# THE SOCIAL FUND: A NEW APPROACH

A Consultation Document
issued by the Department for Work and Pensions
November 2008

## Foreword by the Secretary of State

In these difficult times for the global economy we have a responsibility to do more to help people who are struggling to make ends meet.

It's always hard to manage on a low income. It's even harder when low income is compounded by financial exclusion. Bills are often bigger when you can't pay by direct debit, borrowing to meet an unexpected expense is dearer and you don't know where to get good advice on managing your money. All too often people end up turning to the loan sharks who prey on the most vulnerable. That's why we attach so much importance to promoting greater financial inclusion for people on low incomes and why we have been looking at reform of the Social Fund within this context.

The Government's Social Fund is a lifeline for many people on low incomes. It offers a mixture of loans and grants to help people meet unexpected costs:

- Last year, we made about 1.2 million interest free Budgeting Loans, representing over £500 million to help people meet one-off costs.
- We helped people deal with family emergencies with 1.4 million crisis loans. A further £121 million of real help at tough times.
- £139 million worth of community care grants helped hundreds of thousands of people to handle the costs of things like resettling into a community after leaving care, going to a funeral or visiting a sick relative.
- We are putting in £80 million over six years to increase the supply of affordable credit in low income communities through credit unions and Community Development Finance Institutions (CDFIs).

The Social Fund protects many against the very high interest charges they might have to pay if they obtained a loan from the commercial sector or worse still from falling into the hands of loan sharks.

However, we want to improve the help we give people at a time when many families are struggling. The Social Fund helps with money problems in the short-term, but not the underlying problems of managing a limited budget. Access to the fund is limited when someone takes a job and they must seek alternative sources of financial assistance at what can be a difficult turning point in their lives.

So we are proposing three main areas where we believe the social fund should be improved:

- We should contract with other organisations to offer credit to our customers. Instead of relying on loans from us, people would be dealing with a local organisation which, as well as providing credit, can also offer them advice and other financial services that will continue to be available after they have left benefit and returned to work.

- People needing immediate help before they qualify for their first normal payment of benefit should be offered an advance of that benefit, rather like a new employee receiving an advance of salary before the end of their first month in work. This would replace the current practice of requiring these customers to apply for crisis loans on the grounds that their health or safety was at risk

- Instead of allowing customers to receive budgeting loans after they have been on benefit for six months, or crisis loans in an emergency, we are suggesting a single credit facility which people can turn to as soon as they claim benefit. A single loans system could also cater for some of the needs now met by community care grants. We want to look at how community care grants might be focused more clearly on our vulnerable customers.

Taken together these measures will offer real help to hard pressed families.

**James Purnell**

**Secretary of State for Work and Pensions**

# 1. Financial Inclusion

It is hard to live successfully in modern society without access to financial services like credit, savings, a bank account or money advice. Exclusion from these services creates barriers and costs that particularly affect those with the lowest incomes. It is harder to get a job without a bank account to receive wages; utility bills are higher for those unable to take advantage of the discounted rates often available to those paying by Direct Debit; and where people cannot borrow from mainstream lenders they may only be able to access credit at an unsustainably high cost.

1.1 In December 2007 the Government published *Financial Inclusion: an action plan for 2008-11*, which set out how the Government will use the £130 million Financial Inclusion Fund for 2008-11. The action plan features a range of measures to help people manage their money on a day-to-day basis, plan for the future and cope with financial pressure or financial distress. These measures include continuing to invest in free debt advice services and third sector affordable credit providers, and a series of specific initiatives designed to expand access to a full range of financial services.

1.2 DWP has already taken a number of steps to promote financial inclusion:

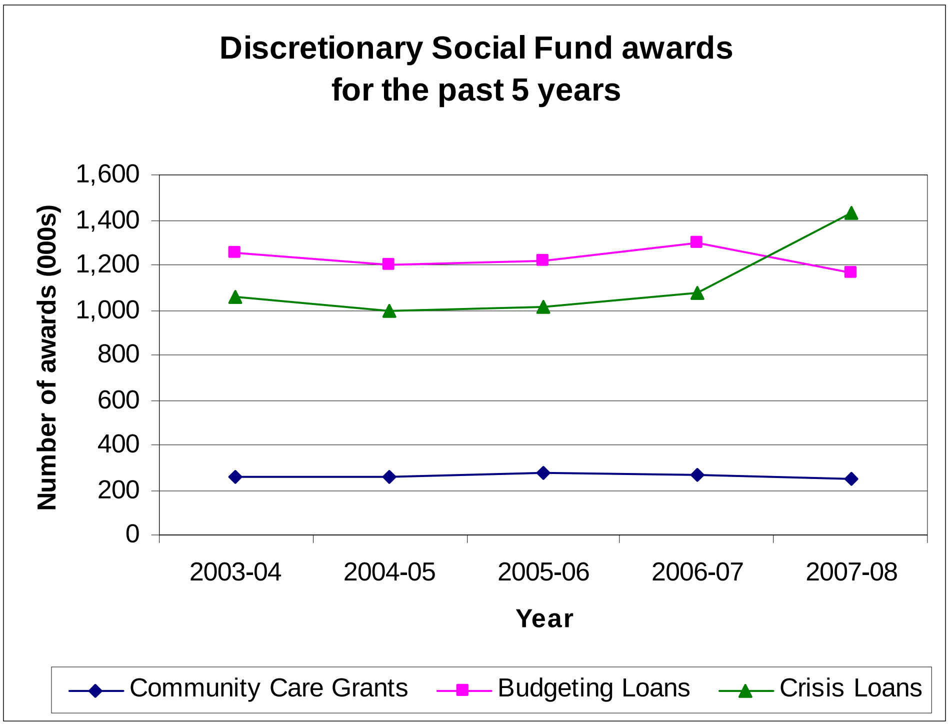
- In December 2006, we set up the Eligible Loans Deduction Scheme as part of the Government's Financial Inclusion Strategy. It provides that a deduction can be made from certain benefits where the beneficiary defaults on a third sector loan. The aim is to contribute to the spread of affordable credit by reducing the risk to lenders of making loans to people in low-income groups.

- We established the Growth Fund of £80 million over the six years from 2006 to 2011, making affordable credit available to thousands of excluded people, through over 150 credit union and community development finance institution (CDFI) outlets across Great Britain. By the end of October 2008, more than 106,000 loans had been made with a total value of almost £47 million. The Growth Fund is increasing the number of credit unions offering full banking services to excluded people. 10 credit unions already provide the service in Great Britain, and a further 11 will get the Growth Fund investment required to introduce it during 2008/09. HM Treasury has carried out consultation on proposals for a Legislative Reform Order (LRO) for Credit Unions and Industrial & Provident Societies and is proposing to introduce legislation. Among the LRO proposals are replacing the "common bond" requirement for Credit Unions with a "field of membership" test; allowing them to admit bodies corporate, unincorporated associations or partnerships to their membership. This is aimed at allowing them to extend membership to organisations such as community groups who can save with them, thus increasing their lending capital. Another proposal is allowing Credit Unions to offer interest on deposits provided certain conditions are met.

1.3 This document explains how we now propose to build on these initiatives through reform of the Social Fund.

## 2. Role of Social Fund

2.1 The discretionary Social Fund is a cash limited system of one-off payments, mainly to people receiving Pension Credit, Income Support, income related Employment and Support Allowance or income-based Jobseeker's Allowance - although Crisis Loans are available to anyone, on benefit or not, without the resources to meet their immediate, urgent needs. In 2007-08 over 4 million applications for a discretionary payment were received and almost 3 million payments worth over £770 million made. The graph illustrates the changes in the number of awards over the last five years. It shows a sharp rise in Crisis Loans awards in the last two years.




There are three types of payment:

**Community Care Grants** To help vulnerable people live as independent a life as possible in the community or to relieve exceptional pressure on families. Decisions take into account individual circumstances and needs. Generally, only the highest of priority needs are met. The main users are disabled people and lone parents.

**Interest free Budgeting Loans** To help people who have been on a qualifying benefit for at least 26 weeks spread the cost of routine lump sum expenses, like replacing a cooker or a bed.

**Interest free Crisis Loans** Available to anyone suffering an emergency or disaster where payment of a crisis loan is the only means of avoiding a risk to health and safety. Payments can be made for immediate living expenses or essential items. Decisions are discretionary. Crisis loans for living expenses are applied for by phone and payment generally made the same day. The table below illustrates the level of help Social Fund provides.

| Social Fund 2007/08 | CCGs | Budgeting loans | Crisis loans |
|---|---|---|---|
| Applications (000) | 543 | 1,552 | 2,105 |
| Awards (000) | 247 | 1,168 | 1,431 |
| Gross Expenditure £m | 139 | 511 | 121 |
| Average award £ | 458 | 433 | 82 |

2.2 The social fund plays an important role in providing accessible credit for people on income-related benefits. The cover it provides is substantial, but it is by no means the major player in lending to people on low incomes. Other credit providers in this sector include credit unions and home credit providers. *Home credit* refers to the supply of small loans, usually between £50 and £500, repayments for which are collected, usually in weekly instalments, from the customer's home.

2.3 The social fund provides credit free of interest charges; credit unions typically charge interest at rates varying from 12.68% to 26.8% APR; while home credit companies can charge interest as high as 246.5% APR. We would like to expand access to affordable loans. As explained in section one, there are several initiatives in hand to do this. However, we would also like to build on the social fund as a further step in this direction.

2.4 In its present form the social fund is limited in scope as a basis on which to expand help for the financially excluded. It has several drawbacks:

- It only offers credit to those out of work.
- It is too passive, offering loans in times of trouble but no advice on how to manage money
- It does not offer an account or the means to save money

We want to link social fund customers to a wider, more active set of financial services. We propose doing so by working in partnership with those organisations, such as credit unions, that already work to provide these services to people on low incomes.

# 3. Proposals for Reform

## Partnership with third sector

3.1 We have studied the feasibility of contracting out social fund loans nationally to a financial provider who could link them with other services, including advice on managing money on a low budget. The Social Fund Reform Feasibility Study - undertaken earlier this year by KPMG Financial Services (final report is now available on the DWP website) - concluded there was no suitable national partner in the current economic climate. We remain convinced, however, that the best route to better financial inclusion for social fund customers lies in access to a wider range of services than credit alone. Affordable loans should be more widely available on a basis that does not provide more preferential treatment to a person on benefit than in work.

3.2 As explained in section 1, we are already building capacity in the third sector and we are interested in how we might work more closely with Credit Unions, CDFIs or other providers - either individually or in partnership - to deliver the financial services and advice our customers need. This part of the financial sector is very experienced in helping people on low incomes and has proved successful in giving them a sound financial basis upon which to progress. Although we accept that they are not yet able to provide national coverage, that need not be a bar to our working with them to offer financial services to our customers in those areas where particular credit unions have achieved sufficient size and security to deal with a large number of clients.

3.3 **We are therefore seeking views** on the merits of taking legislative powers to allow some credit unions, and similar organisations from the third sector, to take over the provision of credit to social fund customers in their areas. As well as offering affordable loans, our new partners could also offer a range of other services, such as savings accounts and financial advice, under contract to DWP. To fund the cost of these extra services, we are proposing that the credit offered under these arrangements could attract an interest charge of 1 - 2% per month - the same criterion which applies to Credit Unions.

3.4 The benefits of the proposed reform would be:

- access to a wider range of financial services for those on the lowest incomes which would not end when they found work and improved their circumstances;

- Financial and budgeting advice provided by people who have a wealth of experience in offering this type of support;

- a further stimulus to the growth of the third sector through working with a new group of customers in partnership with government.

3.5 There are risks associated with lending money to those who are hard pressed to manage on a small budget. To reduce these risks substantially, we would offer our external partners the facility of recovering any money lent under the proposed reform by deductions from their clients' benefit payments. Over 90 % of social fund loans are recovered in this way. Moreover, unlike the Eligible Loans Deduction Scheme, credit unions would be able to use this facility as soon as the loan had been made, rather than waiting until the borrower defaulted on repayments. In using the proposed powers, we would take especial care to ensure our most vulnerable customers do not lose out. The aim of this reform is to use existing resources to provide a better deal for financially excluded people. There is no question of reducing the amount of credit available."

3.6 We are anxious to make speedy progress, including making legislative changes at the earliest opportunity, to improve the help we provide for our customers. We know that many families are struggling and understand how important it is for them to have improved access to credit and financial advice. This is why we are seeking your views over a shorter period than we would normally allow. We will continue to discuss the detail of how these powers might be used in the coming months.

**Reforming the Current Social Fund**

3.7 It will take time before all our social fund customers could access the wider services described above. For them, we will maintain a credit service but in a more modern form. We are looking at the possible introduction of some immediate, short term administrative changes to the current social fund that will improve its efficiency. In addition there are several more significant changes on which we wish to consult.

a) **Advance Payments of Benefit**

Almost 50% of crisis loans are paid to customers at the start of their benefit claim and before their first full payment of benefit can be made. While we remain of the view that benefits, like wages, should be paid in arrears, we recognise that some customers find themselves facing hardship while waiting for their payment of normal benefit to begin. Currently, our customers who need financial help at this point have to apply for a crisis loan. We are looking at alternative ways of helping people at this point and are considering the possibility of introducing a new system of advance payments of benefits, whereby those at risk of hardship could receive 75% of their normal benefit immediately. The advance would then be recovered in 6 instalments once continuing benefit payments had started. Some advance payments would be available before all the normal checks to verify benefit entitlement had been completed but would not replace the need for these checks.

The advantages of introducing advance payments would be:

- to provide immediate help to those who need it in a more efficient, cost effective way
- Customers would not have to make a separate application for a crisis loan

b) **Extended loans scheme : Refocused grants scheme**

The present payment arrangements are confusing. Our customers can apply for crisis loans and community care grants as soon as they start to receive benefit. But they cannot receive budgeting loans until they have been on benefit for six months.

Many of our customers use both loan schemes although the two schemes have different qualifying criteria, work within different lending limits and are accessed in different ways We think there is considerable merit in a single credit scheme which would be available from day one on benefit though the credit limits in the first six months would be lower than those applicable after six months. In essence this means that customers would have an overdraft facility, avoiding the need for intrusive questioning about the nature of their needs and they would have more certainty that a payment would be made. The simpler rules would also lead to faster decision-making on applications **We would welcome views** on having a single loans scheme available as soon as a customer becomes eligible for a qualifying benefit.

We want to retain a grant scheme for the most pressing and urgent needs where it is obvious that a grant is the most appropriate payment and we would welcome views on the sort of circumstances that might be covered. The advantage of a clearer, better focused scheme would be to give our customers greater certainty that they will receive a payment. Under the current grants scheme we know that payment does not always go to the right people at the right time. We feel it would be more appropriate for some of the grants we currently provide, for example for replacement items, to be met from the new loans scheme. **We would welcome views** on the types of need that should be catered for in a more focused grants scheme.

## 4. Impact Assessment

4.1 See Annex

## 5. Responses

5.1 Responses should be sent to,
Social Fund Team,
Department for Work and Pensions,

1st floor,
Caxton House,
Tothill Street,
London SW1H 9NA.

Or by email to social.fund@dwp.gsi.gov.uk by Tuesday 23 December.

For further copies or copies in accessible formats, please contact our email address.

We may wish to publish a list of people and organisations who respond to this document. If you do not wish to be included in such a list, please include a statement to that effect in your response.

Annex

## SOCIAL FUND REFORM: IMPACT ASSESSMENT

### What is the proposal under consideration

The Consultation paper sets out our proposal to work in partnership with Credit Unions and other organisations from the third sector delivering financial services to people on low income, in new arrangements for a reformed social fund loans scheme.

### Why reform is needed

The social fund is currently available to people on certain income-related benefits in the form of interest free budgeting loans. There is very limited access for people not on qualifying benefits through crisis loans in the event of an emergency or crisis.

The system is complex. However applications for crisis loans have risen sharply in the last two years since Jobcentre Plus introduced an improved telephone based service using a free phone number. Budgeting loans do not do enough to help people make provision for the future. Both forms of loans are made on demand with no incentive or support to help people manage their finances better and do not address people’s needs on return to work.

The main beneficiaries of budgeting loans are disabled people and lone parents. The main beneficiaries of crisis loans – which are rising – are the unemployed. See table below.

**DISCRETIONARY GRANTS AND LOANS**

**GROSS EXPENDITURE BY APPLICANT GROUP 2007-08**

| Applicant Group | Budgeting Loans | | Crisis Loans | |
|---|---|---|---|---|
| | Amount £m | % of Total Amount | Amount £m | % of Total Amount |
| **Pensioners** | 32.3 | 6.3 | 1.7 | 1.4 |
| **Unemployed** | 42.2 | 8.3 | 48.4 | 39.9 |
| **Disabled** | 146.5 | 28.7 | 26.7 | 22.0 |
| **Lone Parents** | 258.4 | 50.6 | 25.1 | 20.7 |
| **Others** | 31.6 | 6.2 | 19.4 | 16.0 |

NOTES:

1. This table includes awards on review.
2. Figures and percentages may not sum due to rounding.

**Options considered**

A simplified loans scheme delivered under contract to DWP by a partner from the third or private sector. It would start off on a partial basis where there was a suitable participating partner but the aim over time would be for national coverage. The scheme would be designed to give access to other financial services, including financial advice. It would pave the way to fuller financial inclusion and help people manage their finances better whilst making credit more accessible in a less intrusive way than now at affordable rates.

Interest would be charged in return for these services but this would be at affordable rates compared to those charged by commercial lenders in the same market. We propose to set it at the maximum charged by Credit Unions of 2% per month (26.8% APR).

Building on the eligible loans deductions scheme, DWP would continue to make deductions from benefit in order to keep the cost of lending down for participating lenders from the third, not-for-profit sector.

These arrangements will benefit the groups who currently use the social fund loans scheme and make for a smoother transition on returning to work

**Impact of charging interest**

In 2007-08 the average initial budgeting loan award was £433.30. The estimated average loan repayment for all loans was £10.54 a week. If interest were charged at 2% a month it would take 46 weeks instead of 42 to repay such a loan at such a repayment rate with a total interest paid of £47.80.