Financial Exclusion

Character, Causes & Responses

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Menno Simons College
Fringe banks, Selkirk & Salter, Winnipeg, 2009

Bank branch closure in North End Winnipeg, 2003

Closed Rural Bank Branch, Baldur, Manitoba, 2009
Outline

1. The nature of financial exclusion: The *what*, *who* & *why*

2. Responses to financial exclusion: *government*, *financial institutions* & *non-profit agencies*
1) The nature of financial exclusion

a) *What* is financial exclusion?

- Definitions (1 of 2)
  - *Mainstream, fringe and informal financial services*

- *Financial exclusion*
  - *Unbanked*: a person who has no mainstream bank account & therefore relies on fringe or informal financial services
1) The nature of financial exclusion

a) *What is financial exclusion?*

- Definitions (2 of 2)

- *Financial exclusion* (continued)
  - *Underbanked*: a person who has *insufficient* mainstream bank services & therefore partly relies on fringe or informal financial services

- *Financial inclusion*: efforts to bring excluded persons into *fuller* relationship with mainstream bank
a) **What is financial exclusion?**

- **Size (1 of 3)**
  - *Unbanked*
  - Data limitations

- McKay Report, Financial Consumer Agency of Canada, FCAC-sponsored survey: ‘no bank account’: 3-5% adults; \(\geq 8\%\) low-income adults
a) What is financial exclusion?

- Size (2 of 3)

- Unbanked (continued)

- National unbanked comparison:
  Sweden, Netherlands < Canada, France,
  Germany < US, UK
The nature of financial exclusion

a) *What is financial exclusion?*

- **Size** (3 of 3)
  - *Underbanked*
  - Definitional challenges

- Survey of Financial Security, SFS ‘no credit card’: 21.8% (1999), 17.8% (2005)
a) **What is financial exclusion?**

- Impact (1 of 2)
  - *Fees*: costly when comparing similar fringe and mainstream bank fees:
    - Cheque-cashing ($2.49 + 1.99% on a $500 cheque = $12.44) vs. basic account ($4-5/month for 10-15 transactions)
    - Payday loan vs. credit card ($30/$100 2-week loan = 780% APR)
a) What is financial exclusion?

- Impact (2 of 2)
  - Services: transactional services (to assist a daily transaction, cheque-cashing, bill payment) not developmental services (to build household’s financial capability including financial education; credit repair/building, savings)
  - Business practices not well regulated (e.g., debt collection)
b) **Who is financially excluded?** (1 of 1)

SFS: using 3 indicators of financial exclusion the following factors had explanatory power (direction in brackets):

- *Income* (-), *Wealth* (-), *Age* (-), *Education* (-), *Family type*: large family with few earners (+), lone parent with children aged 5-17 (+), *Home ownership* (-)

- Note that SFS public data do not contain ethnicity variables; analysis of US data find race is a factor (Anguelov & Lee, 2005, p.18)
c) Why does financial exclusion exist?

(1 of 5)

- Why do some people sometimes choose to use fringe banks?
- *Access*: proximity; operating hours
- *Fee*: higher but upfront; consider other costs & benefits to do ‘whole’ calculation
c) Why does financial exclusion exist?

(2 of 5)

- Why do some people sometimes choose to use fringe banks? (continued)
- Services: perceived need for transactions services
- Design: cheque-cashing hold period; personal ID
- Shopping experience: treatment by staff, trust in institution
c) Why does financial exclusion exist?
(3 of 5)

- Underlying causes

- Some argue one of the following factors at work: irrational consumers, predatory lenders, government inaction
c) Why does financial exclusion exist?

(4 of 5)

- Underlying causes (continued)
  - I argue cause is more complex & propose the Institutional theory of financial exclusion
  - Supply-side factors: mainstream bank profit expectations, business innovation (e.g., payday loans, buy-back schemes)
c) Why does financial exclusion exist?

(5 of 5)

- Underlying causes (continued)
  - Demand-side factors: low and modest middle incomes stagnant or declining
  - Policy factors: neoliberalism, consumer-debt led growth
2) Responses to financial exclusion

a) Government responses (1 of 5)

- Federal: Access to Basic Banking Regulations & monitoring
- Any person with required ID: Open account for anyone; Free cashing federal government cheques < $1,500
2) Responses to financial exclusion

a) Government responses (2 of 5)

- Federal (continued): Monitoring via FCAC consumer complaints & mystery shopping: failure to comply can lead FCAC Commissioner sending letter of reprimand or assigning monetary penalties; BUT evidence of enforcement is weak
Responses to financial exclusion

a) *Government responses* (3 of 5)

- Provincial: payday lending and cashing government cheques
- The federal government exemption to Criminal Rate of Interest for payday lenders (PDL) & rely on provincial consumer departments to implement PDL regulations (such as licensing, fair disclosure, fee caps)
- Canada ‘patchwork quilt’ regulation of PDL; no regulation of other fringe banks
Responses to financial exclusion

a) **Government responses (4 of 5)**

- Financial literacy
- FCAC information: e.g., comparing credit cards, understanding payday loans
Responses to financial exclusion

a) Government responses (5 of 5)

- Financial literacy
- Task Force on Financial Literacy

“The Task Force will draw on global best practices and build on the strengths of successful initiatives already in place in Canada. The Task Force will release a consultation document, and submit a final report in the fall of 2010 that recommends to the Minister of Finance a national strategy on financial literacy. The Task Force will make available these reports to the public and any research commissioned to develop their recommendations (Source: TFFL website http://www.financialliteracyincanada.com/eng/index.php).”
Responses to financial exclusion

b) *Financial Institutions’ responses* (1 of 5)

- Access to Basic Banking
  - With ID, account opening & free federal government cheque-cashing
  - Mystery shopping results cast doubt about complete observation

- Observing the law vs. promoting access
b) **Financial Institutions’ responses** (2 of 5)

- Voluntary Codes: low-fee accounts
  - The big banks seem to have established these accounts

- Observing the code vs. promoting accounts

- What about other services such as small loans?
Responses to financial exclusion

b) *Financial Institutions’ responses* (3 of 5)

- Community support programs: a ‘mixed bag,’ including:
  
  - Support for non-profit programs: financial literacy, asset-building

- Special programs (e.g., mortgage assistance, secured credit card, producer micro-loans) for particular groups (e.g., aboriginal people, newcomers)
Responses to financial exclusion

b) *Financial Institutions’ responses* (4 of 5)

- Special community banking projects
- Few in number
- Most have a Credit Union/Caisse Populaire as the partner FI
Responses to financial exclusion

b) *Financial Institutions’ responses* (5 of 5)

- From West → East
  - Pigeon Park Savings, Vancouver
  - Community Financial Service Centre, Winnipeg
  - Cash and Save, Toronto
  - Desjardin Mutual Assistance Fund, Québec
Pigeon Park Savings, Vancouver

Cash and Save, Toronto

Community Financial Service Centre, Winnipeg
c) *Non-profit agency responses* (1 of 1)

- Advocacy: improved access to basic banking (Canadian Community Reinvestment Coalition), regulating payday lending (ACORN Canada)

- Service provision related to banking: financial literacy, asset building, assistance to complete income tax return. Examples: SEDI’s Financial Literacy Centre