Ending fuel poverty and financial exclusion

A Factor Four approach

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Summary report

March 2002

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A research study undertaken
by National Energy Action,
New Economics Foundation and
the Personal Finance Research Centre

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Introduction

Around 20% of households in the United Kingdom have no access, or limited access, to financial services; a similar percentage can be defined as fuel poor. Credit unions and community finance agencies could be developed to have a major part to play in changing these percentages for the better.

Research carried out for Ofgem shows that:

- As providers of an integrated service covering energy and money advice and bill payment, credit unions and community finance agencies could become ‘one-stop-shops’ for the needs of the fuel poor and financially excluded
- Significant consumer demand for this kind of service already exists - and support from ‘partner’ institutions and agencies, such as the energy utilities, for its development is evident
- With sufficient funding to develop a viable initial model, an integrated service could rapidly become self-financing and this, in turn, could act as a powerful agent in the widespread development of credit unions and community finance services.

Background to the research

As part of its Social Action Plan remit, Ofgem recognised that credit union development could have a role in meeting the financial services needs of low-income households. As a result, Ofgem stated that there was "scope for utilities to play a role in development of credit unions to the mutual benefit of the credit union movement, the utility companies and their customers."

Ending Fuel Poverty - a 'Factor Four' Approach

National Energy Action and the New Economics Foundation were commissioned by Ofgem to undertake a study of existing credit union and community development finance institution activity featuring bill payment services and fuel poverty-related initiatives. Evidence from this study indicated that an integrated service needed to be developed which addressed poor housing conditions, low income, expensive payment methods and exclusion from the benefits of the competitive energy market. As a result of this, a Factor Four service model was designed to integrate four key areas:

- Energy advice
- Budgeting and money advice
- Take-up of energy efficiency measures
- Bill payment

The next stage involved a feasibility study to assess the potential market for this Factor Four service, and to identify three areas with sufficient credit union resources and interest to participate in a national pilot; the areas selected were Portsmouth, Birmingham and Liverpool.

Fuel poverty and financial exclusion - an overview

Over much of the past two decades there has been a significant increase in the incidence of general poverty in the United Kingdom. Although recent evidence suggests that the upward trend has been halted, and indeed to some extent reversed, poverty still affects millions of households who lack access to goods and services that would normally be considered essential for a decent quality of life.

The fuel poor

One indicator of deprivation is fuel poverty - where a household would need to spend more than 10% of household income in order to achieve sufficient warmth for health and comfort. In England alone, in 1998, some 4.4 million households could be categorised as fuel poor (DTI and DEFRA 2001). Fuel poverty results from a combination of poor housing and heating standards and low income. It may be exacerbated by limited access, or no access, to more advantageous methods of paying for fuel - for example, the discounts available to those paying by direct debit. Those most susceptible to fuel poverty include lone parents, older people and single person households but overwhelmingly low household income is the common factor.

The financially excluded

In 1999 a report from the Treasury to the Social Exclusion Unit indicated that between 6 and 9% of households had no bank or building society account. Other contemporary research suggested that some 6 million households in Great Britain had no access, or limited access, to financial services. Amongst economically disadvantaged households, almost 1 in 2 had no current account. The introduction last year of a basic bank account operated by all major banks and building societies has improved the situation, but financial exclusion remains a major problem. Energy consumers using expensive prepayment meters are much less likely to have access to banking facilities.

Government action

The Government's Social Exclusion Unit recognises the links between a wide range of deprivation indicators rooted, at least in part, in inadequate financial services and impacting on affordable energy, household insurance and other essential provision such as telephone access. In these circumstances household debt can develop and escalate and may lead to involvement with moneylenders despite exorbitant rates of interest. Initiatives supported by Government to address financial exclusion include:

- Basic bank accounts administered by all major financial institutions
- Operation of a Universal Banking Service through the Post Office network
- Liberalising credit union legislation to promote their development
- Financial education and literacy initiatives
- Support for Community Development Finance projects

The Government established an inter-Ministerial Task Force on Fuel Poverty in 2000 to develop a strategy for the eradication of fuel poverty. The strategy, published in November 2001, analyses existing initiatives to promote affordable warmth and also introduces some innovative elements. In addition to programmes and policies funded and/or implemented by the Government (the national energy efficiency grant scheme, Warm Front, and the Winter Fuel Payments for pensioners, for example) the energy regulator Ofgem has been required to produce a Social Action Plan. This sets out methods by which disadvantaged consumers will be protected and assisted through access to cheaper payment methods, special preferential tariffs and energy efficiency investment.

Credit union services in Great Britain, Ireland and the USA

Credit union development in Great Britain has been relatively modest in comparison with Ireland and the United States. In the United States in particular, unlike in Britain, credit unions have traditionally served middle-income households although some have endeavoured to be inclusive in recruiting disadvantaged individuals and families.

Great Britain

There are some 700 credit unions in Britain at present. Based on either a geographical area or a workforce, credit unions operate as cooperative savings and loans agencies. In recent years the distinction between "common bond" and "employee" credit unions has been relaxed, allowing for large credit unions to develop across an entire city, such as those in Leeds and Edinburgh. There have, however, been restrictions on the expansion of credit unions. Restrictive legislation, lack of personnel and technological resources and a lack of a central services organisation have been highlighted. Development of larger common bond areas and hybrid "live or work" credit unions has seen the emergence of stronger credit unions with a more diverse membership. Further legislative reforms coming into force in 2002 should also facilitate credit union development as other restrictions are removed.

Community reinvestment trusts

Along with credit unions, community reinvestment trusts are also key community finance institutions. The work of community reinvestment trusts runs parallel to that of credit unions and involves providing loans to a range of receivers from self-employed individuals and small businesses to voluntary organisations and community enterprise. Whilst community reinvestment trusts, like credit unions, raise capital by issuing withdrawable share capital they can also recruit individual investors and raise ethical investment from financial institutions and social investors. Community reinvestment trusts also tend to be larger than credit unions with correspondingly higher levels of capital and/or revenue. As a consequence, they are more likely to employ paid professional staff from an early stage of development.

Ireland

The Irish credit union movement began in the 1950s (some twenty years before Britain) and currently has some 2 million members in 600 affiliated credit unions. In total, credit unions in Ireland have savings capital of some IR £3 billion. Membership of credit unions in Ireland is well distributed across socio-economic groups. The scale of credit union membership and activity makes these institutions the major social lender and their work complementary to that of banks and building societies.

Budgeting and payment services for low-income households in debt

Early assistance directed towards low-income households had, as a priority, ending dependence on moneylenders. The initial resources to establish a revolving Loan Guarantee Fund were jointly provided by the Department of Social Welfare and the Irish Bankers Association. This fund, which was established to allow refinancing of expensive debt, encountered difficulty as borrowers recognised the guaranteed nature of the loan and this led to an unacceptably high default rate. A new approach was adopted by a national pilot scheme called the Money Advice and Budgetary Service (MABS). The main thrust of this pilot was debt resolution, budgeting assistance and convenient payment services both for ongoing bills and for debt. The pilots, which were based in five cities or towns, were extremely successful and led to the establishment of 50 centres which currently assist 40,000 households. The MABS system has three main elements:

- Debt and money advice
- Special budget account -linked to local credit unions
- Client access to loan services from their local credit union

The service is entirely funded by central government which, in turn, receives the benefit of secure payments for public sector utilities.

United States

The American credit union movement has more than 10,000 affiliates and some 67 million members. For the past two decades large credit unions in the United States have effectively operated as banks and have concentrated services on middle-income households. To redress the balance, a dedicated trade association for those serving lower-income households was founded in 1974 - this is called the National Federation of Community Development Credit Unions (NFCDCU). The NFCDCU approach identifies four distinct services that should be provided for low-income members:

- Affordable payment and budgeting mechanisms
- Incentives to save in the form of special programmes and attractive interest rates
- Sensible and affordable lending policies
- Home loans and finance for enterprise development

Lessons from Ireland and the United States

Differences in approach to financial services exclusion in Ireland and America are very evident. In Ireland, government support is strong but it is weak in the United States. Conversely innovation in product development is much stronger in the United States. The Irish model of government support could be replicated in Britain if the political will was there and this could result in reducing debt problems and widening access to credit union services. However, there are several good lessons from both America and Ireland:

- Pilots must be well resourced and for a minimum of two years
- Geographical diversity and independent evaluation are recommended
- Financial education, budgeting assistance and debt advice should be integral to the pilots although separately funded

- Bill payment services are popular but can be problematic if insufficiently well resourced
- Credit facilities to cope with peak pressures such as Christmas should be developed
- Social housing organisations are good partners to cultivate
- Secure facilities are needed for bill payment services
- Additional pay-in points will need to be structured

Bill payment services

In recent years, bill payment services for cash payers and low-income households have expanded. These services include those offered by utility companies, agencies like the Post Office or Paypoint and specialist debt repayment services.

Universal Banking Service

A large proportion of fuel-poor households use prepayment meters either voluntarily as a budgeting tool, or as the only feasible and manageable way of staying out of debt. Prepayment use will generally incur additional costs. For those paying by cash, the Post Office represents a major resource. In general, any charges levied on a transaction are paid by the recipient (in this case the energy utility). A considerable portion of Post Office revenue will disappear when pension and benefit payments are automated in 2003. However, the Universal Banking Service, which is intended to widen access to a basic bank account, has numerous positive implications for the fuel-poor - for example, the use of automated credit transfer (ACT) to accounts from the Benefits Agency will be promoted, financial services will be provided in familiar surroundings and the Post Office network will be preserved.

PayPoint and PayZone

PayPoint is a national network that collects bill payments on behalf of utilities. The service is generally operated from local shops and currently serves more than 2 million customers through 8,500 outlets.

PayZone is a competitor to PayPoint and handles quarterly bill payments and budget scheme payments on behalf of utilities. Prepayment transactions are also handled through this system in addition to processing quarterly credit and budget scheme transactions.

Introductory bank accounts

Introductory or basic bank accounts will have an increasingly significant role to play in financial processes in Great Britain. As welfare benefits payments become automatic, they may form the basis for the adoption of mainstream banking use by predominantly low-income households. The basic bank account has its US equivalent - these are known as ‘lifeline’ bank accounts and their main elements comprise:

- Deposit and withdrawal features
- Debit card, pin number and ATM services
- Standing order and direct debit facilities
- No overdraft, credit facilities or cheque books

Debt management and repayment services

There is a range of debt management services in operation. These may be commercial or offered on a more charitable basis - for example, the services offered by Money Advice agencies or Citizens Advice Bureaux. A promising new development is ‘PayLink Trust’. This is a debt repayment service operated in partnership with free money advice services. The work of the service is mainly funded through voluntary contributions from creditors, but its development is constrained by the limited number of relevant agencies with appropriate information technology resources.

Credit union bill payment and energy efficiency services

Credit unions have a history of involvement in initiatives that have been geared towards energy efficiency and fuel poverty reduction. Although initiatives have been small-scale and limited in scope, they can provide an insight into the potential difficulties of devising a much more ambitious project. Initiatives have included:

- Bill payment services
- Debt management guidance
- Energy efficiency loans
- Discounted energy efficiency materials
- Transfer from prepayment to direct debit
- Energy advice and access to available grants

The consumer demand for Factor Four services

As part of the main study into credit unions and the Factor Four service model, the Personal Finance Research Centre at the University of Bristol undertook a research project to assess consumer demand for the Factor Four concept. The project featured focus groups in the three cities chosen as the sites for Factor Four service pilot schemes - namely Birmingham, Liverpool and Portsmouth. The study was followed by a larger quantitative survey involving cash payers across Britain.

Main findings of the consumer research

Profile of cash payers

The profile of those households paying by cash revealed that:

- More than half were tenants in the social rented sector
- Almost half were headed by a single adult with a large proportion of single parents
- There was a disproportionate number of non-pensioner households with no-one in paid employment

Satisfaction with cash payment

Few households were dissatisfied with their method of payment. The perceived advantages of cash payment were focused on greater financial control, custom, habit and convenience. Those with the most interest in changing their method of payment were households with the following characteristics:

- Headed by an individual under 50
- One or two parent families with dependent children
- Only one earner
- Either an owner-occupier with a mortgage or private tenant

Households already using a combination of cash payment and banking facilities were more likely to switch than those without access to banking services.

Attitudes to a Factor Four service

Between 11 and 12% of respondents were interested in a new bill payment system. Amongst the proposed advice services, energy advice was most popular (53%) with fuel switching guidance considered attractive by 38% and money advice seen as beneficial by 36%. Overall 18% would be inclined to use all four factors. Since almost one in three households pays utility bills either wholly or in part in cash, the potential market for one or more of the Factor Four services is enormous.

% of sample		Potential client base
Energy advice	53%	4,240,000
Money advice	36%	2,880,000
Switching supplier	38%	3,040,000
All aspects of service	18%	1,440,000

How the Factor Four service could succeed

There was consensus within the quantitative data and from the focus group findings that for a Factor Four bill payment service to succeed, it must:

- Be free at the point of delivery
- Provide equivalent control and information to the method it replaced
- Be at least as convenient as the current method
- Accommodate all or most bills

The Personal Finance Research Centre estimated that savings of between £4.00- £5.00 per week would be needed as an incentive to large-scale switching. Resistance to Factor Four services was highest amongst pensioner households generally and single pensioner households in particular.

Views of potential corporate participants to Factor Four

Factor Four services appear to have broad appeal to prospective partners and participants. Interviews with potential corporate participants were carried out and showed a generally positive approach.

Energy utilities

Attitudes here were generally supportive. There is currently no integrated approach to link debt reduction, money advice and energy advice with grant assistance amongst the energy utilities. Utilities are receptive to sound and effective proposals along these lines, although firm commitments will depend on the nature and feasibility of what is proposed.

Registered Social Landlords (RSLs)

The area of most interest to RSLs was for some form of affinity deal whereby the tenant had access to preferential tariffs but remained individually responsible for the bill payment. All of the eight organisations interviewed had some fuel poverty reduction programmes in place and energy advice and guidance was generally provided. The integrated Factor Four approach was attractive but it was felt there was a need for clarification of the division of labour between participating agencies.

Consignia and the Universal Bank

There are concerns that, after 2003, there will be massive loss of customers to the banking sector as a result of Automated Credit Transfers being adopted by the Benefits Agency and an increased take-up of bank current accounts. Consignia's attitude to working with credit unions is extremely positive. In the past, there have been approaches from credit unions seeking to obtain a free paying-in point although commercial factors have precluded this. However, there is future scope to develop arrangements with credit unions and community reinvestment partnerships on a sustainable basis.

High Street banks

Five of the ten banks supporting development of the Universal Bank were interviewed. In terms of credit unions, the banks had agreed to fund work on the development of the Central Services Organisation for the provision of bill payment and money transmission services and to improve staff training and marketing strategies. In the event, competing financial priorities including the Universal Bank and the Introductory Bank Account meant that funding for the credit

union initiatives was not forthcoming. In general, the view of the banks was that there was potential for significant credit union expansion whilst recognising the weak existing structure of much of the credit union movement.

Views of regulators

Interviews were carried out with the Financial Services Authority, which governs certain aspects of credit union work, and the Association of British Credit Unions.

The Financial Services Authority (FSA)

The FSA sees weaknesses in the management structure and competence of credit unions as a major problem that must be resolved in terms of future development. The FSA saw money transmission as a significant area of future growth. The current inability to charge for these services is a stumbling block that will be removed next year. Provided Factor Four pilots were well planned and designed, the FSA welcomed the initiative.

Association of British Credit Unions (ABCUL)

ABCUL sees increased credit union powers as essential to their developing in importance along the lines of Ireland and the United States. The ABCUL favours mergers involving large employee credit unions and local community credit unions to maximise competence and efficiency. It is conceded that there is tension between the economic interests of more affluent credit unions and the social imperatives of community credit unions. However, the experience of Ireland and the United States shows how effective, sustainable credit union development can be achieved. ABCUL is happy in principle to support Factor Four services in appropriate locations, but stressed the need for such developments to strengthen community credit unions and their "bottom line".

Projects that currently incorporate elements of Factor Four

Many energy supply companies have been enterprising in developing alliances with external agencies. They see this as a means of fulfilling their social obligations in terms of energy efficiency services and/or those encountering difficulty in paying fuel bills. In several cases, these initiatives have incorporated one or more of the elements that comprise the Factor Four model.

Nest Makers

Nest Makers is a partnership arrangement involving the Eaga Partnership and ScottishPower. It offers a one-stop-shop for:

- Energy efficiency grant aid
- Energy advice
- Welfare benefits health checks
- Guaranteed annual energy charges

Nest Makers is involved in discussions about the development of a basic payment account and has also undertaken small-scale projects with credit unions including a bill payment facility. As an inducement, both the credit union and the customer receive a modest commission or discount on joining the scheme. It is hoped that work with credit unions will be developed on a wider basis.

Fuelsavers Credit Union Pilot Project

In association with three credit unions in the North East, and with funding from Northern Electric, this project explores how these credit unions might develop their services to incorporate fuel bill payments, energy advice and the take-up of energy efficiency grants. The project aims are to:

- Design a service to help credit union customers access advice, information, grant aid and preferential tariffs for gas and electricity
- Support the credit unions in developing these services

The scheme enables prepayment and allows other cash payers to access direct debit terms through an account administered by the credit union. It is intended that the full range of available energy efficiency grants will be offered to participating members, and a special discounted package of low energy lights and an energy efficient kettle is offered as an inducement to join the scheme.

StayWarm

In May 2000, TXU launched a special tariff, StayWarm, aimed primarily at pensioner households. The scheme established a fixed, preferential tariff related to the size of the dwelling and the number of occupants. The scheme offered terms that were guaranteed to be superior to any other option for eligible households. In addition, those households signing up to StayWarm would be assisted to benefit from any energy efficiency improvements for which they might be eligible.

Jigsaw

The Bank of Scotland and British Gas have combined to introduce the Jigsaw account. Aimed at low-income customers, this account enables consumers to reduce their energy costs by gaining access to advantageous direct debit terms for fuel whilst maintaining their preferred method of regular cash payments.

Money advice services and water industry charitable trusts

Money advice services receive support from some major water companies. Additionally, the Anglian Water Trust Fund offers general individual assistance in the form of hardship grants not necessarily linked to water charges. The Severn Trent Charitable Trust offers a similar scheme. Both Trusts feel that other utilities should support similar initiatives.

Home Improvement Agencies (HIAs)

The close involvement of HIAs with low-income elderly households means that promoting energy efficiency is given a high priority. However, there is a lack of training and expertise within HIAs concerning energy and money advice. The benefits of linking their work to utility services with Factor Four as a catalyst for improving access to energy and money advice was recognised.

A Factor Four pilot service

The results of the project indicated strong interest in developing a Factor Four pilot service. Credit union practitioners and the Portsmouth Area Regeneration Trust were involved in the design of the pilot. Essential and recommended criteria included:

- Services offered should be flexible and appropriate to household need
- Adequate funding through grant aid should be ensured
- In the early stages there should be an emphasis on quality over quantity

A further essential element was the recruitment of a cross-section of relevant agencies and institutions to include a utility, RSL partners, the banking sector, Warm Front, the Post Office, local government and the Benefits Agency.

The pilot cities - Birmingham, Portsmouth and Liverpool

The three cities chosen for the pilot are diverse in nature. Credit union involvement in these cities offers a wealth of experience and expertise and a range of innovation to build on. Practitioners in the cities feel that, given the originality of the concept, the first year should represent a "dry run" with a modest number of participants. Those households identified by the research as the most receptive would be targeted and special publicity materials produced. The process of expanding participation and membership will deploy a range of strategies. These strategies might include:

- Incentive schemes - for example, free bill payment where multiple arrangements are in place
- Introductory offers - for example, energy efficient lighting and appliances, prizes or gift vouchers
- Good news stories in relevant publications
- Targeted poster distribution

It must be recognised that a marketing campaign will require significant resources in staff time, training provision and publicity materials. It must also be recognised that location, opening hours and security issues are vital to maximise access (possibly using former premises of financial institutions). Robust security systems and customer-friendly opening hours are also crucial factors.

Given that fuel debt and payment problems do not exist in isolation, it is proposed to develop a 'Monergy Account' service to accommodate a wide range of financial transactions which should be as flexible as possible.

Financial Projections

The financial projections for an effective Factor Four service are positive. The indications are that a model service could recover the majority - if not all - of its operating costs after five years of grant-aided revenue support. Factors analysed as part of this projection are:

- Staffing costs
- Sub-contracted advice services for in-depth energy advice
- Bill payment options and schedules
- Numbers of clients and income from utilities, RSLs, the local authority and other partners
- Summary of income and expenditure including the anticipated shortfall during the initial development period

Conclusion

Financial exclusion imposes costs on everyone: from those denied access to essential services to those providers of services who incur enormous costs in pursuing and recovering debt. The consequences of debt go far beyond temporary difficulty in meeting costs; they can lead to desperate and chronic debt problems with those who face this sort of debt often resorting to borrowing at exorbitant cost. This only serves to exacerbate and perpetuate circles of impoverishment.

Factor Four services to integrate bill payment, budgeting advice, energy advice and debt advice - allied to practical energy efficiency measures - can address these otherwise intractable problems and, as a consequence, tackle both financial exclusion and fuel poverty.

The market and operational feasibility of a Factor Four approach is clear. Subject to consultation with potential founding partners of the Community Reinvestment Partnership in Liverpool, Birmingham and Portsmouth, pilot work will begin in April 2002.

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