LexisNexis® RISK SOLUTIONS

Financial Inclusion

Up to date analysis of access to affordable financial services across the UK

Table of Contents

Introduction

According to the World Bank[1], 1.7 billion, or around 30% of people across the globe lack access to useful and affordable financial services that meet their needs.

Access to affordable financial services can play a huge contributory role in social mobility. Those with a basic bank account, for example, are more likely to apply for credit and savings products, to own their own home and to protect their assets through insurance. Financially included people are more likely to be offered affordable rates on utilities and other credit risk-dependent services. Inclusion can vastly improve personal and economic outcomes – increasing the likelihood of people accessing proper healthcare and education, encouraging entrepreneurialism and boosting consumption.

The global financial inclusion picture has already vastly improved over the past 10 years. Since the last financial crash, an estimated extra 1.2 billion[2] global citizens have gained access to basic financial services, driven in part by the rise of Fintech. Yet, inequality remains, with those from poorer households, rural areas and ethnic minorities disproportionately underserved.

At the heart of the issue is the way in which lenders traditionally determine risk, using credit checks which only consider a very narrow aspect of an individual's propensity to manage their finances. Given that a poor credit history or a lack of credit history (a so-called 'thin file') can significantly limit a person's ability to access financial services, lenders should look at a much broader range of data elements when deciding whether to approve a credit application.

Even in a developed nation like the UK, a surprising number of people can find themselves potentially financially excluded. But it would be a mistake to assume it's a social problem. Migrant workers, divorcees and young people living at home could all be affected by financial exclusion.

LexisNexis® Risk Solutions has carried out in depth analysis of its own UK header data, combining two of the UK's largest Credit Reference Agencies (CRAs), as well as short term loan applications from third party consumer sources, in addition to around 30 alternative public and private sources to create this unique and comprehensive study of UK Financial Inclusion.

Steve Elliot – Managing Director
LexisNexis® Risk Solutions (UK & Ireland)

[1] Global Findex Database 2017

[2] Worldbank.org Financial Inclusion

Financial exclusion – in numbers

LexisNexis Risk Solutions has carried out in depth analysis of its UK data sources, combining two of the UK's largest CRAs, short term loan applications and around 30 alternative public and private sources, to create a unique and comprehensive picture of UK Financial exclusion.

UK Financial Exclusion 2021 snapshot:

Almost 320,000

...individuals in the UK are classed as **Thin File**[†] with no data footprint, financial or otherwise.

1.7 million

...people have no financial or credit service activity in the past 24 months (no CRA).

5.8 million

...people have no record of an open or closed current account.

Around 7.1 million (13.2%*)

...can be defined as potentially financially excluded – i.e. they would struggle to access the most affordable credit.

Over 637,000

...people can be classed as Credit Invisibles (or Unscorables) making them impossible to credit score

Almost two in every five (37%)

...short term loan applications are made by **26-35** year olds.

Younger generations

...have a **worrying dependence on sub-prime lending** with a trend of defaulting on highly leveraged loans.

One in ten

...26-35 year olds and 36-45 year olds – **around a million people in each group** – have some sort of derogatory data, like CCJs or bankruptcy records on their credit file.

† defined as only 2 sources of non-financial data available, and no Derogatory or CRA data.

* 13.2% of the UK population age 16+. Our data coverage gives an account of around 95% of the adult population (16+), with a total population of 53.9 million adults.

Please Note: The potentially financially excluded population is determined by individuals data that meet one or more of the applicable criteria (as outlined in the financially excluded definition). When calculating the figure for financially excluded individuals, individuals are only counted once, to avoid artificially inflating the number.

Why does financial inclusion matter?

Access to financial services plays a huge contributing factor to personal and economic outcomes, with a current account often considered a basic requirement of employment and acting as a gateway to other credit, savings and insurance products. Account holders are more likely to start and grow businesses, invest in their education or health, manage risk and weather financial shocks, all of which can improve the quality of their lives[3].

Conversely, those that find themselves financially excluded talk of how they "feel excluded from 'normal' society[4]." Unable to secure a current account, they face unfair charges for services such as cashing cheques and will likely pay a premium on any licensed financial service they use, offered only the highest-rate, subprime credit.

But banking is just the tip of the iceberg; lacking a credit footprint can be socially limiting and disadvantageous in many ways – in fact wherever traditional credit scoring processes play a role. A person's ability to secure a rental property, for example, could be severely diminished by a bad credit score or thin file, limiting their independence and increasing their reliance on others. Over half of all households in the bottom fifth of income distribution in the UK have no insurance, compared to just 8%[5] among the top fifth – likely a problem exacerbated by their inability to secure fair premiums.

Many could be more at risk of suffering fuel poverty, due to being forced onto expensive pre-paid energy tariffs, and have limited access to the internet due to being refused competitive monthly mobile data plans and broadband packages. Taking such examples into account, Save the Children estimate that poor households are affected by a £1000 annual "poverty premium[6]" due to the methods they're forced to use to pay for utilities and financial services.

The effects of financial exclusion are compounded by the fact that people who are excluded in this way typically experience other forms of social exclusion, or have other vulnerabilities related to old age, disability, deprivation, or a lack of digital skills[7].

Why is this study important now?

The UK is facing the biggest cost of living crisis in living memory with inflation well above the Bank of England's target, pushed up by rising consumer prices on everything from food and fuel to energy prices. Any cost of living rise inevitably affects those living on a budget the most, as the rising cost of daily essentials means they have to make do with less. This crisis comes at the worst possible time for the UK economy already limping from the impact of successive lockdowns during the global pandemic and the fallout of Brexit. Anyone fitting the definition of financial exclusion outlined in this study will no doubt feel the effects of rising costs all the more starkly, forcing more to turn to unaffordable and unfavourable subprime lending just to make ends meet.

[3] Worldbank.org Financial Inclusion Overview

[4] Hand to Mouth – the Impact of Poverty and Financial Exclusion on Adults with Multiple Needs, Ellen Pratt and Sarah Jones, April 2009

[5] Monitoring Poverty and Social exclusion (1998), Howarth et al. P81.

[6] Hand to Mouth – the Impact of Poverty and Financial Exclusion on Adults with Multiple Needs, Pratt & Jones, April 2009, P31

[7] Tackling financial exclusion: A country that works for everyone? © Parliamentary copyright 2017 Contains public sector information licensed under the Open Government Licence v3.0

Business and financial inclusion

Whilst this report focusses mainly on financial inclusion amongst the general population of the UK, it's relevant to consider the effects of financial exclusion on enterprise too, particularly small businesses and sole traders. Migrants are estimated to be responsible for starting one in every seven[8] UK businesses and yet, when they arrive in the UK, these individuals are effectively invisible to the UK financial services sector.

Opening a business in the UK is a fairly straight-forward process, whoever you are, but getting access to financial services is next to impossible with no UK credit footprint against which you can be credit risk scored, as any business owners who are non–residents in the UK will find.

Ironically, restricting access to credit to these individuals and businesses could have negative implications for the UK: migrants may source essential banking services from their home country, diverting revenue and tax income away from government coffers. If a more practical approach was taken to providing financing and banking services to these businesses with specific needs, more of the value and wealth created by their businesses could be kept within the UK's shores.

Definitions of exclusion

A **financially excluded** individual is defined as lacking access to 'useful and affordable' financial services. We used this description to identify groups of the population that it would be difficult for financial services organisations to effectively credit risk score, due to a lack of a data footprint, financial or otherwise. In our definition this includes no evidence of a UK current account or no credit reference agency data in the past 24 months and/or only 2 sources of non-financial data, (e.g. Electoral Roll) and no derogatory data on file.

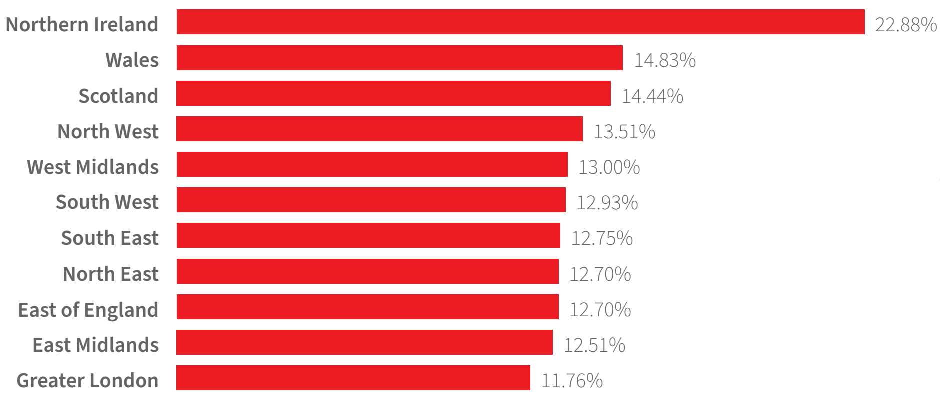
A second group, **Credit Invisibles** (aka Unscorables) are at the extreme end of the financial exclusion scale, with no available credit footprint or history of financial activity, including no derogatory data, subprime applications, and no current account. As such, traditional risk scoring methods would be ineffective in providing a useful picture of them, rendering them ineligible for all but the most unaffordable credit.

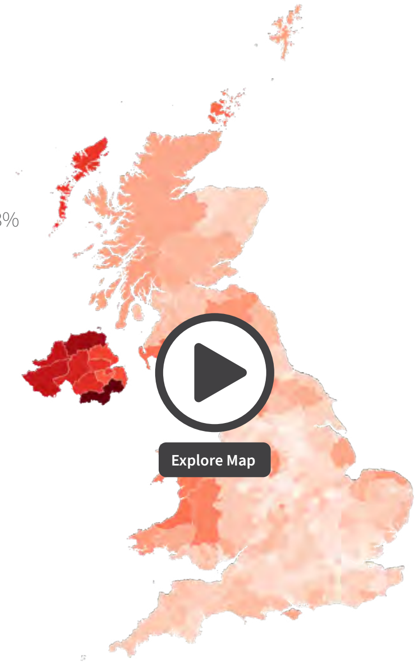
[8] Migrants Behind One in Seven UK Companies, Press release, Centre for Entrepreneurs, July 2013

Potentially financially excluded and credit invisible UK individuals, by age and region

Figure 1:

Financially Excluded: % of population affected

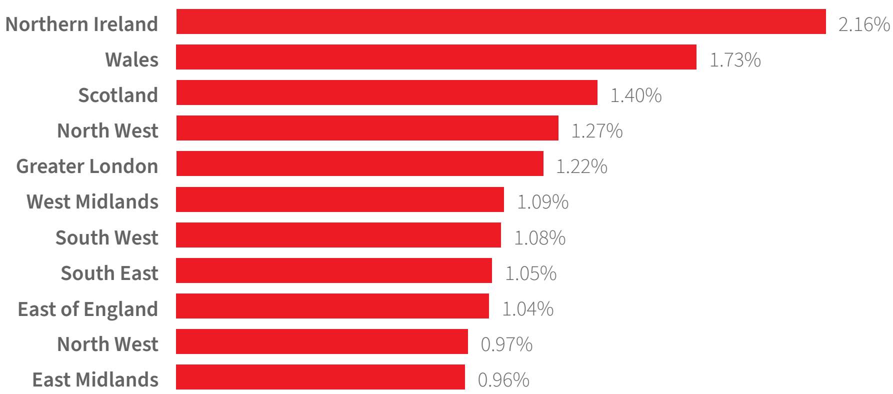


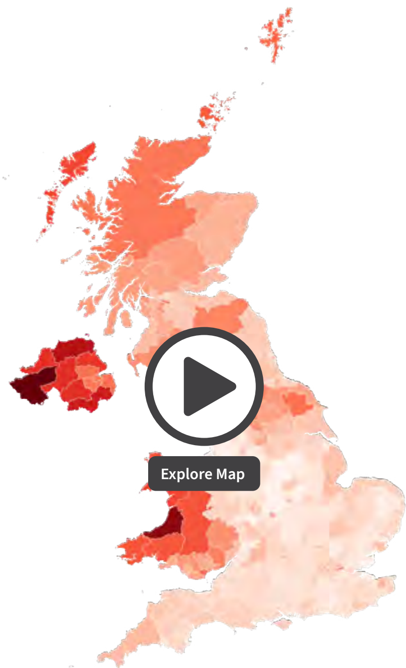


N.B. Our data coverage gives an account of around 95% of the adult population (16+).

Figure 2:

Credit Invisibles: % of population affected





N.B. Our data coverage gives an account of around 95% of the adult population (16+).

What does the UK picture look like?

Our data shows around one in seven adults (7.15 million people) in the UK fall into the definition of 'financially excluded', meaning they could potentially struggle to access affordable and fair financial services. Among them are over 637,000 people (or 1.1% of the population) defined as Credit Invisibles, or over half a million people who are effectively un-scorable in credit risk terms.

As our definition of financial exclusion attests, the primary driver of exclusion – i.e. the inability to access fair and affordable financial services – is the unavailability of credit history against which an individual can be effectively risk scored, or in other words a thin credit file. At face value, our data shows that less than 1% of adults (around 320,000 individuals) in the UK meet our definition of Thin File, namely no financial data footprint and no history of derogatory data. From this it could be concluded that the UK's financial exclusion problem isn't a problem at all, but in reality this may only be a snapshot of the overall picture. A further 1.7 million people (3.2% of adults) have no credit reference data associated with them in the past 24 months, suggesting that this group are not actively using formal, regulated credit services, although they are set apart from Thin File people by the fact that they could have some derogatory data (negative financial markers, like CCJs) against them. Either way, we can say with relative certainty that both groups would struggle to be effectively risk scored via traditional methods.

A third group of around 5.8 million people – one in ten adults – have no record of an open or closed current account. This is significant, given how intrinsic a current account can be to applications for other financial and credit services. An individual with no current account is unlikely to be actively participating in products such as a mortgage and with no Direct Debit facilities, will unlikely benefit from competitive tariffs for a host of services beyond banking. Moreover, most legitimate employers stipulate a salary must be paid into a current account.

How these classifications of exclusion are distributed across age groups and how they individually contribute to exclusion and vulnerability are dealt with in more detail, later in this report.

Our financially excluded group of 7.15 million adults represents a combination of these three key data groups described above – no current account or no credit reference data and/or Thin File and no derogatory data. At the extreme end of this group are around 637,000 Credit Invisibles – defined by the fact that all of the above financial exclusion criteria apply to them simultaneously, thereby earning them the moniker, Unscorables.

In any study of financial exclusion, it's important to look not only at factors that influence current exclusion, like derogatory data, but also consider those that could indicate potential future exclusion, such as subprime application rates. Our data shows that some 3.51 million people (6.5% of UK adults) have some form of derogatory data on their credit history, which will inevitably affect their ability to access the fairest financial services. Remember, this not insignificant group can be counted as additional to the 7.15 million financially excluded adults, by virtue of the fact that the presence of derogatory data omits them from the latter definition. What is more revealing (and more than a little concerning) is the distribution of this derogatory data across the population age groups, which will be discussed later.

Our data coverage for UK subprime loan applications looks at two leading vendors and shows that over 3.6 million people made at least one subprime application between 2018 and 2021, representing some 6.8% of UK adults, and almost 1 million people (1.76%) made 2-3 applications. What is more, the data suggests an unhealthy dependence on subprime lending amongst particular millennial groups, with two in five (37%) short term loan applications between 2018 and 2021 made by 26-35 year olds. The concern around subprime lending is the long-term effect on applicants' credit scores – not only are subprime applications themselves viewed negatively by prime lenders, but the higher propensity for lenders to default makes future financial vulnerability more likely.

[9] LNRS Sub Prime Loan data is sourced from two leading vendors and linked to over 4 million UK individuals, providing indicative coverage of SPL loans in the UK.

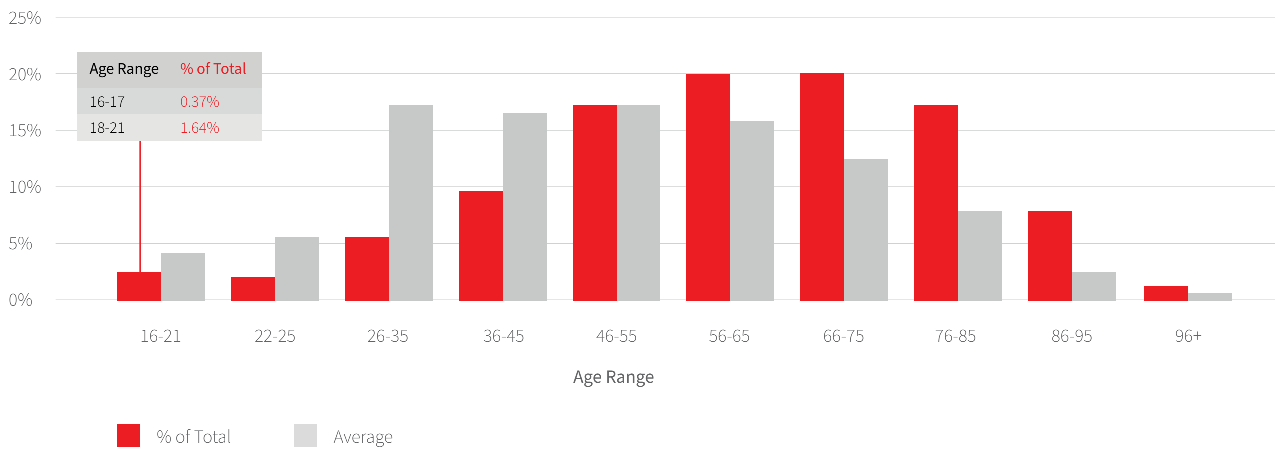
Age analysis

Looking at all contributing factors combined, 56-65s and 66-75s are the most likely age groups to experience financial exclusion, with almost 2 in 5 excluded individuals falling into these age groups. However, the data shows exclusion occurs across the age groups from 16 upwards and the probability of being financially excluded increases the older you get.

The underlying cause of exclusion – to the extent it can be surmised from the data – appears to vary across the age groups. In the case of the older generations, there's a strong correlation between exclusion and lack of access to a current account – with 56-65s and 66-75s accounting for two-fifths (40.03%) of the UK's entire underbanked population.

Figure 3:

UK individuals with no record of an open or closed current account, by age



By comparison, the younger generations (those under the age of 35) account for less than a tenth of the underbanked population, but account for almost half (45%) of all those classed as having a thin credit file – i.e. no credit reference agency or derogatory data, and only 2 sources of non-financial data. This age group also account for 30% of all those classed as Credit Invisibles, i.e. the same lack of credit footprint described above, plus no record of a current account, which could effectively render them ineligible for any form of mainstream credit. People aged 16-21 will naturally tend to have thinner credit files than their older counterparts for various reasons, not least of which is eligibility for credit, but also the modern tendency to continue living with parents into adulthood. What is surprising is the data shows a steady continuation of thin file individuals throughout the millennials and generation X age groups, rather than the stark drop off you might expect.

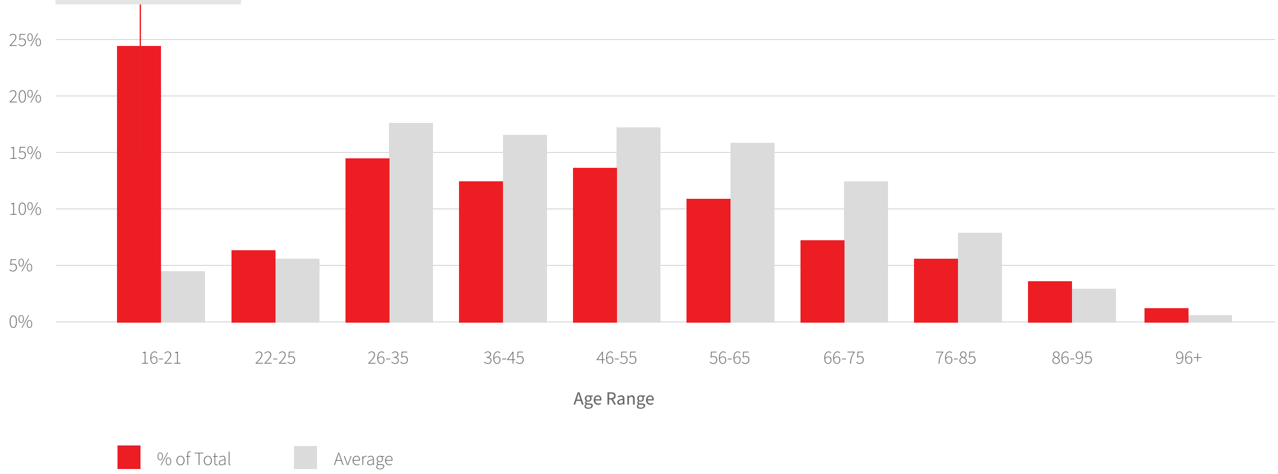
The fact the leading cause of exclusion amongst **older generations** is a lack of a current account may also not be altogether surprising, considering around 2.4 million people aged 65 and over in the UK rely on cash to a great extent in their day-to-day life, according to a study by Age UK[10]. Our data identified some 2.6 million people over the age of 66 with no trace of a current account – more than five times the figure for 16-35s at 489,000 people. Is there some correlation here, between the average age of the underbanked and the continued disappearance of the UK's banking branch network, itself more heavily relied on by the older generations than others? Given that a current account is well recognised as a basic financial tool and gateway to other financial products, the potential vulnerabilities this suggests, should not be underestimated. Physical cash is becoming increasingly obsolete in the digital, post-pandemic world and increasingly scare as the network of free-to-use cash machines diminishes, and does so fastest in the very areas in which residents rely on cash the most[11].

Crucially, an inability to effectively risk-score someone can have far wider implications for their wellbeing than the ability to access credit. And the effects are likely to be more pronounced amongst the older generations. They could struggle, for example, to access affordable insurance, leaving them vulnerable to loss of their belongings, or at risk of losing the use of a car that they might rely on for essential travel, such as to hospital appointments. Worse still, they may not qualify for the most affordable energy tariffs, which often require customers to have a suitable credit score and to set up a Direct Debit, forcing them onto expensive pay as you use energy tariffs, and perhaps ultimately into fuel poverty. Similarly, the most affordable and competitive mobile phone tariffs and data plans are subject to credit score and could therefore be inaccessible to those that would most benefit from them.

Figure 4:

Levels of Thin File individuals in the UK, by age

Age Range	% of Total
16-17	7.41%
18-21	17.44%



[10] One in Five Older People Rely on Cash for Everyday Spending, press release, 26 June 2021, ageuk.org.uk

[11] Independent.co.uk, 18 Sept 2019

Thin File individuals

Traditional credit risk scoring methods rely on the availability of historical credit data, used to evaluate the ability for an individual to manage and repay their previous debts. Thin File individuals with little or no useful credit footprint therefore represent a significant challenge to any organisation making a credit risk decision. The exact definition of Thin File is open to interpretation, but lenders will struggle to make a suitable credit risk decision without any credit reference agency data or negative financial data (such as CCJs), and little or no other 'non-financial' data that proves the person lives and is domiciled in the UK, such as electoral roll entries. Scoring for eligibility is a sliding scale, too – meaning the minimum information required will vary widely between lenders. As such our definition is likely to be closest to a 'bare minimum' requirement.

Whilst levels of Thin File individuals are low as a percentage of the whole population (just over 0.6% of all UK adults), the way in which the levels are distributed across the age groups is significant. Our analysis shows that a thin credit file is the leading cause of exclusion amongst the younger generations, with a quarter (24.8%) of all those falling into our definition of Thin File being aged 16-21. This may be somewhat expected, given that young people will have had less time to build up a suitable credit footprint, however, you might also expect young people leaving full time education or university and entering the world of work to be creating a credit footprint as they rent or buy property, pay utility and phone bills, buy insurance and use credit products. Significantly, the pattern of Thin File distribution continues up through the age brackets with 26-35s representing 14.5% of the Thin File population, and 36-45s and 46-55s representing 12% and 13% of the total respectively, compared to 66-75s who make up just 7.3% of the group.

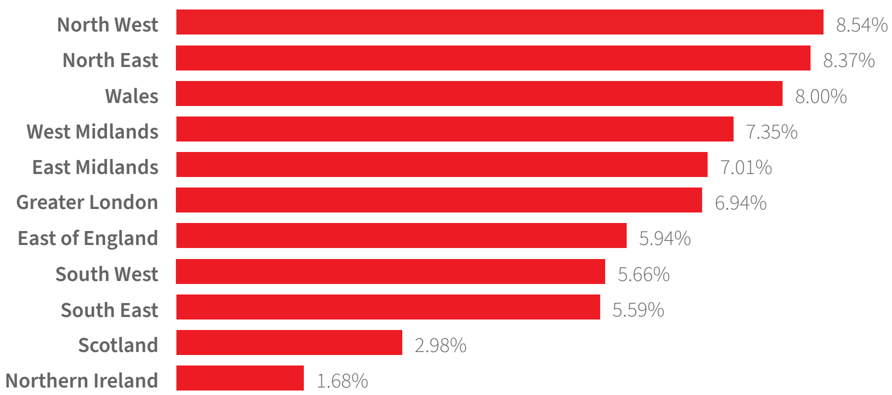
The Credit Invisibles (or Unscorables) group, at the extreme end of exclusion, with no credit footprint and no current account are a slightly bigger group, representing 1.18% of the UK population (around 640,000 people) but follow a similar pattern of distribution as Thin File, affecting the millennial and Generation X groups almost to the same degree as their younger Gen Z counterparts, with almost two in five (39%) Credit Invisibles being represented by just three age categories, covering people aged 26-55.

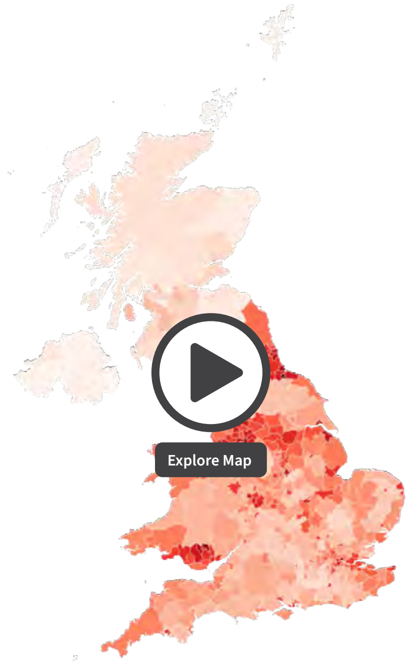
Some of the potential causes of these trends will be discussed later, but a lack of credit data footprints amongst these age groups will undoubtedly be having a limiting effect on individuals' ability to access fair financial services, in turn having significant limiting effects on their social mobility.

Derogatory data and subprime lending

Figure 5:

Derogatory Data: % of population affected

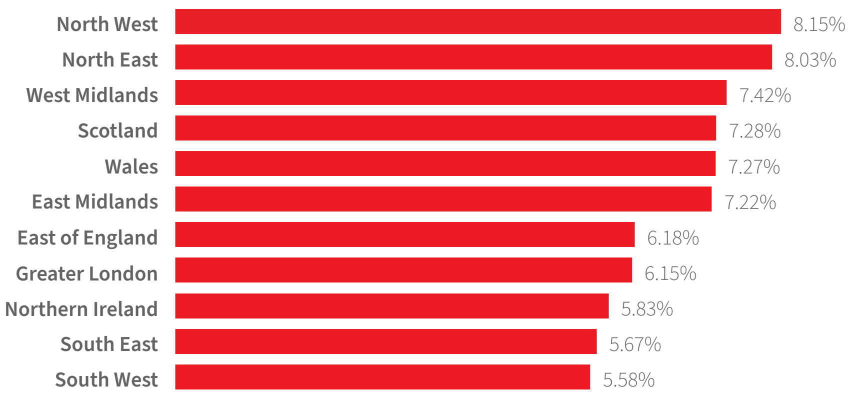


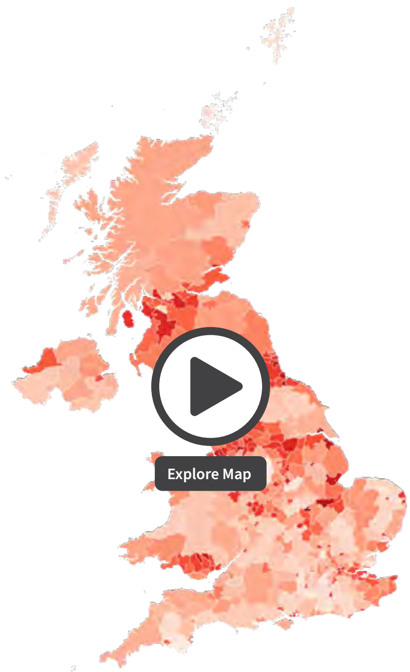


N.B. Our data coverage gives an account of around 95% of the adult population (16+).

Figure 6:

Subprime Lending: % of population with at least 1 application





N.B. Our data coverage gives an account of around 95% of the adult population (16+).

Why is this data relevant?

Subprime loan applications and derogatory data are relevant because of what they tell us about the current position and potential future financial vulnerability of individuals. There's no exact definition of 'subprime', but it typically refers to any loan with a very high rate of interest significantly above the national base rate – APRs of 1000+% are not uncommon, but any rates beyond 10-20% could technically be classed as subprime. Applications for this type of unaffordable credit are a good indicator that someone is experiencing exclusion from mainstream financial services, by virtue of the fact they wouldn't turn to such lending options unless they absolutely had to. It's also a good indicator of potential future financial vulnerability, given that people are statistically far more likely to default on these types of loans. It's worth highlighting that we don't know from the data whether a loan was taken, just that an application was made.

Derogatory data is negative financial markers that indicate past or recent debt issues. This includes County Court Judgements (CCJs), a court-ruled order to pay debts owed, and any bankruptcy or insolvency orders. It also includes Individual Voluntary Arrangements (IVAs) and Debt Relief Orders – relatively new tools to help people reduce their debt burden. Derogatory data would likely have a negative effect on a person's ability to access fair and affordable financial services – i.e. they would likely only be offered expensive and subprime lending rates. Derogatory data remains on a person's file for 6 years, during which time they will continue to be financially vulnerable.

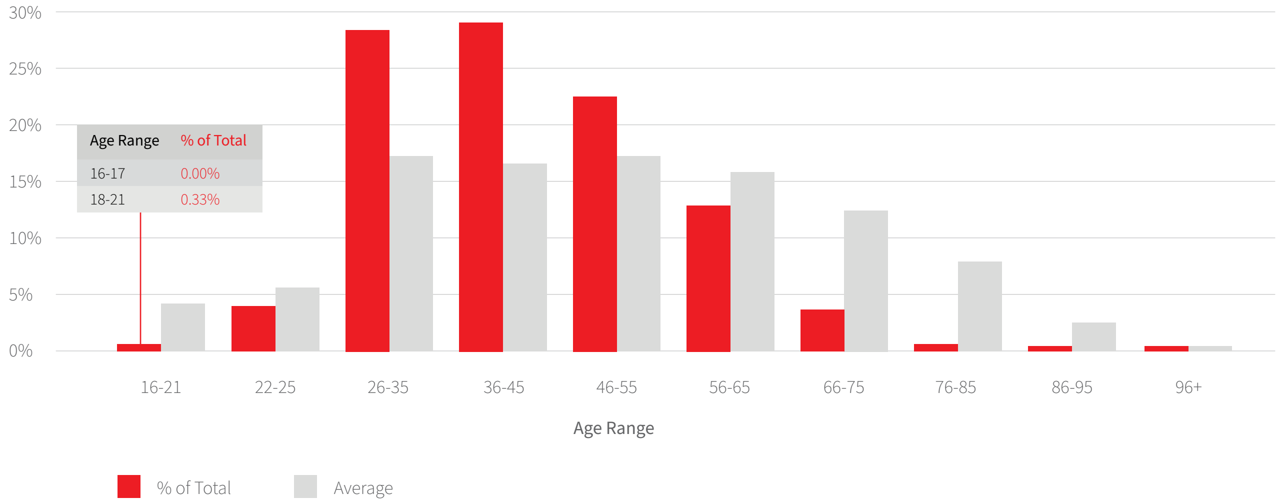
Derogatory data

As we've already reported, some 3.5 million people (6.5% of UK adults) have some form of derogatory data on their credit history, likely negatively affecting their credit score and ability to access prime financial services.

Startlingly, when analysing this data across age groups, we found that Millennials and Gen X groups are far and away the groups most likely to have derogatory data: one in ten (10.78%) 26-35 year olds and 11% of 36-45 year olds – roughly a million people in each group. Put another way, over half (56%) of all the derogatory data in our study is associated with these two age groups alone. A further fifth (22.42%) of the data can be attributed to the 46-55 age group.

Figure 7:

UK adults with derogatory data (% of individuals, by age)



This prevalence of derogatory data particularly among millennials should be a concern and may be to some degree symptomatic of the well-documented financial struggles of these age groups. What is certain is the data indicates that these groups are (or have been) in financial difficulty at a time in their lives when they should be settling student debts, making inroads into their mortgage repayment and starting to build solid long-term savings and investments that will see them into retirement. Instead, these groups will likely struggle to secure mortgages and perhaps other affordable, prime financial services, leaving them in a continuing struggle with their finances. Furthermore, the long-term sticky nature of derogatory data (lasting for around 6 years on their history) means they'll struggle for some time to come. When addressed alongside subprime lending, derogatory data patterns take on yet more significance, as we'll see in a moment.

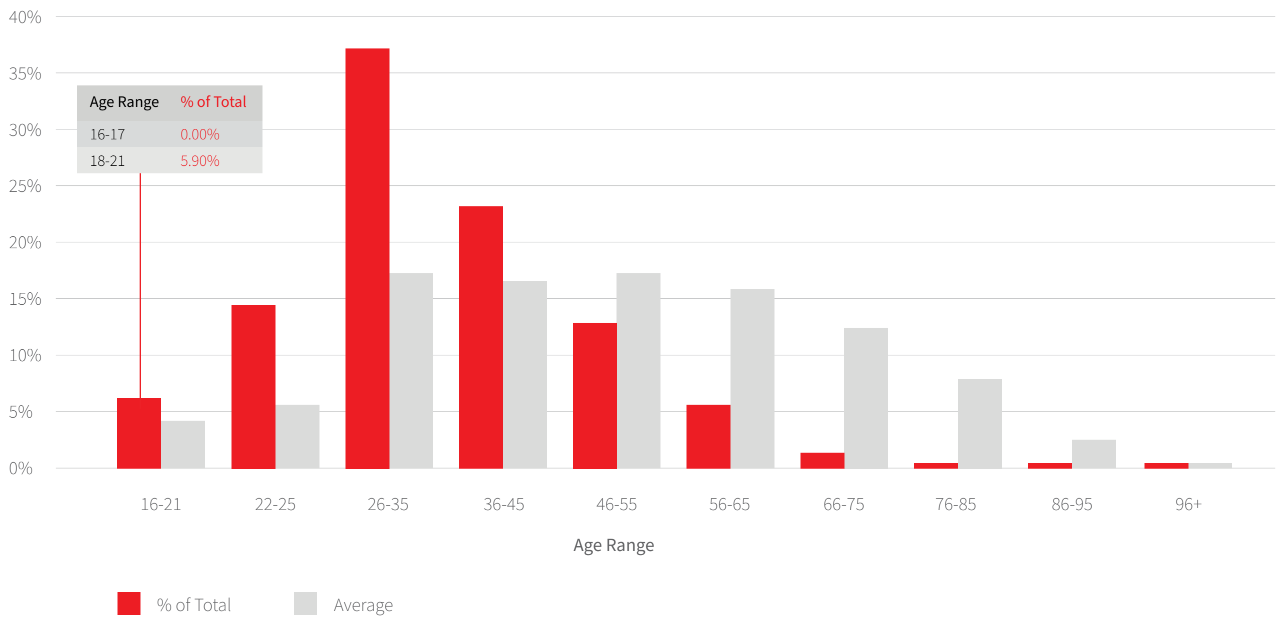
Subprime lending

Similar to derogatory data patterns, our study shows concerning levels of subprime lending among the UK's younger generations. Of the circa 3.67 million subprime credit applicants in our data, around one in seven (14%) were 22-25 year olds, over a third (37%) were made by 26-35 year olds and a quarter (23.2%) by 36-45 year olds – again, Millennials and Gen X. By comparison, just 5.5% of applications were made by 56-65 year olds and 1% by 66-75 year olds – both of the Baby Boomer generation. Given the propensity to default on these loans, it's not surprising to see higher than average levels of derogatory data amongst these age groups too. Again, while the presence of subprime applications indicates financial activity, it also indicates a number of potential and overlapping vulnerabilities:

- They're already struggling financially and suffering from exclusion from mainstream sources, by virtue of the fact they're applying for this type of credit.
- Or, they are eligible for more affordable credit, but lack the financial acumen to understand the nuances between prime and subprime lending
- They are seduced by the pervasive nature of subprime lending advertising and apply without due diligence on the cost or alternative options
- They have an unhealthy relationship with debt and don't consider the consequences of heavy use, or of defaulting.

Figure 8:

Subprime loan applications (% of individuals with at least 1 application, by age)



It's easy to be drawn in by headlines about Millennials and avocados, but the reality is that the use of subprime credit amongst the younger generations is likely driven by a multitude of factors, including physical 'needs' as much as 'wants'. Those already experiencing exclusion from mainstream, prime lending, could be forced to turn to subprime credit for basic day to day necessities like groceries – a 2013 Money Advice Service[12] report found that as many as 77% of such loans were used to buy food.

Whatever the drivers, the result is the same. Subprime applications have the potential to affect both current and future credit scores, being seen as a negative indicator in the eyes of potential lenders carrying out credit scores and significantly increasing the risk of credit defaults, which in turn negatively impact future credit worthiness. All in all, this data points towards an unfortunate reality for millions of people in the UK, drawn into inappropriate subprime credit, either out of necessity or through poor choice, leading them into a subsequent cycle of financial exclusion that limits their future creditworthiness and problems throughout adult life.

Together, the two forms of negative financial marker – derogatory data and subprime applications – are strong and reliable indicators of potential future financial vulnerability and ongoing exclusion, all of which makes their prevalence among the young to middle age groups all the more alarming. After all, these people are at a critical point in their financial lives where they should have already built solid credit footprints and should be reinforcing their financial position through saving, investing and planning for retirement.

Regions matter… but it's not a straightforward case

On a regional level there appears to be some correlation between exclusion and socio-economic status, although it's certainly not a clear link.

It's true, for example that financial exclusion amongst the population rises well above the UK average, to almost one in four people in Northern Ireland (22.8%) with a similar story for Wales (14.8%) and Scotland (14.4%). The drivers behind this, however do not appear to be solely economic – after all Northern Ireland has the lowest levels of working age adult poverty in the UK[13] (17% 2018/19).

Neither do exclusion levels across England's regions, follow expected trends: 13.5% of the population of the North West are excluded, but so are around one in seven of the populations of the South West (12.93%) and West Midlands (13%). Both show higher levels of exclusion than the North East (12.75%) (incorporating Yorkshire & Humberside) and East of England (12.7%). All regions of England other than the North West, fall below the national average exclusion rate of 13.23%.

Notably, exclusion levels vary only by a relatively narrow range across the whole UK – with Greater London bringing up the rear at 11.7% of the population, but less than 2% behind the North West and 3% behind Wales. This suggests that the underlying causes of exclusion – thin credit file and lack of credit reference data or current account – are being felt relatively consistently, everywhere.

At a closer inspection, Northern Ireland ranks top (1st) on two other key definitions. As well as having the highest share of Credit Invisibles (2.16%) amongst its population, almost one in five people (18.3%) are underbanked according to our research. Intriguingly it also ranks as the lowest (11th) region in the UK for distribution of derogatory data amongst its population, at 1.68% of people – well below the 6.5% national average. It should be noted however, that slightly lower coverage of Northern Ireland current accounts in our data may be contributing to the higher exclusion rate here, than other regions.

[12] Low savings levels put millions at financial risk, Money Advice Service, press release, 29 September 2016

[13] UK Poverty Rate By Region, Joseph Rowntree Foundation

Both Scotland and Wales are similarly characterised by high levels of exclusion, a high share of Credit Invisibles per percentage of population and low take up of current accounts, relative to other regions. Wales ranks second highest on all three counts, with Scotland third. Why this should be the case is a topic for discussion, but taking into account some of the underlying causes of exclusion as it relates to our definition, the drivers could relate to a combination population age, rurality of the region and other factors, such as attitude to credit.

Meanwhile, regions of England that are often associated with deprivation and social disadvantage rank relatively favourably on the exclusion measures. The North West, for example, ranks just above the national average for financial exclusion (13.2%) despite eight of the ten most deprived neighbourhoods in England being in the Blackpool area, according to the BBC[14]. Its neighbour, the North East fairs even better; ranking below the national average on levels of exclusion (7th) and underbanked (8th), individuals, and 4th on levels of Credit Invisibles among the population. Why the latter may be higher than levels of exclusions in the area may be driven in part by high levels of immigration. East Midlands and Greater London bring up the rear nationally on levels of financial exclusion and the underbanked, although like the North East, Greater London appears to have unusually high levels of Credit Invisibles among the population, again possibly as a result of high levels of immigration to the area.

Taking a broader perspective and including debt and negative financial markers adds further layers to the data.

Those in the North West (8.54%) and North East (8.37%) are more likely than anywhere else in the UK to have derogatory data on their file, well above the UK average of 6.5% and a little under one in every twenty people. Levels are also high amongst the populations of Wales (8%), the West Midlands (7.35%), East Midlands (7%) and Greater London (6.94%). Whether this reflects an inability or unwillingness to repay debt, or a lack of understanding of debt is unclear from our data, but it indicates a significant vulnerability among the population for financial exclusion in the near and long term. Perhaps intriguing is the position of Scotland and Northern Ireland in this data, with just 2.98% and 1.68% of the population showing negative financial data on their file. While this could be in part accounted for by limited data coverage in these regions compared to others, it's no doubt showing a clear trend against defaulting on debt amongst these populations.

This is in part borne out in the subprime data, which shows Northern Ireland amongst the regions with the lowest levels of subprime lending in the UK, while Scotland sits in the middle in 5th position, just above the national average. The North West (8.15%) and North East (8.03%) again lead the regional pack suggesting a close relationship between use of subprime credit and rates of default. Levels of subprime lending remain above the national average (6.82%) across the West Midlands (7.4%), Scotland (7.28%), Wales (7.27%), and the East Midlands (7.22%), but are notably lower in the southern regions of the UK.

[14] England's most deprived areas named as Jaywick and Blackpool, BBC News, Sept 2019

Local data for local people

At a local authority level, the data becomes more granular and the patterns of distribution of exclusion even less linear.

We see exclusion levels in some of the most affluent boroughs of Greater London, to take one example, at well above the national average. The City of London, at 18.49% of the population has a higher rate of financial exclusion than that of both Scotland and Wales, as do Kensington and Chelsea (16.18%) and Westminster (15.10%). The cause is unclear, but the data reveals that those same areas have the highest rates of underbanked individuals among their residents, as well as ranking highly for Credit Invisibles (occupying positions 2-4 on that league table). The drivers of these trends could well be immigration related and/or may reflect the prevalence of people operating on the black economy in these areas – the two possibly being related. Looked at from the other end of the spectrum, a lack of a credit footprint may also indicate a percentage of the population that don't have a need to use credit, rather than being excluded from it, particularly being in London.

Figure 9:

Potentially financially excluded individuals (Greater London Boroughs)

Local Authority	Region	Population	Selection Total	% of population
City of London	Greater London	12,280	2,270	18.49%
Kensington and Chelsea	Greater London	115,789	18,733	16.18%
Westminster	Greater London	160,370	24,214	15.10%
Camden	Greater London	166,736	22,953	13.77%
Richmond upon Thames	Greater London	157,654	20,469	12.98%
Havering	Greater London	211,581	26,269	12.42%

Meanwhile, all but one of England's top ten most economically deprived authorities (as identified in the Town 2020 study by the Mirror Online, looking at health, crime, qualifications and economic data[15]) sit below the national average (13.23%) for financial exclusion, Thin File and underbanked individuals, as Fig 10 shows. There could be a number of factors at play here, including below average populations of older people who have a high propensity to be underbanked, combined with lower rates of immigration than other areas of the UK, but on the face of it, the data suggests that exclusion and deprivation are not mutually inclusive.

Figure 10:

Potentially financially excluded individuals

Local Authority	Region	Population	Selection Total	% of population
Hastings	South East	74,497	9,593	12.88%
Blackpool	North West	119,872	15,341	12.80%
Stroke-on-Trent	West Midlands	205,262	25,590	12.47%
Middlesbrough	North East	110,368	13,715	12.43%
Blackburn with Darwen	North West	115,843	14,337	12.38%
Burnley	North West	74,542	8,994	12.07%
Nottingham	East Midlands	231,252	26,069	11.27%
Hackney	Greater London	219,289	24,504	11.17%
Kingston upon Hull	North East	208,027	23,222	11.16%

[15] Town 2020 series, Mirror Online, 28 May 2020

It's only when derogatory data is taken into account that a fuller picture is revealed. As has already been stated, the presence of derogatory data disqualifies an individual from being counted as financially excluded, Thin File or Credit Invisible, by virtue of the fact that it indicates financial activity. Yet derogatory data is a strong indicator of financial vulnerability and the populations of all but one (Hackney) of the top ten most economically deprived areas of England have a well above average share of derogatory data on their file. In Middlesbrough and Blackpool, around one in seven people are affected, falling to around one in 10 in Hull (11.65%), Nottingham (11.08%), Burnley (10.36%) and Stoke (10.18%).

Figure 11:

Individuals with derogatory data (% of individuals)

Local Authority	Region	Population	Selection Total	% of population
Middlesbrough	North East	110,368	14,920	13.52%
Blackpool	North West	119,872	15,697	13.09%
Kingston upon Hull	North East	208,027	24,240	11.65%
Nottingham	East Midlands	231,252	25,632	11.08%
Burnley	North West	74,542	7,720	10.36%
Stroke-on-Trent	West Midlands	205,262	20,897	10.18%
Blackburn with Darwen	North West	115,843	11,396	9.84%
Hastings	South East	74,497	6,718	9.02%
Hackney	Greater London	219,289	17,512	7.99%

The pattern is very similar through the lens of subprime lending, with all but one (Hackney again) of the local authorities home to populations dependent on high-cost loans. This time, Blackpool leads the pack with one in seven citizens having made at least one subprime application, followed by around one in ten in Hull (11.78%), Middlesbrough (11.62%), Burnley (10.94%) and Stoke (10.7%).

Figure 12:

Subprime lending (% of Individuals with at least 1 application)

Local Authority	Region	Population	Selection Total	% of population
Blackpool	North West	119,872	15,632	13.04%
Kingston upon Hull	North East	208,027	24,500	11.78%
Middlesbrough	North East	110,368	12,822	11.62%
Burnley	North West	74,542	8,155	10.94%
Stroke-on-Trent	West Midlands	205,262	21,971	10.70%
Nottingham	East Midlands	231,252	23,205	10.03%
Blackburn with Darwen	North West	115,843	10,792	9.32%
Hastings	South East	74,497	6,478	8.70%
Hackney	Greater London	219,289	13,098	5.97%

Accordingly, the data appears to indicate that areas of social depravation more closely follow patterns of distribution of negative financial data and use of subprime lending products across the UK population, than they follow patterns of financial exclusion indicated by this study. This points towards not only exclusion and vulnerability but perhaps a lack of financial education being a catalyst for bad financial decisions that are passed on through the generations.

Drivers of vulnerability

Whilst the data doesn't show that vast numbers of young people in the UK are experiencing financial exclusion in their twenties and thirties, there is certainly evidence that significant proportions are demonstrating behaviours that will negatively impact their financial health in future years, potentially leading to exclusion further down the line.

As discussed earlier, analysis of derogatory data – including bankruptcy and debt reduction tools – indicates 26-35s, 36-45s and 46-55s have a well above average propensity to accumulate these negative markers, with over 79% of the 3.5 million UK adults with derogatory data falling within these age groups. A similar pattern can be seen in subprime lending data, with by far the highest user group of short-term loans being 26-35 year olds.

As already mentioned, it shouldn't be assumed that bad habits are intentionally being formed by these younger generations and as studies referenced earlier suggest, much could be driven by needs rather than wants – taking loans to make ends meet rather than to drive the latest car model. For others it may be a matter of education – simply not understanding the significance of APRs, or drawn in by targeted advertising promising quick access to cash.

What is clear is that the prevalence of this data among these age groups should be of particular concern as an indicator of current and future vulnerability: why do they need to turn to this source to make ends meet, and by doing so, what else are they not doing, such as putting aside money in savings and pension, to help improve their situation in later years? Negative financial behaviours now, only exacerbate issues down the line by continuing to limit access to affordable financial services in the future, leading people back to subprime credit and potentially an inescapable cycle of debt and exclusion that affects the most vulnerable in society.

Exclusion triggers

As we've already seen, it would be a mistake to assume financial exclusion only affects those from the most deprived social backgrounds, exclusively impacting the poorly educated and most vulnerable in society – so what are the other triggers?

Many situational factors can result in someone having a thin credit file (one of the key underlying causes of financial exclusion) which in essence is simply the unavailability of data to credit risk score an individual, rather than the presence of data that indicates an individual poses a risk. Many of the situational factors, explored below, relate to people being inactive in formal financial or other mechanisms that can leave an imprint on official records and provide a means by which organisations can say with certainty that an individual lives and resides in the UK. This hypothesis is supported by the fact that volumes of Thin File individuals drop dramatically among the older generations, suggesting that the longer a person resides in the UK, the more likely they are to leave a footprint, of some sort.

The Graduate

Many young people now choose to live at home after university (the so-called boomerang generation) in order to save for a deposit for their first home, while earning a full time, well-paid graduate job. Their good intentions could be affecting their future credit eligibility however, by virtue of the fact that they are not paying household bills and are not using credit products such as credit cards and overdrafts, all of which builds up a useful data footprint for credit scoring. When it comes to finally leaving home to buy or rent their own home, they may discover they're ineligible for the most competitive rates and either pay more, or find themselves priced out of the market.

Case Study

Marketing graduate, Jennifer, 24, works full time as a project manager and lives rent free in London with her parents while she saves for a mortgage deposit for her first home.

In the past 12 months, Jennifer applied for a loan to help pay for her first car, so that she could gain some independence by commuting to work and seeing friends and socialising more easily.

Jennifer believes that she was denied the loan due to her low credit score, although, she explains; *"They didn't give me a reason, they told me to get in touch with a credit reference agency."*

After her first application was turned down, Jennifer looked to other lending providers. *"I did find some other loan offers but the rates on offer were high and clashed with my income,"* she explains.

"The impact is frustrating. It stops me from fulfilling specific needs like having my independence. It's difficult to have to rely on a small pay cheque each month on top of saving as much as I can for my deposit, so in the end I resorted to borrowing money from my parents, but that leaves me feeling trapped in a vicious cycle."

Jennifer says her situation sets off a mix of emotions. *"Some days I feel motivated and try to be positive about life, but on other days, it's all very overwhelming."*

"Things that many people take for granted, such as going on a holiday and buying a car are simply a dream for me. The more I think about it the more it affects me."

"I'm fortunate I can rely on parents to help and support when the going gets tough, but not being able to live alone or be as independent as other people my own age is something I struggle with," she concludes.

New to the UK / Expatriates

Foreign nationals coming to the UK to start a new life, find work and set up a business could also struggle since their credit and data footprints do not follow them from their country of origin, meaning they have to start from scratch from a credit perspective, too. Not only will this leave them excluded from most forms of credit, not least business loans and accounts, but they'll likely have no option but to use expensive credit products over a sustained period in order to build up a suitable credit score that will enable them to access fairer credit. The same would apply to anyone living outside of the UK for an extended period, even if they were born here and/or held British citizenship. Being based overseas would mean they're not creating a domestic credit footprint and since their credit history won't follow them back to the UK if they are relocated, when they arrive in the UK they would likely qualify as Thin File and struggle to access affordable credit.

Case Study

Entrepreneur, Ahmed arrived and settled in Leeds, UK, a few years ago with the aim of setting up a business.

He needed financial help with his new venture, however, Ahmed found that credit providers were either refusing him finance or not offering him preferable or affordable rates due to his very small credit footprint, as a result of being relatively new to the UK.

"When I applied for a loan facility to start a business here in the UK, I had no credit score since I have only been in the UK for a few years. The lack of assistance has really slowed my progress in starting and growing my business here," Ahmed explains.

Being financially excluded has impacted Ahmed's wellbeing both mentally and physically, leaving him demoralised.

"The lack of support is surprising," he says. *"There are no such credit scoring hurdles in the country I am from to access finance. It was only based on ability to pay back the facility."*

In order to improve his situation, Ahmed is now trying to build on his credit score so that in future he has access to credit to help grow his UK business.

Newly Independent

Other common factors could include a divorced individual coming out of a marriage where their spouse controlled the majority of the finances, resulting in them not having a credit footprint and sometimes even a current account of their own. This could also apply to any situation where, for one reason or another an individual lacked independence and control over their own affairs and were therefore not listed or registered with financial institutions, utilities suppliers or public and government organisations over a prolonged period of time. This could include people in long-term care, prison or those experiencing homelessness, particularly if, in the meantime, they become separated from their identity documents like a passport or driver's license.

Case Study

Since separating from her husband in the last 2 years, Julie, 51 from the East of England, has struggled to access affordable, prime financial products, due to having a poor credit rating.

Julie's poor credit rating is due to her ex-partner previously handling all of the couple's finances, including having no regular payments in and out of her current account and all household bills being in her partner's name, meaning that for an extended period of time, Julie's credit footprint was almost non-existent.

As a result, she is currently only eligible for high interest, subprime loans and related financial solutions.

The effects of this are impacting Julie's wellbeing both mentally and physically, at a time when she should be enjoying her new-found independence.

Julie explains: *"I've had no choice but to decline offers to do activities and socialise with friends and it has made me feel quite trapped and down at times, generally I'm really fed up with everything."*

Julie is now taking steps to improve her credit rating by using credit cards and other short term credit services.

"I was aware that this could happen to people, but I never thought it would happen to me," she concludes.

Long-Term Unemployed

Many people find themselves unemployed through no fault of their own, through bad luck or ill health. Losing your income over a long period could create the conditions for exclusion particularly if the person stops using credit services during their unemployment, as this will affect the traditional credit scoring process. What is more, the requirement to build up a credit score could encourage people to take high-cost debt products like an overdraft that they don't really need.

Case Study

June, 58, is unemployed. Over the past three years she has tried on numerous occasions to secure credit to help make ends meet, but has consistently been offered only the most expensive and uncompetitive lending rates, due to her poor credit score. She is therefore forced to rely heavily on cash for day-to-day transactions.

With no mortgage or loan history to show for over the past few years, and previous borrowing being too low, June believes that she was too high a risk for lenders. To help manage her finances, she even applied for an overdraft, but being unemployed at the time, it was denied.

June explains; *"Once they know I'm unemployed, they no longer consider you for additional credit facilities."*

"I fully understand the need to be able to demonstrate that I can repay debt and I totally respect that banks have to follow procedures. I'm currently looking into working from home in telesales to help change my situation."

The effects of exclusion

Financial inclusion has been shown to vastly improve both personal and economic outcomes. As well as making credit and savings products more accessible, individuals can access more affordable insurance, business accounts and loans, or a mortgage. Financially-included people are more likely to invest in education and health[16], in turn contributing to better personal outcomes. It can even influence the energy tariffs people pay – those with the poorest credit ratings will unlikely qualify for the best rates available via Direct Debit, instead being forced onto expensive, pre-paid tariffs, where they pay what has become known as a 'poverty premium'[17].

Whilst it's certainly not the case that financial exclusion and poverty are mutually exclusive, they can certainly be considered catalysts for one another. In one study, the Financial Inclusion Commission (FIC) estimated that two million people took out high-cost credit in 2012[18] as they were unable to secure any other form of credit. Another study found that 77%[19] of payday loans were used to buy food.

Being unable to access even the most basic financial tools is likely to significantly limit peoples' social mobility, preventing them from living independently, supporting themselves financially or fulfilling their ambitions in life. Many financially excluded people are simply forced through necessity into using unaffordable and unlicenced credit providers, which can open them up to additional vulnerabilities and result in a cycle of debt and credit unworthiness that becomes impossible to escape. Although, as one study[20] found, these so-called loan sharks are sometimes considered a preferable source of credit to those using them, showing just how bad their experiences of being rejected by mainstream credit must be.

Perhaps one of the more revealing aspects of this data is that it demonstrates that financial inclusion is certainly not exclusively an issue linked to poverty and social depravation. The reality is far more complex and can be driven by a multitude of situational and probably cultural factors, over and above a person's ability and willingness to repay credit.

The potentially financially excluded individuals in our study meet one or more of the applicable criteria – there's no evidence of a UK current account, no credit reference agency data or other credit history, and no derogatory data on their file. This inactivity or lack of engagement with the formal financial services could be as much to do with their disenfranchisement with a system that is not well designed to cater for them, as it is a poverty issue. It could equally be symptomatic of a lack of physical access to financial services due to geographical location and the rapidly shrinking banking and ATM network, which would account for the above average levels of exclusion in some rural UK locations.

What is increasingly apparent from studies such as this is that incumbent credit scoring methods that rely on credit history to determine someone's credit worthiness are progressively becoming obsolete in the face of an increasingly dynamic UK population in which people's lives are nuanced and complex. In a modern world that is awash with data, placing people in broad risk buckets using very limited datapoints and models that have been largely unchanged for 50 years or more is unlikely to continue being an accepted mechanism for making useful credit scoring decisions.

[16] Worldbank.org, Financial Inclusion overview

[17] Fair by Design: What is the Poverty Premium fairbydesign.com, 2021

[18] Tackling financial exclusion: A country that works for everyone? © Parliamentary copyright 2017. Contains public sector information licensed under the Open Government Licence v3.0

[19] Low savings levels put millions at financial risk, Money Advice Service, press release, September 2016

[20] P74, Hand to Mouth – the Impact of Poverty and Financial Exclusion on Adults with Multiple Needs, Ellen Pratt and Sarah Jones, April 2009

How alternative data solutions can help

Making a credit risk judgement on someone with a small credit footprint could be likened to trying to identify their face using a pixilated image. By adding data to enhance the image to a full HD quality enables you to get a much clearer picture of who they are. Traditional credit scoring methods are a bit like using pixilated images – they use a relatively narrow range of data points to build a somewhat 'grainy' risk profile of the individual. Expanding that profile using 'alternative data' – i.e. any data that's not normally used in credit risk scoring – can help to add detail, providing more clarity about who the person is and how good a customer they might be, even if they have a small or non-existent credit footprint.

Alternative data sets can incorporate a wide range of information to help build a useful risk-score picture of the individual and their propensity to repay credit – after all, we're not just defined by our address and date of birth, but by a host of factors, including our experiences, our career, our education and our qualifications, to name a few. Including data such as postcode indicators, public records, UK Land Registry data, directorship information and educational and professional accreditations can tell us much more about a person than simple identity attributes alone.

Alternative data has already been proven to successfully enhance credit scoring processes in the US, where solutions are already on the market. A 2013 study[21] showed that an alternative data solution was able to risk score as many as 87% of a group of previously unscorable consumers and that two thirds (64%) of that group proved to be profitable, low risk customers.

Using LexisNexis® RiskView™ UK – a similar alternative data-powered tool, leveraging information from more than 2 billion public and private records – to score our financially excluded population produced equally encouraging results. A staggering 77% of our financially excluded sample were able to be effectively risk scored using alternative data sets. That means potentially transformational access to fairer and more affordable financial services for as many as 5.5 million UK adults, and possibly more.

Whilst longer term analysis would be required to determine whether these individuals prove to be low-risk customers, learnings from the earlier study give promise. Achieving this would be a significant boost to millions of people in the UK, helping to protect them from the social and economic disadvantage and financial vulnerability caused by exclusion from mainstream financial services.

[21] Alternative Data and Fair Lending Whitepaper, LexisNexis Risk Solutions, 2013

To find out how LexisNexis® Risk Solutions can help, contact our team on 029 2067 8555 or email uk-irl-enquiry@lexisnexisrisk.com

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