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This is based on two pieces of research we have conducted, the first in 2016, with low income households (at 70% median income and below) to gain fresh understanding about why the poverty premium arises and with analysis of new consumer data to show how the poverty premium is actually experienced; to calculate how much is incurred annually through poverty premiums.. The second, conducted this year, aimed to produce a guide, in conjunction with businesses, social campaigners, regulators, social investors, and policymakers, highlighting potential solutions to help make the poverty premium history.

The poverty premium, that households in poverty pay more for everyday good and services, is an old concept, dating back to the 1960s, but it remains a very real contemporary concern. At this time, when wages and benefits are falling in real terms, keeping as much of what money there is within low income households is vital. And there are a lot of households affected: currently, 14 million people in the UK live in poverty.

The research we conducted in 2016 found that, on average, low income households spent £490 unnecessarily through the poverty premiums they incurred. And this is not a hypothetical amount, but derived from their lived experience. And it is only an average: over one in ten low income households incurs at least £780 per year. And we found examples of households incurring premiums £1,200, £1500 and even £2,000 per year. These amounts represents a family holiday, clothes and shoes for a household for a year, or a decent, and currently lacking, savings buffer. It also money that could be going back into local communities and businesses. It is key, therefore, to gather evidence on where the premiums are incurring, why they arise, and what can we do to eliminate them.

We found that the biggest contributors to the poverty premium were household energy, insurance and high cost credit. Smaller premiums were incurred through a difficulty in accessing good value groceries, and by paying to access cash.

So looking at energy premium: we found around a third of low-income households used pre-payment meters for their electricity or gas, or were using standard billing, and three quarters were not on the cheapest tariff, which is the single biggest premium. The premiums in this area were both wide (frequently incurred) and deep (costly)

With insurance: A majority of the low income households we surveyed were paying for car or home insurance monthly, and therefore incurring a credit charge for doing so. Living in a 'high risk' area adds to this premium, and the cost associated with this is particularly high for car insurance

In terms of HCC: Credit is something that many low-income households try to avoid: fewer than one in five low-income households in our research used higher-cost short-term credit in the last 12 months. But for those who did use it, the estimated cost in interest was high: ranging from £120 per year for payday loans to £540 for home-collected credit.

However, while we know that these sectors are where the biggest premiums are being incurred, it is perhaps more instructive to understand why the premiums arise at all, and then to consider where there is scope to reduce them.

Often, when those in poverty pay more for goods and services this appears – superficially at least – to be driven by consumer choice. However, our research has shown that poverty premiums arise in complex ways. **At its core, the poverty premium represents a mismatch between the needs and circumstances of low-income households and the markets that serve them.**

We developed a framework to identify and help explain the factors that are disproportionately present or impactful among low-income households.

These include the demand side factors – those driven by the households themselves – including their structural circumstances and needs, such as the difficulty faced to make large lump-sum payments up-front or a greater need for closer, day-to-day budgeting control, but also behavioural factors, including the awareness of the goods and services available, and how their wider values affect their choices.

We looked at supply side factors: such as the higher costs of serving low-income customers, as well as the failure to supply products and services appropriate for low-income consumers, or use of cross subsidy in services and tariffs.

And there also compounding factors, such as digital or financial capability, or geography, which can increase the likelihood of incurring a poverty premium.

But most importantly, it is the way in which these factors interact with each other that traps people into paying poverty premiums.

For example, a low-income household may end up paying more for their energy needs for a number of different reasons: because they need to budget closely (which a pre-payment meter affords them); they are financially excluded, including as a result of prior arrears (which makes other payment options unavailable to them); they are digitally excluded or have low financial capability which, in the context of complex tariffs and evolving markets, makes comparing more difficult; and they are risk-averse, and may not wish to switch, aside from the fact that the alternatives open to them personally may not be any more attractive

Our research, and the research conducted previously, and the research currently ongoing, have all increased our understanding of how and why the poverty premium arises, but we now need to use this knowledge to start developing solutions to this problem.

And as the causes of the poverty premium are complex, so will be the solutions

Relying on market forces alone is clearly not working: markets only work effectively in a level playing field, and this does not occur in practice. We are concerned that increased ‘marketization’ and in particular, a focus on switching as a means to level this market are in fact deepening the disadvantage that low income households face. It is important to challenge the assumptions about the actions low-income households take: they make decisions that work for their particular circumstances, as most households try to, although these might not reflect the collective middle and high-income perspective.

So where should we be looking for solutions? Solutions, at least in the short term, need to work within the constraints of current systems and structures, while continuing to

influence the debate about how financially vulnerable customers should be treated in the longer term. They need to address issues around the control of production and supply, and they need to distinguish between where the markets already have provision, but are not reaching low income customers, and where there is no provision at all. And the solutions needs to arise from both policy and regulation, and through business innovation.

We know solutions can be found: OFWAT have successfully removed the poverty premium from water bills, and Ofgem and FCA have recently introduced regulatory change that should improve the position for those incurring poverty premiums. Through business innovation, and market disruption, the poverty premiums associated with the pay as you go mobile phone market has essentially been removed.

For our most recent report, we held discussions with regulators and policy makers, with social businesses, and with charities and campaigners. And is this report we identified a number of key opportunities for business (where the large or small, established or new) to reduce low income households exposure to poverty premiums. These solutions still need more thought, evidence and testing, but arise from a deeper and more realistic understanding of how low incomes households manage their finances, and what may be possible in business innovation in the future.

Make payments work for low income households;

If we accept that low-income households, by definition, lack affordability, basically, have too little money, then we can start to understand their particular needs around payment methods, frequency and timing. As already highlighted, low and unstable incomes create a particular need for close budgeting control. As a result, payment schedules which reflect budgeting cycles (e.g. weekly or fortnightly) are likely to be beneficial. And many low income customers – including the most vulnerable – may well be forced to default on instalments or repayments from time to time, and I think we do need to accept this.

Therefore, offering flexible payment methods is an essential part of providing a service that fits the needs of low-income households. Direct debit discounts, on the other hand, are an obvious way to create a poverty premium. Ideally, customers would be able to pay

using the methods that suit their particular needs, without penalty. And this may involve accepting cash payments, or cash equivalent payments

Improve credit risk assessment

The costs of serving riskier, often low income customers can contribute significantly to the poverty premium. But credit scoring impacts people's access, not only to consumer credit, but also insurance and energy deals. And it's not clear that the current system is working effectively in judging individual risk. Currently, credit scoring is based on fairly opaque criteria and it can be difficult to build a good credit history if you do not use the 'right' services (typically secured and unsecured credit).

The development of effective but fair credit scoring models should help reduce costs to providers and potentially reduce the poverty premium for some individuals and households. There already such initiatives, such as the Big Issue Invest and Experian's collaboration on the rental exchange, where rental housing data can contribute to their credit score. Alternative models such as Credit Kudos, FriendlyScore and Aire allow a wider range of data (including social media data in some cases) to be included in credit scoring to help determine creditworthiness.

However, there are concerns that some people's credit ratings may deteriorate rather than improve as a result of including this data (including for reasons beyond their control such as late payment of housing benefit), and it is not yet clear how lenders will receive or use rent or other information. So while there is potential, as a solution it needs to be proceeded with cautiously.

Data sharing between organisations could also play a role in building a more nuanced understanding of an individual's realistic credit risk, or even to ensure that help reaches those who are entitled to, in the case of the warm homes discount, which is administered using HMRC data. But, again, caution needs to be applied as data sharing is also not without its concerns, such as potential data protection lapses and recording errors, the effects of which can amplify when data is shared between organisations

The next area for consideration is related to credit scoring – the need to diversify provision for affordable credit

In the context of inadequate household incomes and ongoing welfare reform, increasing access to affordable credit represents a key pillar for poverty premium reduction. Many households will, on occasion, need to borrow. More than any other aspect of the poverty premium, this demonstrates how providing a low-cost service conflicts with the higher costs of serving the poorest (and riskiest) of customers; short term, low amount loans will cost more to provide.

There are already a number of non-mainstream affordable credit options: Fair for you offer an affordable alternative to Brighthouse, Fair Finance and Moneyline, provide affordable short term loans. And credit unions have long offered an alternative capped at 42.6% APR equivalent. However, currently, these and other alternatives, have captured a very small part of the HCSTC market, and greater investment in and promotion of existing affordable credit provision is still needed.

Alternatively, we have the potential of inclusive technology and innovation

As well as increasing the use of existing affordable credit providers, there is potential for Fintech to deliver new models of banking and credit provision; to offer cost-effective solutions to serving the previously financially excluded. The ability to make routine transactions without a bank account may allow some low-income households to benefit from services or tariffs from which they were previously excluded. Smartphone technology can be used to good purpose in this area. New entrants such as Monzo, while not currently aimed at the low income market, demonstrate ways in which technology can disrupt traditional financial services. Similarly, Revolut are offering cheaper mobile phone insurance to the UK.

So there is huge potential in Fintech, but it will not offer solutions for all low-income customers, especially the most excluded and vulnerable. To feel properly valued and supported, customers may want to interact in other ways, including face-to-face. Technology presents both a potential opportunity and a potential threat to reducing the poverty premium. Fintech solutions should be proceeded with cautiously, taking

appropriate account of the target customer base and their likely appetite for Fintech innovations – households in poverty are not homogenous

So finally, what can, and should, policy and regulation do?

We are already seeing the ways in which concerns for financially vulnerable customers are feeding into policy, and subsequent regulatory recommendations. The introduction of a price cap on high-cost short-term credit, in January 2015, and the Pre-payment Charge Restriction for energy customers on domestic pre-payment meters introduced in April 2017 are examples of regulation that aim to reduce the poverty premium, and the early evidence of the effect of these regulation is broadly positive.

So what other ways are there that government and regulators can help address barriers to reducing the poverty premium?

Some potential ideas include:

Addressing the obstacles to data sharing

There is a really crucial role for policy and regulation in credit scoring. Greater sharing of data may allow for better treatment of customers but also risks misuse and exploitation by unscrupulous firms. And it is a complex area of policy and practice because it spans financial services regulation and as well as data protection rules. The implementation of the General Data Protection Regulation in 2018 could help or hinder the role of data sharing in tackling the poverty premium. But it really is a key area for further exploration.

Government also need to ensure that there is an adequate funding mechanism: To serve low-income customers effectively, social enterprise needs funding and other support. There is a particular and pressing need for capital investment. Currently charitable funding and grants are made to social businesses and charities to cover some of the extra costs of providing a service for vulnerable and/ or low-income customers, but there is little help for these organisations to become operationally sustainable in the longer term, which severely limits their capacity to help everyone who needs it. We are seeing a increase in social investment funds and organisations, which is fantastic, but problem on the scale of the poverty premium also needs government support and funding

Finally, the poverty premium debate should not be left to individual regulators, or even just between regulatory bodies. To effectively tackle the poverty premium, across the sectors in which it arises, requires greater coordination of action between regulators as well as between policy, regulators and industry. Interventions have to be properly evaluated to fully understand the effects of policy and regulation on low-income individuals and households. Policy and regulation can have counterproductive unintended consequences, and may conflict with one another in a complex area such as the poverty premium. For example, the current regulation for credit unions allows many the access to credit at affordable rates, but also constricts their ability to charge a rate of interest that can support more lending to higher-risk, low income borrowers.

In particular, the poverty premium needs to be part of a wider discourse around the treatment of low-income households in the current economic climate. For example, the water industry recognises that low-income customers can struggle to manage their bills; so it provides lower tariffs to these customers, While there are many concerns over the implementation of Universal Credit, and the focus on the consolidation of benefits, having all households data in one point does offer an opportunity to be able to identify and target households on lower incomes with greater ease when needed.

Our research, and what I have spoken about today, is really a starting point, and what became clear as our discussions progressed is that currently there really is a need for greater evidence on what does actually work in tackling the issue of the poverty premium. I look forward to hearing the results of the enquiry and seeing more steps being taken to make the poverty premium history.