Working Paper

LEGISLATIVE ACTION BY GOVERNMENT TO PROMOTE FINANCIAL INCLUSION

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Introduction

Legislative action by governments to promote financial inclusion can be grouped in three main areas:

- **Direct legislation,** designed to impose upon financial services providers an obligation or prohibition to provide a certain kind of financial service, and to organise, regulate, monitor or control financial services provision in order to ensure financial inclusion.
- **Indirect regulation,** designed to remove obstacles that reinforce financial exclusion
- **Positives incentives,** designed to encourage the changes in the banking system to promote financial inclusion.

Based on the country reports carried out in 14 European countries studied, the first three chapters of this working paper present the existing legislative actions in those three areas, their characteristics and their impact on financial exclusion.

The last chapter states policy recommendations regarding government action as a legislator in order to promote financial exclusion.

1 Direct legislation to promote financial inclusion

Multiple legislative interventions with the purpose to impose upon financial services providers an obligation to provide financial services or in order to regulate, organise, or control financial services provision have been developed by governments all across Europe.

Direct legislations implemented in that field of action aim to achieve various objectives, like:

- Ensuring banking institution financial capability
- Ensuring consumer protection and therefore increase trust in the market (improvement of general relationships between banks and customers, mediation for disputes settling, protection for investments products ,...)
- Ensuring transparency and information about products and costs in order to ensure effective competition among providers
- Dealing with over-indebtedness and implementing curative measures
- Promoting financial inclusion and access and use of appropriate financial services

This working paper will focus on direct legislation aiming specifically to promote financial inclusion by addressing the two main following concerns in that respect: the right to an account, adequate transaction and payment banking services provision as well as appropriate lending.

Of course, direct legislations pursuing other objectives (dealing with over indebtedness, ensuring consumer protection) may also have a positive impact on financial inclusion and should therefore also be strongly considered by government as worth implementing and improving.
The need of assessing the final impact of regulation is crucial because if not implemented properly, it can add to distribution system costs, which, in turn, increases costs for consumers and/or pushes the low-income ("marginal") consumers out of the market. Another risk is that the relationship between financial institutions and consumers becomes too complicated and less educated people are frightened by contracts.

1.1 Right to an account, adequate transaction and payment banking services provision

Accessing to transaction bank accounts and payment services is a crucial issue today because without reasonable and affordable access to these services, the chances of participating in normal social life are reduced, leading to a greater risk of social and financial exclusion.

In some European countries (France, Germany, Belgium, the Netherlands, Italy and United Kingdom), pressure from government and public opinion led the banking sector to address problems of transaction banking exclusion through the establishment of voluntary charters and codes of practices whereby banks committed to provide "basic bank account" services.

The efficiency of this self-regulation is deeply connected to cultural, political and economical context, which may vary from one country to another. If in some of them, self-regulation seem to be sufficient and effective[1], in others, the lack of effectiveness has led to formal law, as it has been the case in France and in Belgium.

Among the 14 countries studied, access to a transaction bank account is also ensured by a law in **Norway**.

Identified measures implemented trough direct legislation in order to ensure access to transaction banking account and payment services are the following :

- **Legal requirement** that every citizen or resident should have access to transaction banking and payment services, and definition of the types of services that make up the pool of "guaranteed" transaction banking and payment services, as well as pricing criteria and other requirements;
- **Creation of a monitoring body, settlement procedure** and other provisions in order to guarantee the law's implementation;
- **Creation of a a compensation system** to guarantee that service provision is evenly shared among all the providers.

Legal requirement and definition of the types of "guaranteed" transaction banking and payment services, as well as pricing criteria and other requirements

In **France,** the banking law n°84-46 of 24 January 1984 stated that every individual without a current account who had been refused by three banks was entitled to ask the *Banque de France* to designate a bank or the postal bank to provide a free account. The main weakness of this legislation was related to the absence of banking services definition.

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[1] See chapter of the final report of the present study devoted to voluntary chapters and codes of practices.

In 1992, the banks via the French Banker's Association (today, French Banking Federation) introduced a voluntary charter which involved providing an account opened via the right to an account with facilities such as an ATM card, free access to cash machines, bank statements and a negotiable number of cheques. These facilities had to be provided at a reasonable price.

In 1998, the government stated that access to the right to an account was too difficult, and that the banker's charter was ineffective. The law n°98-657 of 29 of July 1998 said in article 137 that the right to an account is accessible after only one refusal by a bank (before it was three) and that basic banking services will be provided for free. This basic banking service was defined in 2001 by the decree n°2001-45 of the 17 of January.

Moreover, the decree 2006-384 of the 27 of March 2006 on basic banking services make the **provision of a payment card requiring systematic authorisation not optional any more but compulsory.** The law set the mandatory obligation to all banks to offer alternative payment mechanism to people who are not entitled to a chequebook or a credit card. Individuals who are not considered sufficiently reliable and trusted to use fiduciary payment instruments which involve risk for the issuing bank can now use alternative payment mechanisms without resorting to cash. These are payment cards with systematic authorisation and other alternative payment mechanisms. Most banks have developed specific package people with a systematic authorisation payment card but it seems that they do not advertise it a lot.

The French legislator is also concerned with the **level of banking charges for bounced cheques.** When customers fail to pay cheques they face bank charges but also, if the situation is not resolved within 2 months, they face a penalty fee from the state. All these fees are regulated by law.

If the amount for the cheque is under 50 euros, bank fees cannot be over 30 euros (decree 2002-694 of the 30 of April 2002). Over 50 euros. The amount of banking fees are capped and should not exceed the amount unpaid (Article 70 of the law n°2007-290 of the 5 of March 2007 about right to housing and various measures for social cohesion and decree 2007-1611 of the 11 of November 2007).

In relation to the fees from the state (penalty fees), if the customer does not resolve his/her situation within the two months delay, he/she will have to pay penalties fees to recover his/her right to write cheques. The amount of these fees is 5 euros if the amount unpaid is under 50 euros and 22 euros for each slice of 150 euros unpaid (art. 15 of the law n°2001-1168 of the 11 of December 2001).

In Belgium, the law of 24 March 2003 makes it compulsory for all banks whose activities include opening current accounts to offer a basic banking service to individuals for the transactions that the latter carry out for non-professional purposes. Access to a basic transaction banking service is stated as a right for all consumers residing in Belgium, on condition that they do not have a current account or other related products with a credit institution.The basic banking service is not intended to facilitate borrowing. Therefore, transfers or withdrawals may not be made if the current account has a debit balance or would become overdrawn as a result of the intended transaction. The total charge for this basic banking service cannot exceed €12.62 a year.

In Norway, the law ensures that anyone can open a regular bank account as long as they have a D-number (dummy number) issued by the government.

Creation of a monitoring body and settlement procedure

In the three countries were a legal right to a bank account has been created, an independent supervisory body has been created to enforce and control the implementation of the right.

In Belgium the scheme is monitored by a non judicial and independent claim organism: "Service mediation Banques - Crédit- Placements", composed by both consumers and banks representatives, that deal with claims regarding basic bank account demands and collects statistics on the number of basic bank account opened and closed, the denial decisions and motivation of denial decisions regarding opening of a basic bank account.

Disputes concerning the basic banking service, including decisions to refuse to open a basic current account or to close such an account are settled by the service. If it considers that such a decision is unjustified, the dispute settlement body may require the credit institution that has taken the decision or another credit institution to open a basic current account, if applicable subject to certain conditions. In the first case, the basic banking service will be free for two years.

The injured party also has the right to institute court proceedings to obtain a cease and desist order (see above). The Federal Minister for Economic Affairs, a trade association and certain consumer organisations are also allowed to institute such proceedings. Any party that intentionally infringes the law or fails to comply with a cease and desist order is liable to a fine.

In France the supervisory body is entitled to intervene to enforce the implementation of the right. However, evidence shows that appeals have been limited in number although the banks have applied severe conditions to other services related to these accounts.

In **Norway**, the law is monitored by the Financial Supervisory Authority of Norway (Kredittilsynet).

Creation of a compensation system

In **Belgium,** The law introducing a basic banking service provides for the creation of a compensation Fund for the provision of a basic transaction bank account service, managed by the Belgian Central Bank and supplied with the banks' contribution system. Any bank providing transaction bank accounts to individuals should contribute financially to the Fund and those which manage - in terms of percentage - a number of basic banking services proportionally higher than their own economic importance on the Belgian market may apply to the Fund for support.

This mechanism has not been implemented yet. In 2005, an evaluation of the law's application among transaction banking service providers showed that, one year after the law implementation, there were no such variations on the market that would push an actor to apply for the Compensation Fund. Since actors may have to deal with this Compensation Fund if it appears they do not provide efficiently their share of basic bank account services, all providers currently respect the rules. The implementation of the Fund may, according to the law, only be decided after a second evaluation of the law which is planned to take place in 2008.

Impact of direct regulation regarding transaction bank account provision and payment services on financial exclusion

In **Belgium,** aside from the curative effect of the law (5.000 basic bank account service provision opened in 2005) introduction of the mandatory obligation to offer a basic transaction bank account has also had a preventive effect: mainstream banks do sometimes offer a regular bank account (with no overdraft) to people asking for a basic transaction bank account. People who would have been refused such a service in the past therefore have the opportunity to access the legally designed product, but sometimes also access to a regular mainstream product which cost is higher but offers larger services.

In **France,** the legislation introduced in the recent years together with the debate on the right to an account has improved access for people with difficulties. At the end of 2005, over 26.000 accounts were opened according to the right to the account, almost ten times more than in 1995 (2950) (Banque de France, 2006).

1.2 Direct legislation in the area of appropriate lending

Achieving financial inclusion regrading credit: when appropriate credit services are offered and meet all reasoned demand

The need to borrow exists among people at all income levels, although most of the countries participating in this study have reported that two groups of people find it difficult to access credit from mainstream providers, such as the banks. These are people with low and unstable incomes and people with an impaired credit history. Both groups of people have a greater need to access credit for essential expenditure (such as replacing a cooker that has broken) than others in society.

Many of these people do not have such a high risk of defaulting on payments that lending to them would be irresponsible. The experience of the reputable sub-prime lenders in countries such as the UK and Ireland shows that default can be kept to a manageable level, particularly if they have products and lending and repayment practices that reflect the circumstances of their customers. Moreover, there is a large body of research showing that financial difficulties that lead to an impaired credit record frequently occur as a result of a change in circumstance such as job loss (see for example: Gloukoviezoff, 2006; Le Duigou, 2000; Kempson 2002; Kempson et al, 2004; Koljonen and Romer-Paakkanen, 2000; Korczak, 2001; Springeneer, 2005). For most of the people affected the situation is temporary and their incomes return to a level where borrowing again is both a feasible and financially responsible decision.

The key elements to achieve financial inclusion on the credit market are therefore to **overcome both access and use difficulties by offering appropriate credit products** (provision appropriate to the person's situation and needs, not leading them to overindebtedness) **to meet all reasoned credit demand** (borrowing is both feasible and financially responsible regrading to the person's situation and needs) .

Direct regulation: a tool to prevent use difficulties and ensure appropriate credit provision...

Clearly it cannot be argued that access to consumer credit should be a right for all citizens granted by a legislation, in the same way as one might argue that everyone should have the right to transaction banking or a savings account. Addressing access difficulties to credit of people with reasoned borrowing demand is therefore to be addressed trough other policy responses than direct regulation, such as government intervention ans facilitator and market responses.

On the contrary, the role of direct legislation is essential to address credit use difficulties by protecting vulnerable consumers from exploitative lending and ensuring the provision of appropriate credit on the market. Most of the countries studied do have direct legislation of this kind, but the nature of this legislation varies.

In order prevent use difficulties and ensure appropriate credit provision, some countries studied (like France and Belgium) have developed very strict and preventive legal frameworks, leading to a strongly regulated mainstream market , were appropriate credit products are offered, but not all reasonable demand is served.

On the other hand, some other countries (like United-Kingdom and Ireland) have limited direct regulation and opted for self regulation of the credit market, allowing the development of a very diversified offer in terms of type of products (from mainstream to sub-sub prime) allowing a wider access to financial products, among which some are inappropriate and cause use difficulties,

The following type of measures have been identified in the countries studied:

- Ceiling on interest rates
- Requirement for creditors to report payment defaults and to consult credit reporting agencies before granting credit
- Requirements for lenders to check a borrower's ability to pay before lending money to them or granting a credit line
- Lenders compulsory contribution to a Compensation Fund

Although these have similar policy intent, they can have quite different outcomes in terms of financial exclusion.

Interest rate ceilings

The purpose of interest rate ceiling is to protect vulnerable people against usury practices, which can be defined as lending at an excessive interest rate, making profit from the state of need of the borrower.

More than half of the countries studied were reported as having interest rate ceilings, including Austria, Belgium, France, Germany[2], Netherlands, Italy, Poland and Slovakia.

The level of these interest rate ceilings varies both between countries and within them for different types of credit. For example, in Belgium they vary between 13% and 21% annual

[2] Strictly speaking there is not a legal ceiling but in practice it is 28-30%APR.

percentage rate of charge (APR) (for loans of €5,000 or more and under €1,250 respectively), with rates varying between loans and credit cards and with the amount borrowed. In France, rates range between 8.72% and 20.35% APR – again depending on the sum borrowed and type of credit used. Italy has 15 different rates. In the Netherlands there is a single ceiling, set at 17% above the central bank base rate; in Poland it is four times base rate.

In Ireland, although there is not a statutory interest ceiling, there is a ceiling in practice. Credit companies must renew their licences to trade annually and there is a policy that companies charging more than 200% APR will not be granted a licence.

Concerns were expressed in four country reports (Poland, Italy, Ireland and the UK) that such ceilings, if set too low, can act to exclude people for whom the costs of providing credit are higher than the ceiling. These concerns relate especially to people who want and need to borrow small sums of money for short periods of time, where their circumstances require more expensive payment collection methods or where their likelihood of default is higher than average. Research has shown that in such circumstances the costs of providing credit will be high even in a not-for-profit organisation. If the price is to be low some form of subsidy would be required (Kempson and Collard 2004).

In Italy it has been argued that the interest ceilings they have mean that people perceived to have a high risk of default are refused credit by mainstream providers and are therefore prey to informal and illegal lenders (Porta and Masciandro, 2006). Similar findings have been reported in France (Babeau, 2006).

It has also been suggested that the interest rate ceilings in Germany and France have led to higher levels of illegal lending than in the UK, where there is no ceiling (Policis, 2005). These conclusions must however be interpreted carefully, since the standard of what is illegal lending or not is very different in Germany and France than in the UK, were the provision of inappropriate credit products can occur within the legal market.

The **United Kingdom** Government investigated the desirability of introducing an interest rate ceiling when consumer credit legislation was up-dated in 2006. This involved commissioning research into the impact of such ceilings elsewhere (Policis 2005), and issuing a public consultation document. This aspect of the legislation was also debated extensively as the Bill made its way through Parliament.

In the end it was decided not to introduce a ceiling. This decision was reached for a number of reasons but the most important was a concern that a ceiling would lead to a displacement of costs and a loss of transparency for the consumer. The UK has a number of home credit lenders specialising in small, short-term loans to people on low incomes who would not be able to access credit from a bank. Loans from these companies tend to have high APRs (200% or more) but unlike other lenders they do not make default charges if someone is late with a payment – indeed they reschedule loans so that payments can be missed, without additional charges. They tend, therefore, to have a policy of debt write-off rather than arrears recovery that involves court action. They also collect repayments at borrowers' homes to minimise the risk of default. Even so, the majority of their customers are unable to repay their loans to term and they like the certainty of cost involved with this type of credit and the flexibility of payments when they are unable to pay. In contrast, there are other sub-prime lenders targeting the same group of borrowers who advertise much lower interest rates (29.9% APR) but, like prime lenders, have many additional charges that makes them considerably more expensive. Indeed it has been calculated people in their situation would pay far more were they to use a prime lender, need to take out payment protection insurance and incur occasional default payments not covered by the policy (Policis, 2005).

*S*imilar concerns were expressed when the Polish Government also investigated the desirability of an interest rate ceiling. Here such a ceiling was introduced in 2006 but only applies to the interest and default charges not to the total cost of credit (and therefore the APR). It is interesting, therefore, to see how companies have reacted to its introduction. Because the restriction applies only to interest and default charges, companies have restructured their charges to comply with the new law. A lender specialising in small loans, with repayments collected in the home has, for example, separated the collection charge from the interest on the loan and now sells insurance alongside the loan to cover the rescheduling that was previously covered in the total cost of credit. In other words, the interest rate ceiling has not achieved a price reduction for users – merely a change in the way that these are presented to them. This has resulted in a loss of transparency, as was feared would happen in the UK.

Loss of transparency and displacement of charges as a consequence of interest rate ceiling can be avoided when, like in **France** and **Belgium**, ceiling applies to the total cost of credit (the APR). Moreover, in **Belgium**, the costs and charges related to default payment are also strictly limited by law.

Credit reporting

All the countries covered by this study have national registers of negative information (that is payment default as well as bankruptcies and court judgements). Most also have registers of positive information too (that is a record of credit commitments held by the population, including those not in default). In some countries these registers are run by the central bank – for example, the Bank of **Italy** operates a database covering both positive and negative information. Indeed, supervision rules require the Italian banks to check the ability to repay and to enter the register "Central Credit Register" with bad loans and insolvency. Furthermore, for consumer credit there is CRIF: Eurisc (the CRIF Credit Protection Bureau) is a private credit bureau, founded in 1989, which collects data on payment behaviour and on all credit requests of consumers and small businesses.

In others, such as **Spain** and the **United Kingdom**, there are several credit reference agencies that are run by private companies. In these instances access to data is restricted to the companies that supply information. Some databases restrict their coverage to credit transactions; others also cover payments to mobile and other telephone companies, utility companies and rent payments.

More significantly, while even negative reporting by creditors is voluntary in some countries, in others it is compulsory. This is the case in **Belgium**, **France**, **Norway** and **the Netherlands**, for example. Moreover, in **Belgium** and **the Netherlands** lenders are required to check the credit register before granting credit.

The length of time that information is retained on databases varies across countries and can even vary within countries. In **Spain**, where there are several credit reporting agencies, retention of default information varies from 30 months to six years. In other countries, default information can be kept for up to ten years. It also differs for negative and positive information – with negative information normally being held for a longer period of time. In **Belgium**, for example, positive information is held for three months and eight days after a commitment has been repaid in full; while default information is retained for ten years if it is not settled. In the UK, default information is retained for six years.

This can mean that someone will retain a bad record for a considerable period of time, with limited positive information to show that they have since managed credit commitments without payment problems. The problem is most acute where lenders are required by law to make checks with credit reference agencies before granting credit.

Most of the country correspondents claimed that credit checks, linked to credit scoring, act to exclude people from accessing consumer credit in their country. In **Germany**, for example, it was reported that this means that people turn to unlicensed lenders to borrow. At their most benevolent, these are private individuals known to the borrower who will lend money at an agreed rate that is above that normally paid to a bank. But less scrupulous lenders also exist, and credit brokers, who will arrange credit by circumventing credit checks for a fee, are relatively common. This corroborates research on the situation in Germany that was undertaken for the UK Government (Policis, 2005).

In the **United Kingdom** and **Ireland,** where there are no interest rate ceilings, the situation is somewhat different. In these two countries there are large near- and sub-prime credit markets that apply risk-reflective pricing. At the cheaper end of the near-prime, rates are only slightly above those in the prime market and much of this credit is offered by subsidiaries of the main banks. At the opposite extreme, are the home credit companies (described above) that specialise in small short-term loans to people on low and unstable incomes. These near- and sub-prime companies supplement checks of data held by credit reporting agencies with more detailed information collected from the consumer. Indeed, the home credit companies have claimed that information held by credit reporting agencies is not predictive of default among their customers, for whom the commitment to repaying in future is much more important than the consequences of past financial shocks.

This highlights a particular problem with credit reporting that includes positive information and only covers optional commitments such as consumer credit. Many people have nothing at all recorded about them and this can make lenders wary about lending them money. In contrast, where credit agencies also collect information about utility bills, this enables people to build up a credit rating.

Duty on lenders to check ability to repay

Norway is particularly interesting in that it has neither an interest rate ceiling nor does it compel lenders to consult the credit reporting agency before granting credit. Instead, legislation on financial agreements places a duty on lenders to advise consumers against borrowing when they assess that they will have difficulty repaying the loan. How lenders do this is left entirely to the market, and this has acted as an impetus to the development of credit scoring systems by individual lenders. There are no direct sanctions for failing to comply with this legislation, although lenders do risk losing part or all of their claim should the borrower default. A commission is currently investigating the possibility of strengthening this legislation.

In **Belgium,** the 12 June 1991 law related to consumer credit imposes to the lender to check the financial situation of the client and ensure his solvency and ability to reimburse. To do so, lenders have to check the national credit reporting agency and gather all information the consider as to be necessary. The lender and borrower must select among the products usually provided the kind and amount of credit most appropriate according to the candidate situation and aim of credit.

If those obligations are not respected, the following penalties can be applied by courts:

- rejection of all or parts of the late penalties
- diminution of borrower's payment obligation to the borrowed amount only, excluding all interests and fees, borrower keeping the advantage of the payment instalments
- damages recovery for the borrower

Duty on lenders to contribute to a Compensation Fund

The Belgian law dated 5 July 1998 on collective debts payment introduced the Over-indebtedness Treatment Fund. Each lender is to pay to this Fund an annual contribution calculated on the basis of a coefficient applied on total arrears for credit contracts registered in the Centrale des Crédits aux Particuliers managed by the Banque Nationale de Belgique. In other words, the more a credit provider will grant credits injudiciously, the more it should contribute to the Fund. With such earnings, the Fund will repay fees and expenses for debt mediators who could not be paid by debtors.

Impact of direct legislation in the area of responsible lending on financial exclusion

The above analysis suggests that both interest rate ceilings and legislation requiring lenders to consult credit reporting agencies before lending can be blunt tools. While they undoubtedly provide important consumer protection they both carry the risk of excluding people to whom lending might, in fact, be responsible.

There is evidence that interest ceilings can restrict access and can also lead to additional charges which are less transparent, while complete transparency and predictability of charges is important to people on low incomes. Mandatory use of credit reports in lending decisions can prevent people who have previously experienced a change in circumstances from accessing credit long after their financial position has improved.

These legislation measures are an efficient protection to prevent overindebtedness issues and meet appropriately the objective of addressing use problems, ensuring appropriate credit provision by the market. However, they might be insufficient to guarantee access to credit for some people with a reasoned demand.

Other initiatives, requiring more extensive checking of ability to pay, coupled with legislation that enables credit agreements to be considered by the courts and terminated if inadequate checks were made, seem likely to provide responsive protection for consumers and at the same time to carry a lower risk of exclusion.

It is also important to recognise that people to whom banks and other mainstream lenders will not lend often need to borrow. If they are not to be exploited by commercial lenders they need an alternative source of credit. The funds established in Italy to assist victims and potential victims of exploitative lending, the Irish Money Advice and Budgeting Service, the NVVK in the Netherlands and the steps taken in the UK to develop not-for-profit lenders provide useful models of how this might be achieved.

2 Indirect regulation to remove obstacles reinforcing financial exclusion

Sometimes, specific obstacles remain that hinder the involvement of some people with the banking system despite the existence of direct legislation and regulation, governmental interventions as facilitator and market initiatives aiming at financial inclusion.

These obstacles can be considered as "side effects" generated by the application of legislations aiming at other purposes than financial inclusion, having as practical consequence to deny people from accessing financial services or to deter them from accessing or using it (called self-exclusion).

Indirect legislation includes provision aimed at removing those specific obstacles.

The following **obstacles reinforcing financial exclusion** have been identified within the countries studied:

- **Legal requirements regarding customer identity and impact of money laundering regulation** as an obstacle to access and use transaction banking and savings services
- **Risk of income seizures** as an obstacle to use transaction banking services.
- **Disproportionate impact of taxes for those on low incomes** as an obstacle to access and use transaction banking services.

Negative consequences of national transposition of EU Anti-Money Laundering Directive.

This kind of obstacle has been identified in Ireland, United Kingdom, Belgium and Spain.

In **Ireland,** the application of the money laundering Directives are considered to be the greatest barrier for low-income consumer opening bank and credit union accounts (Corr, 2006). As a result of EU Anti-Money Laundering Directive transposed into Irish legislation, financial institutions are required to obtain two separate documents (usually a passport/driving licence and a utility bill) from potential customers to prove their identity and address. Guidance Notes for Credit Institutions published in 2001 and revised in 2003, outlined alternative identification which could be accepted. However, groups working with low-income consumers have found that there are inconsistencies across various financial institutions in applying the guidelines. Research has also found that low-income groups are not always made aware of the alternative options (Corr, 2006). A further problem highlighted by NTMABS (2006) is that the guidelines assume that the non-financial sector (e.g. Garda Síochána, solicitors etc.) will provide proof of identification and that is not necessarily the case.

In the United Kingdom, although money laundering rules have always excluded some people, real progress had been made in addressing the problem until the US terrorist attacks on 9/11 2001. The situation then rapidly reversed. Since then there has been sustained pressure to consider the impact of regulation in this area on financial inclusion – with some success. The one area of continuing difficulty is in relation to small remittance companies – used extensively by the UK ethnic minority communities. The fact that such companies were believed to have been used to supply small levels of funding to the Madrid bombers has made this a difficult area to tackle as one is being asked to weigh financial inclusion against national security.

In **Belgium,** the transposition of the EU Anti-Money Laundering Directive played an important role in financial exclusion regarding banking and savings.

In **Spain**, preventing the use of the financial system for money laundering and financing of terrorism involves a greater bureaucracy in financial transactions. However, this does not seem to create a serious obstacle for accessing or using banking services, with the exception of the migrants' segment, which has more usage difficulties.

The anti-money laundering regime has just changed again as a result of the Third Anti-Money Laundering Directive, which was published in November 2005. EU member states were required to introduce the provisions of the third directive by 15 December 2007. To avoid as much as possible a reinforcement of financial exclusion due to the national implementation of the European Directive, government can develop, together with the credit sector and the organisations working with low-income consumers and migrants, practical solutions which address the needs of those who do not possess the standard documentation whilst meeting the fairly stringent legislative requirements placed on credit institutions.

In **Norway,** (not concerned by EU Anti-Money Laundering Directive) the concern of facilitating identity checks for immigrants and people staying only temporarily in the country has been addressed. Bank now accepts D-number (dummy number) as identification to open a bank account. To apply for a dummy number, the candidate must contact the local tax office.

Risk of income seizures once paid on a bank account, deterring people from use of transaction banking services

This obstacle has only been identified in Belgium so far. In 2005, 25% of Belgian unbanked people did not want to have or use bank account because they were afraid of seizures of their income by creditors (Disneur et al., 2006). At that time, due to a lack of legislative provision on that specific matter, creditors were entitled to proceed to a seizure of the entire amount of money available on their debtor's bank account, despite the fact that Belgian law considered that a part of it should be considered as "guaranteed minimum income" and therefore be protected from seizures.

To solve this self-exclusion problem, Belgian law has been modified in order to specifically protect the income part corresponding to the "non seizable guaranteed minimum income" from creditor seizure for 30 days once it is paid on their transaction bank account.

Disproportionate impact of taxes for those on low-incomes in accessing bank accounts

This last obstacle has been identified in Ireland and Italy.

In **Ireland,** government stamp duty of approximately €10 per annum is normally charged to a bank account for the use of an ATM card or debit. A further €40 government stamp duty is annually charged for the use of a credit card. This charge is a serious deterrent for those on low incomes in accessing bank accounts.

In **Italy,** duties and taxes on banking services represent also a heavy burden for people on low incomes, reducing the convenience of using banking services.

No governmental intervention has been taken so far in those countries regarding this deterrent effect of high taxes on low-income people.

3 Positives incentives to promote financial inclusion

The final area of legislative intervention consists of positive incentives aimed at encouraging the use of banking and bank products by people at risk of exclusion. These generally fall within one of the following four categories:

- **Tax relief** (products free of tax or with tax benefits);
- **Guarantees to reduce credit** risk and therefore increase creditworthiness;
- **Occasional monetary incentives** (such as bonuses and premiums under specific circumstances);
- Incentives resulting from **cooperation between public and private bodies**, in which monetary incentives from private organisations, usually not-for-profit institutions, are matched by tax relief from the public body[3].

We will only adress here the **positive incentives** which have been implemented in the country studied **to promote the use of savings accounts.**

In **Belgium,** savings account interest are free of taxes for the holders, while in **Germany,** interest income from savings investments and other unearned income are exempted from taxation up to 750 Euro in 2007 and in **Spain and France**, a fiscal incentive is granted to persons who save and deposit their savings on a special deposit account with the aim to buy their home.

Still in the area of savings, targeted savings account have been implemented for **public matching scheme** pilot experiment. These initiatives are called "Individual Development Accounts" and usually share the following elements: a restricted and dedicated use of the savings (education, housing, business creation) and for each amount saved, it is doubled up by the government.

4 Policy recommendations

Market responses, sectors self-regulation and government intervention to promote financial inclusion are more often mutually inclusive rather than exclusive. A country's response must always be considered appropriate or not in regards to its respective market and institutional context.

That being said, experience shows that in most of European countries, a public obligation or at least some form of public encouragement is necessary to make banking institutions engage in the fight against banking exclusion.

Therefore it seems necessary for the State to intervene as a regulating authority and to ensure adequate access to financial services to the clients faced with financial exclusion, without distorting the competition rules.

[3] It is easy to understand that, for reasons connected to the image of public policies, it is easier for public bodies to provide incentives in the form of tax relief (i.e., lower revenues) than as direct benefits (i.e., higher expenditure).

When implementing a **mandatory obligation to all banks to offer basic transaction bank account** services or alternative payment mechanism to persons who are not entitled to a chequebook or a credit card, policy makers should deeply consider reinforcing the impact and effectiveness of such right considering carefully the following key components:

- Clear definition of services to be provided an at which price, with specific attention paid to targeted customers in terms of access conditions and product design;

- Creation of an external supervisory agency in charge of monitoring the law's implementation;

- Effective complain procedure, specifically designed to be accessible and appropriate for people at risk of financial exclusion;

- Effective advertising of the right towards both targeted individuals and governmental and non governmental organisation dealing with people at risk of financial and social exclusion

To ensure that basic bank account provision is evenly shared among all the providers, a compensation fund may be legally created and supplied with the bank system's contributions, in order to reimburse banks that open and manage a larger number of accounts than their own economic importance in the country market would justify.

When considering the opportunity to **implement direct legislation in order to ensure appropriate credit provision,** consequences genereted by market regulation on credit access and use problems have to be considered : a strongly regulated market ensures provison of appropriate credit but can generate access problems while a poorly regulated market ensures the largest access to credit products, some of which not appropriate and generating use problems.

The following mesures can be implemented as a regulatory framework ensuring in a preventive way an appropriate credit provision by the market :

- Ceiling on interest rate : ceiling has to be carefully considered in order not to be set too low, and should apply to the total cost of credit (APR). to ensure no desplacement of the costs, the total charges related to default have also to be limited;

- Credit reporting : Impelmentation national register of both negative information (payment default and and and bankruptcies judgments) as well as positive information (record of credit commitments held by the population) and duty for creditors to report information;

- Duty for lenders to consult credit reporting as well as any other relevant information in order to check a borrower's ability to pay before granting credit coupled with legislation that enables credit agreement to be considered by the courts and terminated if inadequate checks were made;

- <u>Duty on lenders to contribute to a compensation fund</u> proportionnaly to arrears for credit contracts they have registered, used to repay fees and expenses for debts mediators who could not be paid by debtors.

When implementing such measures, a specific attention should be paid to the development of complementary policies to overcome access problems faced by people with a reasonable credit demand which might not be served by the regulated market (development of non commercial provider, Corporate social responsibility among the banking sector, ...).

Aside from the direct legislation and facilitator actions to ensure financial inclusion, **indirect regulation** should be considered to remove **obstacles reinforcing financial exclusion generated by the application of legislations aiming at other purposes than financial inclusion.**

Once identified in collaboration with organisations dealing with people at risk of financial exclusion, it is of government's appreciation to decide how to address in the most appropriate way the financial exclusion problem, whilst meeting the purposes of the legislation generating it.

Moreover, other obstacles than the ones identified in the countries studied (proof of customer identity, risk of seizures and disproportionate impact of taxes for those on low incomes) can arise in the future due to the implementation or application of a new legislation. We therefore recommend the legislator to be careful when adopting new legislation on general and to proceed to a "financial inclusion" compliance test of the new rules and procedures to be adopted.

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