information and price, which are key elements of the credit market, are taken into account in a

complementary way through the central credit register and interest rate ceilings. In order to prevent overindebtedness, interest rate ceilings are applied so that the riskiest lending practices are rendered unprofitable. These rates differ depending on the type of credit and are higher for instalment credit, which better suits the needs of borrowers. However, a usury rate also makes access to credit more difficult.

In that respect the publicly run central credit register plays a significant role. Providing centralised and reliable information regarding the borrower's indebtedness helps lenders assess the level of risk of the credit application in a more effective way and at a lower cost. The available data indicate that the central credit register has promoted access to credit and reduced the risk of arrears, although no effect has been observed on overindebtedness. However, only borrowers with a current loan have benefited from wider access to consumer credit. Therefore it is unclear whether this greater access has benefited those who were excluded from accessing credit. Despite this potential weakness, it seems that the linking of the interest rate ceiling and the central credit register helps to prevent overindebtedness and to increase access to credit.

Second, financial education is not a key element of the Belgian strategy. While there is a target to increase the financial awareness of the population, there is no dedicated structure for financial education. Efforts are more focused on personalised advice through the debt mediation service provided by public services (e.g. CPAS) or private services (e.g. lawyers). As well as regulating debt recovery, it helps debtors to negotiate with their creditors and to promote their rights. When this mediation is provided by social workers, some financial education may also be provided.

Finally, the Belgian approach takes into account how financial difficulties lead to overindebtedness. The collective debt settlement procedure offers an appropriate and progressive answer, from amicable debt settlement to a judicial one, including partial or total write-off of the debt. This procedure – where the debt mediator plays a key role – allows for a really personalised solution which takes into account the interests of all stakeholders.

Conversely, one of the key weaknesses of the Belgian strategy is that it does not facilitate greater access to credit for those experiencing access difficulties, and microcredit providers like Credal are unable to mainstream such practices.

Despite strong political involvement, another shortcoming of the Belgian strategy is the lack of evaluations carried out of the different policies. For instance, it would be interesting to evaluate the impact of the central credit register, particularly regarding access to credit for people who were previously excluded, and the prevention of overindebtedness. Similarly, there is a lack of data regarding the medium- and long-term effectiveness of the debt mediation as well as the collective debt settlement procedure.

### **3.6 Lessons for Ireland**

While each country needs to find its own way of dealing with the challenges of promoting responsible credit, the following elements, which have been effective in other countries, could inform a specific Irish strategy.

#### **3.6.1 A comprehensive perspective**

In order to implement an efficient strategy to promote responsible credit, it is important to remember that credit plays a key role in people's lives and in society as a whole. It helps households finance their needs and cope with unexpected expenses. While the UK is similar to Ireland, the situation in France and Belgium is substantially different. In these two countries many of the financial needs which are met by credit in Ireland or the UK are satisfied in other ways (e.g. higher level of public services or social benefits).

##### **3.6.1.1 A political issue**

The social role given to consumer credit is the result of political choices. If collective schemes (i.e. social benefits and public services) are not well developed more people will rely on credit. Both choices have pros and cons. If public services and social benefits need to be developed, this questions their effectiveness as well as how they should be funded. However, extensive use of consumer credit questions its ease of access, as well as its appropriateness (and therefore it questions the availability of alternative financial answers when credit is not the appropriate solution).

Another example of the political role of credit is when a choice needs to be made between increasing access to credit and reducing overindebtedness, recognising that these two targets are sometimes contradictory. This choice has to be made prior to assessing the technical dimensions of how to achieve it.

Therefore the first step in promoting responsible credit is to identify what social role consumer credit will play in society. Ireland currently has a strong “consumer credit society” which means that the political choices made until now have been to favour access to credit. This choice could be pursued or reversed depending on the advantages and disadvantages of each option.

### **3.6.1.2 A specific strategy**

In relation to access to credit, it is necessary to take into account the difficulties faced by people who are unable to access credit as well as the difficulties of people who have access but in an inappropriate way (i.e. price, conditions). In that respect, promoting responsible credit means promoting appropriate access to credit for every potential borrower. However, it is not a “right to credit”, as potential borrowers who cannot afford a loan should be denied access. Ireland has succeeded in developing very easy access to credit. However, the appropriateness of it remains questionable, in particular for low-income households.

People who have access to credit can face difficulties with repayments and this needs to be addressed in the interest of all stakeholders. The situation in Ireland is characterised by a real lack of understanding of the causes and consequences of financial difficulties. According to the Law Reform Commission (LRC, 2009), debtors in arrears are considered as refusing to pay (won't pay), while in the vast majority of cases they are unable to pay (could pay, cannot pay). Therefore financial difficulties are only taken into account when it is necessary to punish the debtor and to make him/her pay what he/she owes. Such an approach is based on commercial agreements and court procedures which are totally inappropriate ways of addressing overindebtedness. Even if MABS offers good quality support to debtors, the lack of an appropriate framework to take into account financial difficulties is even more problematic, given the key role credit plays in Irish society.

Ireland has placed more efforts on increasing access to credit than any of the other countries examined in this report. The vast majority of the population is able to access credit through some source. However, conditions to ensure quality of access have been widely ignored. Conversely, the UK has made an effort to develop alternative, appropriate sources of credit, while France and Belgium

have implemented interest rate ceilings in order to limit the level of risk taken by lenders.

Even though preventative measures would be extremely effective, they cannot suppress financial difficulties and overindebtedness. “In this light, the law must recognise that a consequence of a credit society is that certain individuals will become overindebted, and thus a means of rehabilitating such debtors must exist” (LRC, 2009, p.69).

Therefore a potential Irish strategy needs to ensure as wide as possible access to credit without sacrificing its quality, as well as allowing for fair treatment of financial difficulties. It should neither prevent lenders lending nor favour irresponsible behaviour from either lenders or borrowers. In order to achieve such a goal, six key elements are necessary:

- quality information for lenders (i.e. credit register);
- appropriate pricing (e.g. level of interest rate);
- variety of suppliers (i.e. alternative lenders);
- pedagogy for borrowers (i.e. information, education, advice);
- fair arrears management (e.g. when debts are considered separately);
- debt settlement procedures (e.g. answers to overindebtedness).

Ireland could also improve its regulatory framework to promote responsible credit for each of these key elements, similar to what has been done in the UK, France and Belgium.

### **3.6.2 Areas of action**

Successive European Consumer Credit Directives have homogenised the legal framework regarding disclosure of information prior to the credit agreement. However, these are limited in scope which is why the three other countries (UK, France, Belgium) went further to promote it. Ireland could adapt some of their responses for its own strategy.

#### **3.6.2.1 Better informed lenders**

The availability of information for lenders regarding the existing indebtedness of potential borrowers as well as their history of

repayment difficulties is seen as a key element of responsible lending. However, there are different ways to make this information available which affect its quality.

The main provider of information in Ireland is the Irish Credit Bureau (ICB). The quality of its information is not very good as all lenders are not part of the information exchange scheme and even those that are, are not constrained to provide all their information.

In this regard, the Belgian credit register would be a good example for Ireland to follow. The public credit register holds information about every borrower and it is compulsory for lenders to contribute to it as well as to check information prior to granting a loan. The register has obtained real results, increasing access to credit in a more appropriate way, as arrears have been reduced although it has been unable to prevent overindebtedness.

There is also much debate on whether a credit register should be public or private. The credit register in Belgium is publicly run in order to avoid excessive or inappropriate use of the information collected. The crucial element is that it should be compulsory for every type of lender (e.g. mainstream, subprime, credit unions, etc) to participate (e.g. to inform the credit register and to check information) so as to ensure the quality of the information displayed and its effectiveness.

However, information provided through credit registers is not sufficient in itself for assessing the demand of a potential borrower. Interviewing the borrower is potentially a very efficient way to obtain information about his/her income as well as specific needs and constraints that could affect the repayment.

### **3.6.2.2 An appropriate price: the question of interest rate ceiling**

An interest rate ceiling is a highly controversial question. On the one hand, high interest rate levels are seen as impoverishing borrowers. On the other hand, it is argued that capping interest rates can make access to credit impossible for the riskiest and poorest borrowers, especially when it could suppress some lenders such as home credit companies who often meet their credit needs. Nevertheless, the higher the interest rate is, the higher the level of overindebtedness. While both these arguments are justified, neither takes into account the context as well as the diversity of interest rate ceilings possible.

Firstly, it is necessary to consider the social role of consumer credit. The consequences of an interest rate cap in France and

Belgium – where financial alternatives to consumer credit exist, i.e. social benefits, public services, etc. – are different than in Ireland or the UK where they are much weaker.

Secondly, capping interest rates reduces the profits of numerous lenders and could lead to the disappearance of some of them. This is an important issue as it can explain the strong lobbying of the industry against this potential measure.

Thirdly, there is more than one way to cap interest rates. Ireland for example is capping interest rates as follows: lenders who lend over 190% APR are unable to renew their licence, while credit unions cannot lend over 12% APR. Even in France and Belgium interest rate caps vary between 8% and 20% depending on the type of credit.

Therefore the effectiveness or ineffectiveness of introducing an interest rate ceiling:

- is related to the institutional context as well as the ceiling's characteristics, and
- needs to be compared to the effectiveness of the present situation.

In relation to the prevention of overindebtedness, it seems that it is more effective to cap interest rates than to reopen credit contracts to assess whether the conditions are extortionate, which is currently the case in Ireland and the UK. The latter approach assumes that people are aware of this option and have easy access to justice – which is not necessarily the case. Capping interest rates assumes that there are alternative solutions. Even though France and Belgium have good social benefits and public services, these are not always an appropriate answer for all borrowers excluded from credit. Appropriate alternatives would involve mainstreaming the micro-credit pilots.

Ireland and the UK are in a different situation: the Irish credit union movement could provide an affordable alternative, while the British government is currently investing money in promoting alternative lenders. But in both cases these alternatives have not been successful in offering a viable substitute to high cost lenders. The main issue is that they cannot always compete with high cost lenders on the quality of the service (i.e. home collection, weekly repayment, etc.). If an interest rate ceiling were to be introduced in Ireland and

the UK, subprime lenders would not be able to maintain their seductive characteristics in a profitable way. Therefore their borrowers would become more interested in credit unions and other alternative providers. The key question is at which level to set the interest rate ceiling: 20%, 30% or 40%? This level should be defined in relation to the cost of providing the credit in a way that satisfies the borrowers' needs but remains appropriate regarding its price.

Credit unions provide a good service at a rate of 12% a year. However, they would have to change their practices (e.g. higher interest rate) in order to welcome borrowers who are currently customers of moneylenders. It could be pertinent to have different interest rate ceilings, depending on the type of credit provided (e.g. with or without a savings history). However, it is essential that these interest ceilings are applied to all lenders in the same way.

In summary, any debate on interest rate ceilings needs to consider two essential elements:

- the level of the ceiling;
- the provision of alternative access to credit and to other financial solutions (social benefits, public services).

### 3.6.2.3 Appropriate credit alternatives

While the UK, Belgium and France have to invest public money in order to develop appropriate alternative providers, Ireland already has the credit union movement. The credit union movement could be seen as the perfect answer to the promotion of responsible credit as it is widespread and popular and provides alternative credit. However, it has two key shortcomings:

- It requires that people save for a period of time before being allowed to apply for a loan.
- It has to compete with other suppliers who can develop more seductive products in terms of services even if their cost makes them inappropriate for poor people.

The first weakness has been partly addressed through the "social fund" which allows clients recommended by MABS to access credit from certain credit unions even if they have no savings history. However, this scheme is not widely publicised. Such a partnership is similar to the one developed in France to promote personal

microcredit. In Ireland it could be seen as a pertinent strategy to give emergency access to consumer credit even if the requirements (e.g. meeting the assessment requirements of MABS workers) are more demanding than a request to moneylenders. Therefore even if it were mainstreamed, such a scheme does not solve every problem. In that respect Ireland could learn from the UK where funds have been invested to allow credit unions to lend without requiring a savings history.

Once an appropriate, alternative source of credit is available, it is crucial that a regulatory framework is designed which allows it to produce the beneficial effects. In order to encourage borrowers to use credit unions it is necessary to limit the availability of subprime credit. As mentioned in the previous section, this could be achieved with the introduction of an interest rate cap.

Ireland already has the resource to set up a strong and fair alternative credit sector. The ability to develop it relies on the political will to build the appropriate regulatory framework.

#### **3.6.2.4 Financial pedagogy: information – education – advice**

Similar to most other European countries, financial education is at the heart of the Irish strategy to promote responsible credit. This generic label covers a diversity of tools which vary in effectiveness.

Firstly, information is provided to borrowers in order to help them make decisions in relation to borrowing or to deal with financial difficulties. This information can be provided through adverts (newspapers, radio, TV, internet), website or leaflets. It can be general or specific in nature (e.g. about the risk of overindebtedness in relation to consumer credit) or practical (e.g. template of a letter to send to a creditor if financial difficulties arose or if the borrower required information about his/her rights).

Secondly, education is provided in order to improve the financial skills of the population and to make the best use possible of the information available. Sometimes it is more targeted at people on a low income. In Ireland, this education is mainly provided in school. Such training tries to increase participants' awareness about budgeting techniques as well as the characteristics of financial products.

There is no evidence to suggest that information and education have a significant impact on responsible borrowing. Nevertheless, the availability of information and the increased awareness among

the general population of financial products can only be beneficial. However, it is questionable whether financial education merits a key role in any responsible borrowing or financial inclusion strategy.

The benefits of financial education and information are limited because when people face difficulties or an emergency their decisions are influenced by their emotions. Furthermore, the complexity of their needs (e.g. to be able to consider the global financial situation as well as the different solutions available) requires skills that only professional people hold. Only these professionals can remain objective when examining the financial difficulties and can provide possible solutions in cooperation with the borrower.

The “Money Guidance Pathfinder” in the UK, the *Points Passerelle* or the *Parcours Confiance* in France, and the debt mediation services in Belgium have all been set up as dedicated structures with specialised professionals to respond to such needs. They are similar to MABS, so Ireland already has a very effective structure to provide financial advice and education to people. However, its work could be made more efficient, in three ways.

Firstly, MABS workers are currently facing substantial increases in the number of requests for help from borrowers. Their work requires time to assess the client’s overall financial situation, define a personalised strategy with the borrower and negotiate with creditors (if necessary). The quality of their work (e.g. to solve borrowers’ difficulties) is totally dependent on their ability to dedicate enough time to those borrowers. In order to maintain this quality, it seems that MABS would need to recruit more financial advisers. Such a cost does not necessarily need to be funded by public monies; all lenders could contribute to it.

Secondly, the organisational structure of MABS could be improved by replicating what the British government has done with both the “Money Guidance Pathfinder” and the Consumer Financial Education Body. Local MABS and MABSndI in collaboration with the National Consumer Agency (NCA) could replicate their work by providing information, education and advice in a more comprehensive way and through different media (face-to-face, telephone, website). MABS already performs a large part of this role but it could be increased by giving the service the financial and statutory means to be the cornerstone of the pedagogical aspect of a responsible credit strategy. Local MABS could deal with the queries of people facing financial difficulties, or respond through the above-

mentioned media, while MABSndI could collaborate with the NCA and the different stakeholders in order to provide:

- a unique website dedicated to financial information;
- information campaigns through different media;
- financial education tools for teachers and interested people.

The expertise of MABSndI regarding people experiencing financial difficulties would be an added value to the competencies of the NCA.

Thirdly, it would be useful if MABS could develop the quality and the output of the data provided through its MABSIS database (e.g. monthly newsletters/updates). This would help inform policy. Furthermore, MABS could develop or promote research in order to improve the understanding of financial difficulties and overindebtedness in the Irish context.

These recommendations concur with those of the European Commission's report on overindebtedness:

*Probably the most effective way to co-ordinate and develop training and standards is through a central organisation, either some type of "umbrella" organisation for debt counselling [...], or a national agency [...]. These organisations can also play an important role in representing the interest of debt counselling services and their users at a strategic and political level. (OEE, 2008, p.86)*

### **3.6.2.5 Arrears management**

When difficulties occur, the situation can either improve or deteriorate depending on how they are taken into account as well as the impact of the regulatory framework. There are four options.

Firstly, a moratorium (up to 24 months) could be set up for debtors who face an unexpected difficulty (e.g. having lost their job) but whose situation is likely to improve. Such a possibility exists in France where a judge can reschedule a debt over this period of time.

Secondly, arrears recovery needs to be regulated in order to define procedures that prevent inappropriate practices. It would also be an improvement if creditors had to inform debtors two weeks before they begin the procedure about their readiness to recover the debt and the possibility of finding a solution. This exists in Belgium where debtors can contact debt advisers (similar to MABS workers) in order

to find a negotiated solution. Such procedures should be compulsory for both creditors and debt recovery agencies. These companies should also be registered as a means of guaranteeing the quality of their work along with the possibility of implementing sanctions.

Thirdly, the protocol between MABS and the Irish Banking Federation (IBF) is an appropriate way to find a negotiated solution to arrears. According to the Law Reform Commission (LRC, 2009), such a partnership should be extended to cover all types of lenders. This could work in a manner similar to the role of debt mediators in Belgium and could be organised around MABS as it is a free and effective service. If commercial entities (i.e. lawyers, accountants, etc.) are involved, they need to be carefully regulated because their prices and quality vary in both Belgium and the UK. "Debt mediation" would obviously only be opened to debtors who are willing to pay. The others would continue to deal with the legal system.

Such a protocol would require a set of standardised documents and procedures, similar to those developed in Britain between debt advisers and members of the British Bankers Association. These procedures would also have to be defined with care as it would significantly increase the work of MABS. As mentioned previously, the funding of this mediation service could be shared between stakeholders (even debtors when they are able to contribute), as it is beneficial for all of them.

Fourthly, dealing with arrears sometimes requires rescheduling the debt. If the creditor is not willing to reschedule or if there are several creditors making it difficult to reschedule the overall amount, the debtor's situation may deteriorate. Therefore there is a need for an appropriate financial tool. For example, the *Point Passerelle* in France obtains very positive results with its personalised assessment of the situation and negotiation of the debt. A social partner assesses the situation, negotiates the debt and supports the borrower during the repayment period, while a financial institution provides the credit and a guarantee fund which reduces the risk.

If this model were to be replicated in Ireland, MABS could act as the social partner while the credit unions act as the financial institution. A guarantee fund could be set up involving public and private funds. This could provide a quicker and more appropriate solution for people who could pay if the conditions of their debt were adapted. However, such a scheme could present a risk: creditors trying to sell their "bad debts" to credit unions and the guarantee

fund. In order to avoid such an adverse effect, it is necessary to define conditions of access that deter lenders' opportunistic behaviours (i.e. conditions like the fact to have agreed to reduce the global amount of the rescheduled debt, to fund the guarantee fund, etc.).

### 3.6.2.6 Dealing with overindebtedness

The Irish way to deal with overindebtedness is out-of-date. Debt enforcement procedures are court led, each element of the global debt is assessed on an individual basis, and it is presumed that debtors won't pay rather than can't pay. The Law Reform Commission (LRC, 2009) provides an impressive and comprehensive analysis on how to improve the Irish legal system. This report shares the views of the Law Reform Commission and proposes to complement its work through the analysis of policies from the three other countries studied.

Ireland needs a more gradual and personalised procedure to overindebtedness and many lessons could be learned from the Belgian experience.

When arrears or difficulties fail to be managed by debt advisors/mediators, debtors and/or creditors, a legal collective debt settlement procedure needs to be available. Such a pilot was set up by MABS, the IBF and FLAC in 2002 for a short period of time – the *Pilot Scheme for Alternative Debt Settlement*. In order to build on this, an appropriate regulatory framework would need to be developed which would imply that:

- the involvement of all creditors would be compulsory;
- only MABS or other registered debt mediators could be involved in negotiating the agreement;
- the length of time dedicated to negotiation should be limited (e.g. two periods of six months in Belgium);
- the conditions for the agreement to come into force would have to be defined. Different possibilities exist:
  - If a creditor rejects the agreement, a valid reason should be provided and an assessment should be carried out by an external third party (e.g. a judge in Belgium);
  - The agreement of two-thirds of the creditors (regarding the value of the debt) should be sufficient to validate the agreement;
- the agreement is legally binding.

Such an amicable procedure would only be open to debtors who are unable to pay. Again, the “won’t pay” debtors should be dealt with in the court system.

If the amicable debt settlement step fails to produce a sustainable agreement, it should be transferred to the judge to decide, based on the elements put together by the debt mediator. The judge should have a limited length of time to make a decision (e.g. six months in France) and the tools available should be precisely defined:

- possibility to reschedule the debt over a maximum period of time (8 years in France, approximately 5 years in Belgium);
- possibility to suppress interest and various fees;
- possibility of partial or total write-off in order to allow debtors to have a real fresh start;
  - Debtors are eligible to total write-off when they are too poor to satisfy any repayment plan.
  - The write-off of debts leads to the sale of the belongings of the debtor but in a way that protects the dignity and essential assets of the debtor regardless of any outstanding debts.

A total write-off would replace the actual bankruptcy procedure which is very costly, overly punitive and may never end. A period of 2 or 3 years before the write-off becomes definitive seems appropriate.

An effective Irish debt settlement procedure would need to take into account two other elements. Firstly, it needs to be sustainable for the debtor in case his/her situation remains stable or changes. This involves a clear definition of an appropriate minimum income, taking into account the size of the household. Both amicable and judicial procedures would have to respect this minimum. In addition, it would be useful if the debtor had access to budget support during the repayment period if the need arose.

Secondly, both the amicable and judicial procedures should establish incentives for creditors and debtors to participate. The cost of the procedure, its results and the availability of potentially costlier alternatives should encourage them to find an agreement as early as possible (e.g. even before the collective debt settlement procedure or to favour the amicable step to the judicial one). However, in order to

be equitable, the cost of the procedure should be shared between all stakeholders (debtors, creditors, state) in relation to their means. Debtors should pay as little as possible (it is free in France), and in any case the poorest debtors should not have to pay anything.

### **3.6.2.7 High quality qualitative and quantitative research**

An efficient, responsible credit strategy needs to be informed by good quality qualitative and quantitative research. In Ireland there is a dearth of research on responsible credit, although those that have been produced could inform the basis of a responsible credit strategy (see Corr, 2006; FLAC, 2009; LRC, 2009). Research is needed to address the causes of access difficulties to consumer credit, the reasons for repayment difficulties and overindebtedness, as well as evaluations of any solutions provided. The UK has produced the most comprehensive range of research studies on the issue, funded by public and private funds. This has allowed stakeholders to base their analysis and proposals on scientific evidence and it provides complementary evidence to that provided by the stakeholders.

## **3.7 An effective Irish strategy to promote responsible credit**

In order to define an effective strategy to promote responsible credit, Ireland has to address its weaknesses by building on its strengths. Such a strategy should ensure as wide as possible access to consumer credit, while at the same time ensuring that the access is appropriate and that the negative consequences of repayment difficulties do not result in people falling into poverty. It is a difficult exercise because these different goals are partly opposing.

Firstly, credit providers are commercial entities and it is in their interests to make as much profit as possible even if this may sometimes have a negative impact on the borrower. An effective regulatory framework would need to reconcile the interests of the lenders with those of the borrowers. Such a goal could be achieved by ensuring that inappropriate lending practices are not profitable or are impossible. Potential solutions include regulations on prices and arrears management as well as better evaluations of credit applications. Credit unions could play a very significant role within this strategy; they would be needed to compensate for the reduction of inappropriate credit supply as a result of regulation (part of this compensation could also be provided through social benefits or public services).

Secondly, it is necessary to ensure that borrowing practices are appropriate. Information and financial education have a role to play in this respect. However, the availability of fair and independent advice is essential to help debtors develop a clear understanding of their situation and of the implications of the credit for which they are applying. MABS is already able to play this role.

The third and final element of such a strategy is addressing the financial difficulties of households within a more appropriate framework. Even though some debtors refuse to pay, the vast majority is willing to pay. Some of them would need to see their debt rescheduled, while others are unable to repay and need to see their debt written-off. A personalised, comprehensive and gradual approach is needed. MABS and other potential registered debt advisers could play an important role. This approach could be seen as a three-step process:

- First step: commercial negotiations. MABS could advise the debtor and negotiate with the creditor(s) in order to find an appropriate solution.
- Second step: amicable collective debt settlement procedure. Very similar to the commercial negotiation except that creditors' participation is compulsory.
- Third step: judicial collective debt settlement procedure. When the amicable phase has failed, the judge makes a decision about a repayment plan or a total write-off, allowing a fresh start for the debtor.

At each step MABS and potential registered debt advisers could intervene in order to provide their expertise to debtors and facilitate the negotiation with creditors.

The effectiveness of such a strategy would be increased if each aspect is developed within a legal framework that would ensure the regular assessment of their effects. The British approach has favoured self-regulation based on the involvement of the industry as well as social corporate responsibility and "name and shame" mechanisms to encourage professionals to respect their commitments. The involvement of the industry as along with all other stakeholders is a key element. However, the effectiveness of self-regulation is undermined by the profitability constraint. Belgium has favoured a more appropriate option based on the involvement of all stake-

holders and the implementation of a proper regulatory framework which is able to limit the influence of the profitability constraint. The challenge is therefore to define appropriate sanctions in order to encourage stakeholders to implement this strategy.

The costs of a responsible credit strategy in Ireland should be carefully assessed at different stages (short-, medium- and long-term). Such a strategy would be costly in the short term but would be beneficial over time. Certainly the need for such a strategy is urgent given that the consequences of the crisis are becoming more challenging by the day. Finally, it needs to be remembered that:

- the French way to deal with overindebtedness partly fails despite the appropriateness of the procedure because there is a lack of investment in independent debt advisers such as MABS;
- the British strategy to promote appropriate credit alternatives faces challenges in being mainstreamed despite the high level of financial investment. This is due to the refusal to regulate interest rates which makes it difficult to compete with high cost lenders who are able to provide easier access even if at a higher cost.

## General Conclusion

Tackling financial exclusion through the promotion of access to basic banking services as well as affordable credit and appropriate responses to overindebtedness requires an appropriate framework. This report assesses what such a financially inclusive framework in Ireland would look like, based on what has been done in the UK, France, and Belgium.

But, overall, it has to be stated again that promoting financial inclusion is a political issue. Therefore, reducing the influence of a financialisation led by market logic can be achieved in two ways. The first way is to promote appropriate alternatives so that people are less dependent on financial services providers. The second is to reduce the influence of market logic on financial services providers.

In relation to the first approach, it is possible to limit the consequences of market logic by giving households access to alternative responses, especially regarding consumer credit. While access to appropriate forms of consumer credit is necessary, attention needs to be paid to what Thiel (2009) asks about the UK: “Do we really believe that the best way for poor people to make ends meet is to take out more and more credit, and above all credit for which they frequently don’t repay the principal, but only the interest rates?” (p.28). The provision of alternative responses to consumer credit involves questioning the level of wages, the characteristics of social welfare benefits, and the quality of public services. Even though these are different issues from that of financial inclusion, they are important elements in the promotion of responsible credit.

The second way involves limiting the influence of market logic over commercial institutions such as financial services providers. Such a goal requires selecting an approach that would have a stronger influence. Without it, market logic would considerably weaken the effectiveness of those responses. The concept of corporate social responsibility (CSR) which is at the heart of the British strategy is an example of such an approach. Hitherto the United Kingdom, France and Belgium tried to tackle financial exclusion through self-regulation. These choices were made at a time when belief in free market effectiveness dominated, but they have

systematically failed despite marginal improvements.<sup>58</sup> In France and Belgium self-regulation has been replaced by legislation, while there are numerous calls for a similar development in the United Kingdom.<sup>59</sup> However, not all legislation is effective, given the failure of the French “Right to an account”.

In order to tackle the process of financial exclusion, regulation is needed, but it must be appropriate regulation. An analysis of the various international examples of regulation indicates that three key elements are required for its effectiveness:

- The definition of precise targets on financial inclusion, based on a range of indicators
  - Targets regarding basic banking services and credit should be related to both dimensions of financial inclusion: access and use. Therefore indicators will need to be quantitative and qualitative.
- Independent assessments to be carried out of the policies implemented, and the results regarding the targets adopted
- The implementation of incentives and sanctions in a manner that ensures the involvement of all stakeholders
  - This could involve the implementation of different mechanisms such as the creation of a financial inclusion fund, which could be used to cover part or all of the costs of dedicated services (e.g. MABS) that contribute to financial inclusion.

A regulatory framework based on transparency and accountability could limit the influence of market logic without suppressing its positive elements. While financial inclusion goals are usually defined by governments, the more technical aspects in relation to implementation are the responsibility of all stakeholders, including financial services providers. A financial inclusion taskforce (or the existing Steering Committee on Financial Inclusion) could be a useful body to promote and monitor a financial inclusion strategy in Ireland.

Based on the assessment of what has been done in the United Kingdom, France and Belgium, this report outlines some guidelines

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<sup>58</sup> These improvements were mainly obtained when financial providers were threatened by the implementation of a potentially more coercive regulation.

<sup>59</sup> See Devlin (2005) and Mullineux (2009) as well as the *Financial Inclusion Manifesto* of the Financial Inclusion Centre:

[http://inclusioncentre.org.uk/doc/financial\\_inclusion\\_manifesto\\_summary.pdf](http://inclusioncentre.org.uk/doc/financial_inclusion_manifesto_summary.pdf)

regarding the promotion of access to appropriate basic banking services and responsible credit. However, even if these recommendations are based on evidence, there is no one way to promote financial inclusion. The success of such a strategy relies on its ability to complement the specific context of a society. It also relies on a culturally defined definition of financial exclusion, agreed by all the key stakeholders. The guidelines provided in this report will hopefully contribute to this discussion.

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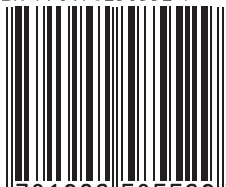
The Policy Institute at Trinity College Dublin aims to advance new and innovative ideas in public policy by promoting active debate and engagement between the academic and policy communities in Ireland and by supporting the analysis and development of effective policy solutions. The Policy Institute publishes its outputs in the series, *Studies in Public Policy*, which provide short, rigorous, but accessible analyses of policy issues of major importance.

In modern societies like Ireland, every citizen needs to have appropriate access to a current account, a debit card or credit in order to lead a normal life. However, Ireland has the lowest level of access to a current account in Western Europe, some of its population relies on moneylenders to access credit, and an increasing number of borrowers are facing overindebtedness. Therefore, financial inclusion is a key social policy issue for a cohesive Ireland. However, it is an extremely complex one as it requires reconciling the interest of low and moderate income people and banks.

This paper, *Understanding and Combating Financial Exclusion and Overindebtedness in Ireland: a European Perspective*, looks at how Ireland could promote financial inclusion. It does this by developing an in-depth analysis of the responses implemented in the United Kingdom, France and Belgium. The paper examines their successes and failures in relation to financial exclusion and assesses what policies would be appropriate in an Irish context. The paper sets out guidelines for an appropriate framework to deal with financial exclusion in Ireland by building on its current strengths while also learning from experiences in other European countries. The guidelines address access to basic banking services and affordable credit as well as appropriate responses to overindebtedness.

Georges Gloukoviezoff has a PhD in Economics and specialises in financial inclusion and overindebtedness. His work deals with difficulties of access to basic banking services, overindebtedness as well as potential solutions such as basic bank accounts, microcredit and financial regulation. He is a former Visiting Research Fellow at The Policy Institute and has been involved in numerous research projects at national and European level. In 2010 his book on financial exclusion was published in France: *“L’exclusion bancaire. Le lien social à l’épreuve de la rentabilité”* (Presses Universitaires de France). He is Director of G2 Research (Dublin, Ireland) and member of the board of the National Observatory of Poverty and Social Exclusion (Paris, France).

ISBN 978190258552-9



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