CarnegieUK TRUST
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ADVANCING AFFORDABLE CREDIT

February 2021

Definition of terms: When referring to 'affordable credit providers' we are referring to not-for-profit providers of credit, specifically Credit Unions and personal lending Community Development Finance Institutions. We use the term 'affordable credit sector' and 'community finance sector' interchangeably throughout the report.

Background

The credit poverty premium

Most people in Scotland will need to borrow money at some stage in their life. This could be to deal with an unexpected bill, to manage changes in income, or to help support a large purchase. For most people, borrowing money is relatively straightforward and affordable, through mainstream financial products such as mortgages, bank loans, credit cards or overdrafts.

Credit is not, however, equally available to everyone in Scotland. For decades, those on the lowest incomes have been denied access to mainstream credit and have been unable to borrow money to meet their needs in the same way as others. Limited income, poor or thin credit history and a lack of take-up of other financial products, including bank accounts, are factors that contribute to this exclusion.

This lack of access does not mean that those who are excluded do not need to borrow on occasion. What it means is that those unable to access mainstream credit have instead, for many years, had to rely on high-cost alternatives such as payday loans, doorstep or logbook lending and rent-to-own stores. The result is that the people in Scotland who have the least money end up paying the most for credit. We have previously estimated that 150,000 people in Scotland borrow £250 million from high-cost lending markets every year, with a significant financial premium in interest payments attached.[1] This poverty premium compounds financial inequality and social exclusion; drains money from household budgets and from local communities; and contributes to significant mental health concerns including anxiety and stress.

A further breakdown of credit patterns in Scotland is provided for information in Appendix 1.

[1] https://www.carnegieuktrust.org.uk/news/scotlands-poorest-families-set-to-benefit-from-investment-to-tackle-high-cost-credit/

Taking action

Scotland has a range of not-for-profit providers of affordable credit[2], who aim to serve those excluded from mainstream financial markets. In particular, there are more than 80 credit unions and a small number of Community Development Finance Institutions (CDFI) across Scotland, all providing cheaper credit than commercial high-cost providers, plus offering a range of other support, such as debt advice, income maximisation, savings opportunities and access to basic bank accounts. Taking a £500 credit union loan instead of a high-cost loan could save someone up to £393 over a 12-month period.[3] Taking a CDFI loan could generate savings of over £280.[4] However the number of people reached by this ethical, affordable credit sector remains a fraction of the potential number of beneficiaries it could serve and it is dwarfed by the commercial high cost credit market.

The question of how to make this type of more affordable credit much more widely available to those who need it has long been a complex and contested public policy issue. We have seen significant positive progress on this agenda in in recent years in Scotland, and in other parts of the UK. Most notably, credit has increasingly been recognised as an issue of strategic importance to tackling poverty in Scotland, via its inclusion in the Fairer Scotland Action Plan and the Tackling Child Poverty Delivery Plan, and in a number of local child poverty action reports. Practically, the affordable credit sector has received support through the Scottish Government's £10 million Credit Union Investment Fund and the £2 million Affordable Credit Loan Fund (backed by both the Scottish Government and the Carnegie UK Trust). During the COVID-19 pandemic, 21 credit unions also received funding from the Scottish Government's Third Sector Resilience Fund.

However, this is a complex, long-standing and deep-rooted issue and there remains much to do if long-term change, at scale, is to be achieved. There is now an opportunity to build on the progress that has been made to date and imagine a different landscape for the provision of credit in Scotland, as part of the country's journey to build back better from COVID-19.

The recommendations in this paper

As part of the September 2020 Programme for Government, the Scottish Government asked the Carnegie UK Trust and the Affordable Credit Action Group to consider what more could be done to bolster affordable credit provision in Scotland and to explore alternative sources of help such as housing associations or employers.

To underpin this work the Trust held a series of three workshops, plus a dedicated session with the Affordable Credit Action Group. All sessions were chaired by Chair of the Action Group, the Very Reverend Dr John Chalmers. In total more than 40 different organisations took part in the

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[2] We use the terms 'affordable credit' and 'community finance' interchangeably throughout the paper to describe this sector.

[3] A £500 credit union loan at 42.6% APR would cost £603, a £500 loan from Satsuma at 315.7% APR would cost £996. Further details in Appendix 2.

[4] A £500 loan from Conduit Scotland at 99.8% APR would cost £713, a £500 loan from Satsuma at 315.7% APR would cost £996.

sessions, to consider proposals for action. In each workshop a set of emerging recommendations, developed by the Carnegie UK Trust, were presented and the background rationale explained, followed by breakout discussion sessions in smaller groups. A list of organisations attending the workshops, or the Action Group discussion, is listed in Appendix 3.

As the Scottish Government assesses the recommendations set out in this paper, we would encourage consideration of the following points:

- **Advancing affordable credit is a complex, deep-rooted challenge. Commitment, innovation and investment over a number of years will be required if change at-scale is to be achieved**. There is no 'silver bullet' solution, but a rather a series of complementary interventions that are needed, across different parts of the system. The recommendations in this paper aim to advance a number of such interventions. They seek to provide a package of work to build on progress to date; and are intended to initiate further technical, strategic and systemic changes that will continue advancing this important agenda.

- **Many of these recommendations are in sync with proposals advanced recently by the Woolard Review[5] and by the Money and Pensions Service (MaPS).** In October 2020, the report by the Challenge Chairs, who advise MaPS on the UK Strategy for Financial Wellbeing, put forward recommendations on building the UK's financial wellbeing in the light of Covid-19[6] and specific recommendations for Scotland[7] which Carnegie UK Trust staff were involved in. We are aware that the Scottish Government is already working with MaPS on the advancement of this activity and we would encourage the Government to bring together that work and the recommendations in this report, as part of a joined-up plan for advancing affordable credit activity in Scotland.

- **The current state of the affordable credit sector may not be its future state. The impact of 2020 has focussed the mind on the structures, functions, relevance and sustainability of community finance.** Legitimate questions are raised from the way lending is determined and delivered; relationship (bricks and mortar) versus transactional (digital); the borrower / member demographic; the type of infrastructure and communications that are required; and the precarious nature of consumption, lending and recovery. The borrowing requirements of modern consumers will change, accelerating certain requirements and reducing others. The "new normal" considerations apply to community finance as pertinently as they apply to any industry or sector. The critical question for public policy is to consider what type of interventions are required to support a sustainable, at scale affordable credit sector in this new landscape.

- **There are a number of interdependencies and relationships between the different recommendations**. For example, some affordable credit providers need investment in order to have capital to lend to customers. Providers also need investment to develop their

[5] https://www.fca.org.uk/publication/corporate/woolard-review-report.pdf
[6] https://moneyandpensionsservice.org.uk/wp-content/uploads/2020/11/Building-the-UKs-financial-wellbeing-in-the-light-of-Covid-19-MaPS-response.pdf
[7] https://moneyandpensionsservice.org.uk/wp-content/uploads/2020/11/Building-Scotlands-financial-wellbeing-after-Covid-19.pdf

organisational infrastructure (IT, staffing, etc), to provide a good quality service and to become more efficient and effective, ultimately reducing costs and improving outcomes for customers. Advertising is required to let people know that these services are available and are significantly better than the alternatives they might be faced with (such as payday lending, home credit or rent to own). This advertising is reinforced if augmented with positive messaging and clear signposting from trusted third parties such as social landlords or employers. Growing demand then leads to a need for more investment, to enable more people to access the services, generating a virtuous circle of growth, with more people receiving support.

- **The report looks across the not-for-profit affordable credit sector in Scotland as a whole. However, it is important to recognise that it is far from a homogenous set of organisations who comprise this sector**. Most notably, there are significant differences between credit unions and personal lending CDFIs, in terms of their purpose, structure, customer base and development needs. There are also differences between individual credit unions and between individual CDFIs. The recommendations in this report are focused on supporting the growth of provision of both credit unions and CDFIs, so that they can serve many more people. The recommendations are therefore most likely to apply to the parts of the sector that wish, and are able to, go on a journey to sustainable growth.

- **In the workshops we held to inform our work, the recommendations received a positive reception, with most feedback focused on ideas for refining and strengthening the initiatives rather than identifying major issues or gaps**. We recognise that some stakeholders may prefer a different emphasis or accent in certain areas, or they may diverge from our position on the actions to arrive at the desired outcome. We believe these are marginal distinctions, but obviously some views will not be as represented as others. We have developed our paper through conversations with informed opinion from our Affordable Credit Action Group and colleagues working in the field and in related professions. Ultimately, this paper represents the views of the Carnegie UK Trust.

- **The nature of this project and the timescales involved means that some recommendations are naturally more developed than others**. We hope that the ideas set out here give the Scottish Government a solid platform to inform its future actions.

The impact of COVID-19

It is important to set the recommendations in the context of the COVID-19 crisis, which has exposed the fragility of the financial resilience of many households across the UK and has placed considerable pressure on the community finance sector.

The Resolution Foundation has tracked the effects of the pandemic on household incomes. In 2020 they reported that:

- 38 per cent of adults in the top income quintile have experienced no income hit alongside a reduction in spending – implying a strengthening of the household finances – compared to just 12 per cent of those in the bottom quintile.[8]
- Housing conditions have had a stronger independent effect on well-being during the pandemic than prior. Even after controlling for key characteristics such as pay and relationship status, the well-being gap between renters and owners has widened over the lockdown period.[9]
- During the Summer and Autumn 2020, families with children estimated to be in the lowest pre-pandemic income quintile were twice as likely to report an increase in spending (36 per cent) than a decrease (18 per cent).[10]

The pandemic has also been a challenging time for credit unions and CDFIs across the UK. A survey of more than 60 affordable credit providers published by Carnegie UK Trust last year showed that providers were experiencing:

- a decline in total loan values issued;
- a reduction in the size of loans being sought;
- a rise in the number of customers seeking payment holidays on their loans; and
- an increase in saving deposits.

Providers have furloughed staff and closed branches to help them deal with the impact of the pandemic. Some have adapted their business models, increasing the use of digital tools and introducing new products.[11]

There are a range of reasons behind the drop in credit issuance seen through 2020. Positively, it may be because people have had support through other channels set up in response to the pandemic, such as the Job Retention Scheme or an interest free overdraft. There have also been fewer opportunities for consumption during the crisis. Bank of England data indicates in that there were negative consumer credit figures in seven separate months in 2020[12], and ten negative credit card months indicating a paying down of debt. Before 2020, the last month in which a negative consumer credit figure was returned was in back in November 2012.

Conversely, the Resolution Foundation reported in January 2021 that whilst average household spending has fallen during the Covid-19 pandemic, driven by lower expenditure on leisure activities, meals out, holidays and commuting costs, this overall spending fall (and commensurate rise in saving) does not reflect the experience of all households. They highlight that families with high pre-pandemic incomes were much more likely to have seen spending fall and rates of saving rise during 2020 than those on lower pre-pandemic incomes. Likewise,

[8] https://www.resolutionfoundation.org/publications/return-to-spender/
[9] https://www.resolutionfoundation.org/publications/lockdown-living/
[10] https://www.resolutionfoundation.org/app/uploads/2021/01/Pandemic-pressures.pdf
[11] https://www.carnegieuktrust.org.uk/publications/fear-and-loaning/
[12]https://www.bankofengland.co.uk/boeapps/database/fromshowcolumns.asp?Travel=NIxSUx&FromSeries=1&ToSeries=50&DAT=RNG&FD=1&FM=Jan&FY=2011&TD=1&TM=Feb&TY=2021&FNY=&CSVF=TT&html.x=106&html.y=34&C=O0Q&C=1I2&Filter=N

more than half of adults in families from the lowest income quintile have borrowed more to cover everyday costs since the pandemic began, while those that entered the crisis with low savings have been the most likely to have run those down during 2020.[13] As many commentators have reported "*We are all in the same storm, but we are not all in the same boat.*"

Some people may not have sought a loan from an affordable credit provider because their financial position has worsened and they may have had to take other action, such as borrowing from family and friends or going without an important purchase. The nature of the different stages of lockdown has also meant that for considerable periods of time affordable providers have been unable to offer face-to-face services – the core delivery channel for many – meaning that it has been significantly more difficult for customers to access their services. This is compounded by the under-developed digital platforms in the affordable credit sector; and by the relatively high levels of digital exclusion experienced by those who use affordable credit or could potentially benefit from access to it.

As the financial support interventions introduced in response to COVID-19 eventually taper off and unemployment rises further, household finances will come under even greater pressures. Affordable credit providers could have a crucial role to play in supporting people through this prolonged period of economic distress. It is therefore essential that the affordable credit sector is itself supported to sustain and scale during this challenging period, so that it can support households and communities in the months ahead.

Finally, it should be noted that the COVID-19 pandemic has changed ways of working for many organisations, allowing for a greater degree of flexibility and the ability to deliver services differently. For example, the pandemic has shown that local authorities have the functionality to move payment dates for Council Tax or offer more flexibility in payment schedules. There is a real opportunity to build on the flexibility shown during the pandemic and make positive changes that were previously unimaginable.

[13] https://www.resolutionfoundation.org/app/uploads/2021/01/Pandemic-pressures.pdf

The recommendations

We make the following 10 recommendations to the Scottish Government:

1. Establish a new partnership between Scottish Government and Fair4All Finance to improve the supporting infrastructure for affordable credit growth in Scotland.
2. Develop and deliver a 12-month marketing and promotional strategy to bring a step change in the visibility and validity of community finance in Scotland.
3. Commission an in-depth feasibility study on options to deliver improvements in the technology infrastructure and use of data in affordable credit supply in Scotland.
4. Strengthen the commitment to financial wellbeing through key interventions with Scotland's business community, including Fair Work First and the Scottish Business Pledge.
5. Boost the take up of Help to Save and Prize Linked Savings schemes.
6. Establish a short-term working group with social landlords and affordable credit providers to agree an action plan to strengthen links between the two sectors.
7. Establish a Community Finance Strategic Support Fund that supports community finance to consider their future operational state.
8. Establish a short-term working group to report to the Minister on the feasibility, costs and benefits of a social enterprise digital debt collection and arrears management social enterprise.
9. Undertake a trial of rent-flex for social housing tenants and encourage flexibility in Council Tax payments to support households with irregular income.
10. Commission new research into the prevalence of online illegal money lending in Scotland.

Recommendation 1: Establish a new partnership between Scottish Government and Fair4All Finance to improve the supporting infrastructure for affordable credit growth in Scotland.

Why is this needed?

As set out in the introduction to this paper, the question of how to grow the provision of affordable credit to reach many more people is a long-standing challenge. However, it is well understood that achieving very significant growth in the reach of credit unions and CDFIs, to build a sector delivering at scale, via sustainable operational models, will require substantial investment, innovation and expertise over a number of years. This proposal aims to seize on a unique opportunity to put in place the supporting infrastructure to help deliver such a change in Scotland.

Fair4All Finance was founded in 2019 with £55 million of funds from dormant assets money to increase access to fair and affordable financial products and services, with a particular focus on credit. In May 2020, an additional £41 million of dormant assets monies were allocated to Fair4All Finance to advance its mission. In the coming year Fair4All Finance expects to leverage a further £40 million from UK financial services providers to invest in affordable credit providers, alongside its dormant assets monies.

However, as the core funding held by Fair4All Finance all comes from the Dormant Assets Scheme, the organisation is currently only able to support affordable credit providers that predominantly serve people in England.

In our view the scale of resources available to Fair4All Finance; the additional funding that it is able to leverage; and the expertise that it has been able to attract to its team, provides a unique opportunity to realise the type of at scale, sustainable growth in affordable credit that is required. At present there is a risk that Scotland could miss out on these opportunities, including the additionally leveraged funds from financial service providers. This ultimately could result in people in Scotland having fewer affordable credit options than those elsewhere in the UK.

Fair4All Finance combines financial support with capability development to build capacity in the affordable credit sector. They have identified five challenges facing affordable credit providers and have a dedicated team to pursue changes to collectively scale and improve the services offered by the sector. These challenges are identified as:

- Systems change and impact
- Funding, finance & investment
- Operational excellence & capability
- Governance, leadership & talent
- Markets, consumer insights & product design

From our own work in the affordable credit field over many years, we would agree that these are the appropriate priorities that require focus and attention within the affordable credit sector.

Fair4All Finance are addressing the challenges with comprehensive due diligence work and are recommending and supporting a range of significant improvements to structures within community finance providers. This includes advice and/or investments in providers' IT, marketing, sales, fintech, and cyber security operations. Fair4All Finance are providing financial support via grant and equity investments to assist those affordable lenders which demonstrate the greatest appetite, ambition, and skills to reach higher standards. This will propel the sector to greater volumes and increased sustainability, with the eventual outcome of more low-income households receiving access to affordable credit.

In Scotland, whilst the five broad Fair4All Finance themes may be addressed in certain areas, under certain programmes, they are not embedded with the conditionality, expertise and discipline that Fair4All Finance brings; a rounded programme of activity that we think providers in Scotland would benefit from.

The two main beneficiaries of significant equity investment in Fair4All Finance's Phase 1 Investment in 2020 were CDFIs: Moneyline-UK (received c.£7million of investment), and Fair for You (received c.£5 million of investment). Both operate across national borders, and Fair for You currently lend in all 32 local authorities in Scotland.[14]

These are firms that are likely to expand in the future, leveraging the new equity on their balance sheets to attract commercial debt loans for on-lending. As currently configured, their expansion is likely to focus on England as the restrictions on their source of equity funds necessarily impinge on their ability to expand in Scotland.

Actions proposed

We propose that the Scottish Government should open discussions with Fair4All Finance with the aim establishing:

a) A formal relationship that will enable affordable credit providers in Scotland to access the additional resources of expertise, assessment, research insight and investment available through Fair4All Finance

b) A discrete Scotland-fund as part of the overall Fair4All Finance framework, to match the investment already taking place in England

The relationship with Fair4All Finance should be developed on the basis of adding value to the work of organisations already operating in Scotland. It should not seek to duplicate or displace this activity.

[14] Moneyline 43% outside England (Information provided by CEO, October 2020), Fair for You 23% outside England (information from Fair4All Finance MI – shared subject to restrictions)

Fair4All Finance would welcome the opportunity to extend their support into other nations. Preliminary discussions with the CEO and Executive Chair of Fair4All Finance around this proposal has elicited their support. They have indicated that they could consider different options for a partnership to enable them to work in Scotland, including for example, funds being held by a Scottish institution on behalf of Fair4All Finance. They have indicated that an investment of approximately £10 million, over a period of approximately 4-5 years, to support the supply of affordable credit in Scotland would provide a per capita equivalent to the investments that they are making in England.

If Scotland developed the closer connection with Fair4All Finance that we recommend, then:

- Community finance lenders that currently operate within one nation only could extend to others, potentially bringing valuable economies of scale in a small sector.
- Community finance lenders in Scotland currently unable to access Fair4All will be able to get access to funds, resources, expertise, and guidance provided they meet the Fair4All threshold. This threshold includes being an asset locked organisation; being mission driven; paying the living wage; and demonstrating commitment to social impact by supporting individuals and communities experiencing. The lenders they work with must be committed to scaling up and have a starting point of a loan book of £2 million (although there are examples of investees where the loan book was under this sum, but they had otherwise convinced Fair4All of their ambition to scale).
- Community finance lenders that currently do not operate in Scotland and are not minded to do so whilst the funding supports prioritise England, will be unencumbered and can choose to operate in Scotland.
- Credit Unions in Scotland will be able to access the additional range of support to enhance and develop their infrastructure, marketing, IT and collections processes. Accessing this support will produce better outcomes with employers, for example, which in turn, will improve the sector’s sustainability.

Recommendation 2: Develop and deliver a 12-month marketing and promotional strategy to bring a step change in the visibility of community finance in Scotland

Why is this needed?

Affordable credit providers in Scotland are highly valued by those who use them. But they are (largely) small operations, with very limited marketing budgets and they face significant barriers in reaching all those in Scotland who may benefit from their services.

Credit Union membership in Scotland is 8% of the adult population, around 370,000 adults. In 2019 c.115,000 members had borrowing of c.£363 million and the membership held deposits in shares of c.£581million. There are principally three other community development finance institutions (CDFIs) providing affordable loans in Scotland – Scotcash, Five Lamps (trading as Conduit Scotland) and Fair for You. Between them, they issue approximately £4 million a year of affordable loans in Scotland. Fair for You has provided goods to households in all 32 local authorities in Scotland.

Brand recognition and perception has held back the development of the affordable credit sector for many years. In 2012, the DWP reported very low levels of credit union knowledge among low-income consumers: "…*of 4,500 low-income consumers contacted, more than 60% wanted the type of local, trusted service that credit unions provide. The challenge is, however, that only 13% are currently aware of the services credit unions provide.*"[15]

Limited investment in marketing in the affordable credit sector contributes to this low level of awareness amongst potential beneficiaries. At the height of the payday lending curve in 2013, with over 10 million loans issued annually worth £2.5 billion, Britain's top five payday lending brands spent £36.3million a year on advertising[16]. By way of contrast Scotcash, the personal lending CDFI in Glasgow spent just £26,000 on advertising in 2019, representing 1.8% of its administrative spend[17]. It had a loan book of £1.3m. Right Way Credit Union located in Paisley with around 5,000 members holds nearly £4m in savings and around £2m in loans spent <1% of its expenditure on marketing in 2020. The CMO Spend Survey 2019–2020 would infer that both of these amounts are considerably lower than required if the affordable sector wants to draw from the largest company expectations on marketing spend:

Table 1 - Budget allocations and expectations North America and the UK, 2019 and 2020

	B2B Services	**B2B Manufacturing**	**B2C Direct Sales**	**B2C Indirect Sales**	**Even Mix of B2B and B2C**

[15] DWP Credit Union Expansion Project Steering Committee Feasibility Study Report: May 2012. https://webarchive.nationalarchives.gov.uk/20130125113612/http://www.dwp.gov.uk/docs/credit-union-feasibility-study-report.pdf
[16] https://www.thisismoney.co.uk/money/news/article-2409676/Wonga-sees-profits-soar-36-63m-massive-advertising-splurge.html
[17] Scotcash Financial Statements 31st March 2019

Marketing budget current year (2019)	10.0%	10.4%	10.4%	10.9%	10.9%

While affordable lenders cannot realistically compete with the size of mainstream advertising budgets, neither can the sector continue to rely predominantly on word-of-mouth referrals if it is to grow as we wish, to benefit a significant number of additional people in Scotland.

Alongside the issue of visibility of affordable credit suppliers there is a need to tackle a perception in some quarters that credit is not an appropriate intervention to meet consumption needs for certain groups. This view is prevalent even where credit is delivered by affordable, not-for-profit providers charging significantly lower rates than the high-cost alternatives.

We agree that affordable credit is not a substitute for decent welfare benefits and decent wages and must fit within wider anti-poverty work (as the Scottish Government has sought to do through its Fairer Scotland Action Plan and Tackling Child Poverty Delivery Plan). However, the stark reality is that most people *do* need to borrow money on occasion for the reasons set out in the introduction to this paper. If affordable credit supply is restricted because of a reluctance to accept it as part of an anti-poverty solution then the outcome is not that people do not borrow money; it is that they instead they borrow from other, more expensive, less desirable sources, which charge higher interest rates and which don't offer the range of other financial inclusion services that affordable credit firms provide.

In a 2018 report for Carnegie which interviewed 80 former payday loan borrowers, 40 of whom were in Glasgow, the researchers sought information on what action the borrower took after no longer being able to access the payday loan market, as lenders in that market changed their practices. Most still sought credit, with the majority utilising friends and family and trying to access other high-cost lenders. Despite Glasgow having, at that time, over 30 credit unions and 1 CDFI the researchers highlighted that:

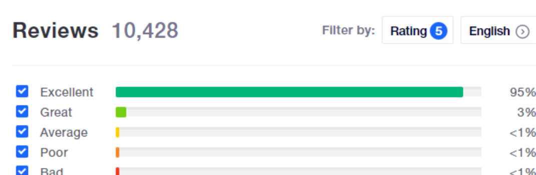
"*…interviewees had very limited knowledge of alternative credit providers be they low-cost options, or the growing number of mid-cost borrowing options (such as Credit Unions and Community Development Finance Institutions (CDFIs)). Work is needed in this space, to market and promote these services to ensure they are widely available – and better known – to many more people*."[18]

More positively, there is substantial evidence that affordable credit is highly valued by those who use it. For example, affordable credit firms Fair For You and Moneyline score extremely highly on the consumer platform Trustpilot compared to, for example, brands with much higher levels of awareness such as TSB and RBS (see Figure 1). Such data provides a solid foundation for future marketing activity.

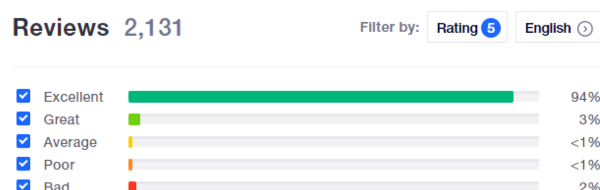
[18] https://www.carnegieuktrust.org.uk/publications/payday-denied-exploring-the-lived-experience-of-declined-payday-loan-applicants/

Figure 1 – Trustpilot scores of community finance organisations and mainstream banks

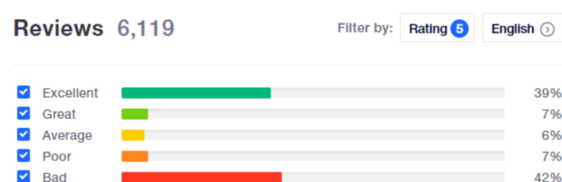
Trustpilot score: Fair for You[19]



Trustpilot score: Moneyline[20]



Trustpilot score: TSB[21]



Trustpilot score: Royal Bank of Scotland[22]

Actions proposed

We recommended that the Scottish Government invests up to £800,000 in an ongoing campaign over 12 months to increase the visibility of Scotland's affordable credit lenders through a dedicated marketing and promotion campaign.

This figure is based on the analysis provided pro bono by AMS Media[23] and FrontPage[24], media buyers and a creative agency respectively, to support the Trust in the scoping of this proposal.

We recommend that the deployment of this investment should follow a 'test and learn' approach. An initial period of spend on a pilot campaign should experiment with various campaign messages and how they are received. The Scottish Government should then review the learning from the pilot, modify and shape from the learning, and create a larger campaign based on what has been found to be effective.

[19] TrustPilot score accessed on 4 February 2021
[20] TrustPilot score accessed on 4 February 2021
[21] TrustPilot score accessed on 4 February 2021
[22] TrustPilot score accessed on 4 February 2021
[23] https://www.amsgroup.co.uk/
[24] https://www.frontpage.co.uk/

The campaign should seek to address the two challenges set out above: validate the appropriateness and value of affordable credit in certain circumstances; and improve the visibility of affordable credit providers, how they operate and the range of services that they provide. Consideration should be given to how the campaign tackles the question of the APRs charged by affordable credit providers, which are higher than mainstream credit, but which are significantly cheaper than the realistic alternatives for most affordable credit users. The campaign should cover the services provided by credit unions and CDFIs which wish to grow to serve many more people on a sustainable basis.

This campaign would seek to build on previous work to promote credit unions funded by the Scottish Government. It would be informed by learning and any evaluation of previous marketing campaigns and build on existing assets. It would be iterative, learning from an initial pilot campaign. It would clearly set out to *validate* the use of affordable credit in certain circumstances, where previous campaigns may have focussed on visibility. The campaign would be ongoing over 12 months to allow for learning to be incorporated from the pilot and ensure reinforcement of the messages from the current and previous campaigns. There are also positive examples of successful marketing campaigns that individual affordable credit providers have undertaken. The lessons from such initiatives can be drawn to inform campaign content and take it to a more significant scale.

The campaign should promote ‘affordable credit’ as a brand, focussing on validity of accessing affordable credit as well as signposting to further information about credit unions and CDFIs. It is important that any campaign directs customers towards affordable credit providers who can deliver a high quality, professional service. If the Scottish Government proceeds with Recommendation 1 around Fair4All Finance, the call to action could, for example, direct people to organisations supported by, or working with, Fair4All Finance in Scotland. These would be the organisations that have made a clear commitment to scale and sustainability – the two core principles for the overall approach set out in this report. Achieving scale is unlikely to be part of the future plans for all affordable credit providers in Scotland and we believe it is important that investment in the sector is considered proportionately, with a clear focus on enabling many more people to benefit from it.

Credit is not utilised by a homogenous group. The campaign should have specific strands to engage different potential beneficiaries of affordable credit in Scotland, drawing in numerous data points and sources such as public attitude polling and Acorn segments (see below) to identify appropriate marketing to particular groups, reflecting different options available to lower income households dependent on their credit needs. This can be tested in the piloting phase. Any marketing campaign should reflect the range of affordable credit options that exist for both short term, small sum needs, and for larger items of expenditure.

Carnegie has been assisted on a pro bono basis by AMS Media[25] and FrontPage[26] to identify the target audiences for a campaign and put forward a recommended media strategy for a launch campaign of 3 months. Using their in-house insight tools, AMS Media identified 4 primary Acorn groupings as the core target audience based on age, household income, household size

[25] https://www.amsgroup.co.uk/
[26] https://www.frontpage.co.uk/

and whether people had or planned to take out a short term or payday loan. These Acorn groups are 'Difficult Circumstances,' 'Striving Families,' 'Young Hardship' and 'Student Life.' Full details of these ACORN groupings, along with slides from AMS Media, are given in Appendix 4 (confidential).

AMS Media propose a combination of channels to inform and engage the target audience, based on knowledge of their media consumption from YouGov. Awareness generation is proposed through TV (live), outdoor adverts and radio, with engagement proposed through social media ads, online adverts and paid searches. The launch campaign is likely to require a high amount of activity at the outset to achieve high levels of coverage at effective average frequency of exposure. The primary call to action in a campaign is likely to be to "visit our website", which can direct people to a source of further information, potentially organisations supported by Fair4All Finance in Scotland if this recommendation was taken up. All media activity would carry this call to action and all online clicks would drive web visits.

The proposed campaign should measure awareness and engagement of those targeted before and after the campaign, including the extent to which the campaign makes participants feel more/less likely to engage with affordable credit providers. Success should primarily be measured in terms of pre- and post-awareness. Once people are aware of the availability of a better option then their lifetime behaviour, in terms of where they may seek a loan, is likely to change. A 5x change[27] in credit union membership in Scotland would increase the membership to around 1.8m adults – a step change in the delivery of affordable credit.

[27] Typically, large companies that invest circa 10% of their expenditure on marketing identify a ROI figure from 5x their investment on sales. It is clearly not as straightforward to seek a 5x ROI on this campaign as it is trying to do several things – raise awareness, increase membership, and increase sales. The 5x figure is for illustration on the type of change that a successful campaign of awareness might reach.

Recommendation 3: Commission an in-depth feasibility study on options to deliver improvements in the technology infrastructure and use of data in affordable credit supply in Scotland.

Why is this needed?

If Scotland's affordable credit providers are to grow significantly to reach many more potential beneficiaries, then technology will have a critical role to play.

While the affordable sector has traditionally operated as a face-to-face, relationship-based service, digital channels are now vital in enabling providers to deliver fast, responsive, user-friendly services to the people that they support. This has been the direction of travel for a decade or more. However, it has been brought into sharp focus during the COVID-19 pandemic when face-to-face engagement has been highly restricted and digital delivery has become the default operational model for many providers.

The realistic credit alternatives of many potential affordable credit users, such as payday lenders or rent-to-own providers, operate highly sophisticated digital platforms. It is imperative that the affordable credit sector can offer a comparable quality of digital experience or it will not be able to attract customers away from these harmful markets. At present, however the affordable credit sector in Scotland faces a myriad of challenges to developing and sustaining the type of digital infrastructure that is required to support significant sector growth.

A report by Fair4All Finance in December 2020 of nearly 60 community finance firms, including 16 which have some operations in Scotland, found that:

- 93% of providers expect they will need to substantially increase their technology in the next five years - in many cases in order to survive.
- There is a shortage of IT capability in the sector, particularly across the smaller providers and even among some of the larger organisations.
- Without IT expertise and experience, providers can become over-reliant on their suppliers and less likely to plan or undertake strategic change enabled by technology.
- Funding of technology is tight across the sector. Three-quarters of firms surveyed spend less than £50,000 each year on IT. And the ability of each provider to manage and fund its own silo of technology is likely to become even more difficult as their legacy systems are replaced.
- For the sector to be sustainable, the way that technology is delivered and funded for the smaller lenders will have to be challenged. Building silos of technology services for 400+ lenders (UK wide) and 90+ lenders within Scotland is highly unlikely to deliver a user-friendly experience for affordable credit customers and is not a long-term, financially viable approach for the sector.[28]

These challenges in the digital operations of affordable credit providers have a significant impact on the people that the sector supports or could support. It can take longer than is

[28] https://fair4allfinance.org.uk/news/understanding-the-role-of-technology-in-community-finance/

desirable for a decision on a loan application to be processed; the application process may require manual intervention at certain key stages; systems may not support the supply of a range of important financial inclusion services alongside the loan application; there is limited integration between affordable credit providers; and the whole system may feel clunkier or less intuitive than the best-in-class digital platforms.

A key feature of the community finance sector compared to commercial high cost (and mainstream) lenders is the way that customers are treated. As not-for-profit organisations, affordable credit providers want to help improve their customers' financial wellbeing regardless of whether they are approved for a loan. For example, while someone may apply for a loan, this may not be the most effective intervention for their particular circumstances. This could be free, confidential debt advice; a "critical friend" who can highlight spending patterns that are detrimental to the individual; advice to support the individual to receive all the benefits they are entitled to; or help to access lower or no cost alternatives to meet their needs.

Affordable credit providers, predominantly operating face-to-face, have provided these relationship-based services, drawing on the knowledge and expertise of their staff team. As services become increasingly online and aim to operate at a larger scale, this type of engagement is increasingly required via digital channels. However, community finance providers in Scotland have to date only made limited progress in harnessing fintech solutions to nudge or improve outcomes for customers.

If the IT infrastructure in the affordable credit sector could be significantly improved, and fintech deployed much more widely, then there are a range of benefits that could be achieved for customers. For example, affordable credit providers could:

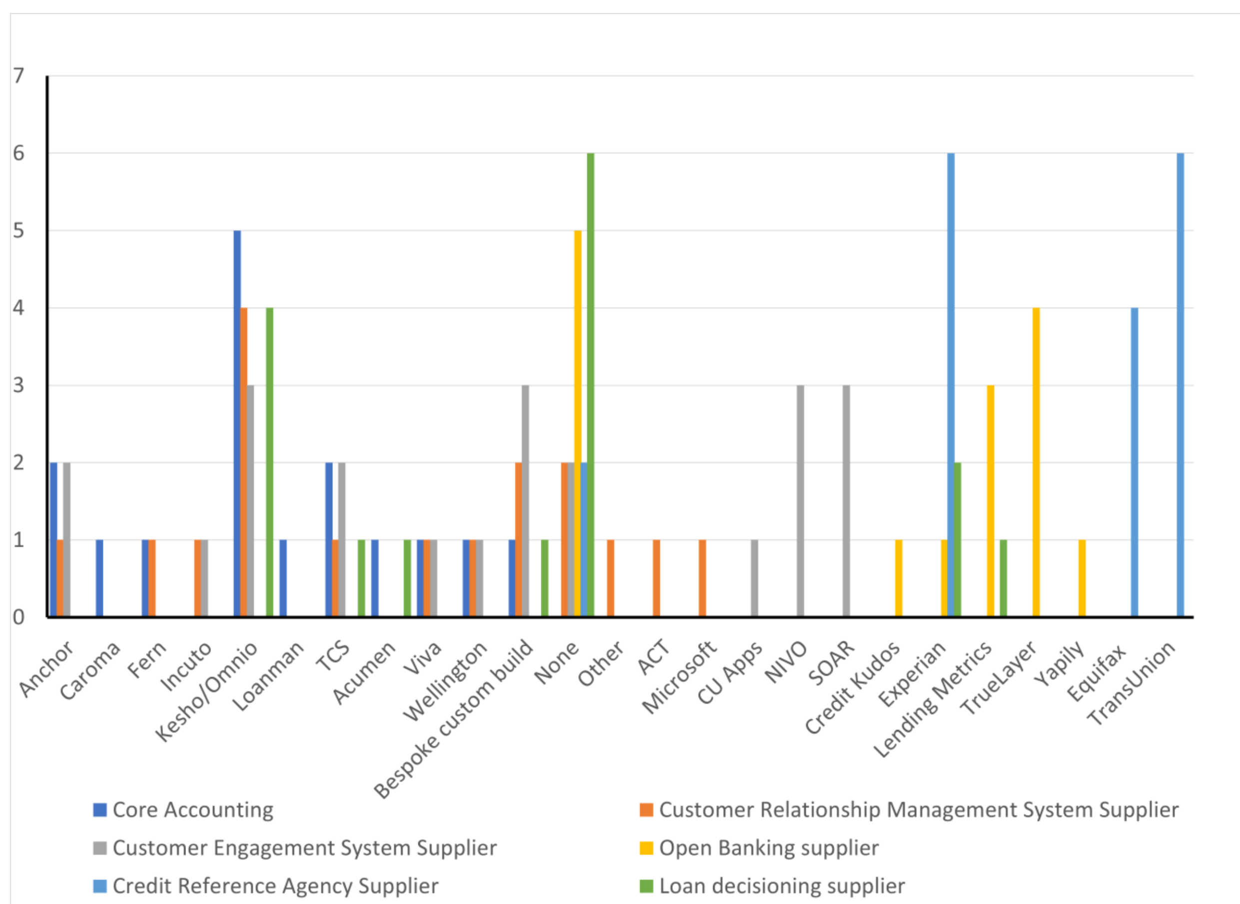
- use and interpret the data supplied by the customer to highlight other products or services that might better meet their needs.
- replay back information to customers about their spending profile, with nudge indicators on the amounts that could be saved in reducing certain expenditure, therefore improving the customer's financial wellbeing and/or future creditworthiness.
- identify where it may be helpful and appropriate to link borrowers to budgeting and savings apps, or benefit calculators.

There is some good practice to build upon in this space in the affordable credit sector. For example, some lenders like Castle & Crystal CU will send their customers emails on how to improve their finances or build their credit score. Lenders like Scotcash work with energy suppliers or apps like Snoop to offer a variety of solutions including switching services and budget tips. Some lenders offer advice on pre-owned or free goods suppliers which might address their customer's particular need to borrow. Many offer linked savings products and one, Moneyline, trialled through the FCA's sandbox a successful pilot to offer home contents insurance products to ensure contents were protected in the home.

The challenge is to enable such innovations to be offered systemically across the affordable credit sector, in a fast, responsive and appealing way for beneficiaries; and in a way which supports the sector to achieve economies of scale; and to significantly extend its reach.

The complexity of the challenge to “fix” the IT problem is illustrated in Figure 2, using the data supplied by the sixteen providers included in the Fair4All Finance survey who operate in Scotland. These providers between them operate ten different core accounting systems, and five different Open Banking suppliers. A third do not use Open Banking, which is widely regarded as a more accurate and streamlined tool to verify affordability.

Figure 2: IT suppliers used by 16 Scottish Community Finance Providers



Source: Fair4AllFinance research, raw data supplied December 2020

Actions proposed

These are complex issues but are fundamental to the future development of affordable credit in Scotland and the potential of the sector to serve many more people.

We recommend that the Scottish Government should commission a comprehensive feasibility study to examine the options to achieve a radical improvement in the technological infrastructure of Scotland’s affordable credit sector.

We suggest a budget of £150,000 to £250,000[29] should be allocated to the feasibility study. Further significant investment would be required to support the implementation of the study’s

[29] Figure based on our own knowledge and understanding of the sector and the scale of study likely to be required and sense-checked with the Technology and Strategy Lead at Fair4All Finance.

results. As noted above, the majority of the sector does not currently have sufficient resources available to it to make such an investment. If the Scottish Government chooses to proceed with recommendation 1 in this paper, relating to Fair4All Finance, there may be potential to apply some of the resources allocated under that initiative to this work, as well as drawing upon expertise available from Fair4All.

We suggest that the Scottish Government engages with an appropriate advisory group of sector representatives and industry experts, led by FinTech Scotland to inform the development of the detailed specification for such a study. We suggest that the challenges and opportunities set out above provide a starting point for the scope of the study and the issues that it should examine.

The aim of the study should be to provide an evidence-based framework upon which practical action can be taken to achieve a step-change in the IT infrastructure for affordable credit in Scotland. In considering the options for future development it will be particularly important that the work is cognisant of the limited financial resources in the sector to support the type of change that is required (and therefore the need for external investment); the very different starting points of different providers, some of whom have invested in their digital offering and some of whom have not; the challenges in dealing with legacy systems based on outdated technology, to which many providers are harnessed; and the need for future solutions that are effective for providers of different sizes, serving different customer groups. The study should also recognise the difficulties of previous attempts to achieve this and work in partnership and proportionately with the different lenders that continue to operate in the community finance sector.

Recommendation 4: Strengthen the commitment to financial wellbeing through key interventions with Scotland's business community, including Fair Work First and the Scottish Business Pledge

Why is this needed?

Employers are increasingly aware of the impact of financial worry on their employees. Anxiety, stress, low productivity, absenteeism and a lack of focus on work activities can be linked to financial stress.[30] Employers can play a role in easing that stress by offering a financial wellbeing package that includes giving employees the opportunity to build up a savings pot and to access affordable loans, through partnerships with local credit unions. In such arrangements, which are well-established in many workplaces in Scotland, employee payments into their savings pot, or repayments to their affordable credit union loan, are deducted from their salary at source with minimal administrative burden for employers.

Highlighting the pathways for employers to offer seamless deduction at source to an appropriate affordable credit provider will assist in increasing a small and regular savings habit among employees, especially those whose financial position may be the most fragile. Even before the pandemic, half of all people in poverty were in working households and two-thirds of children in poverty lived in a working household.[31] Analysis by Ipsos MORI Scotland of the 2015 Scottish Household Survey found just under one in four households (24%) had no savings.[32] The 2019 Scottish Household Survey found 60% of single parent households had no savings in 2019.[33]

It has been widely reported that household spending has fallen, and savings increased in 2020 during the COVID-19 pandemic. However, families on a low income and families with dependent children are more likely to report increased spending during the pandemic.[34] This is due to increased food and energy costs while families have been at home, as well as spending on internet access and laptops or other devices for home schooling.

Research by the Resolution Foundation found that in September 2020, half of adults with less than £1,000 in savings report drawing down on them since February 2020, and over half (54%) of adults in the lowest-income quintile report using borrowing, such as from family and friends, to a greater extent than they did pre-pandemic to cover everyday living costs.[35]

The need to build financial resilience, particularly due to changes in circumstances during the pandemic, is clear and employers have a critical role to play.

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[30] https://www.cipd.co.uk/Images/health-and-well-being-at-work-2019.v1_tcm18-55881.pdf
[31] https://fraserofallander.org/household-finances-in-scotland-now-and-in-the-future/
[32] https://www.carnegieuktrust.org.uk/publications/use-of-credit-and-financial-resilience-analysis-of-the-scottish-household-survey/
[33] https://www.gov.scot/publications/scottish-household-survey-2019-key-findings/pages/8/
[34] https://www.resolutionfoundation.org/app/uploads/2021/01/Pandemic-pressures.pdf
[35] https://www.resolutionfoundation.org/app/uploads/2020/11/Caught-in-a-Covid-trap.pdf

Actions proposed

We recommend that the Scottish Government builds on its commitment to fair work by strengthening the connection between fair work and financial wellbeing, through two specific actions:

- Adding new criteria to the Fair Work First framework, to require employers to provide opportunities for employees to access payroll savings and loan schemes.
- Providing additional guidance and case studies on the Scottish Business Pledge savings and loans commitment, to encourage greater take-up amongst signatories and potential signatories of this Commitment.

The current Fair Work First framework encourages genuine workforce engagement such as trade union recognition, alongside payment of the real Living Wage.[36] We recommend that an element of financial wellbeing should be added within the workforce engagement section of the framework, enhancing the offering made by employers to employees to include measures such as payroll deduction schemes. By encouraging employers to pay the real Living Wage and offer means for employees to save and access affordable credit, the Scottish Government can be responsive to the clear need to build financial resilience, particularly at this difficult time.

After the refresh of the Scottish Business Pledge in February 2019, workforce engagement remains an element of the Pledge. Businesses already signed up to the Pledge are required to confirm that they meet the core elements of paying the real Living Wage, only using Zero Hours Contracts in appropriate ways, and are taking action to address the gap in pay between genders, as well as committing to achieving 5 of 7 additional Pledge elements over time. The Scottish Business Pledge website mentions payroll deduction schemes within the Workforce Engagement Section as a way to help a workforce 'take control of their finances'.[37] Saving through an automated payroll deduction arrangement helps employees to build a buffer to cover unexpected expenses and cultivate a savings habit. If the payroll deduction scheme is arranged with a Credit Union, individuals can also access credit at an affordable rate.

Misconceptions may still exist about the administrative burden and bureaucracy involved for employers which could be tackled through clear guidance or case studies as part of the Business Pledge community. There is also a need for employee engagement about the benefits of payroll deduction schemes. During the workshops held with stakeholders an example was given from a local authority where payroll savings were offered to employees, but it was difficult to gain buy in. Again, this could be helped by guidance or case studies from Business Pledge signatories. We provide a short case study from our Credit Union Consortium pilot in Appendix 5.

We are aware that encouragement of payroll deduction schemes was previously included in the 2016 report *Scotland's Credit Unions: Investing in our Future.* However, there is a need to

[36] https://economicactionplan.mygov.scot/fair-work/fair-work-first/
[37] https://scottishbusinesspledge.scot/pledge-elements/workforce-engagement/

continue emphasising the benefits and clarify the process of payroll deduction schemes, for both employees and employers. The engagement that the Scottish Government has with employers through the Scottish Business Pledge and Fair Work First provide ideal opportunities to keep promoting these actions. We note that the Social Renewal Advisory Board has also recommended that the Scottish Government partner with employers to consider what more employers can do to deliver greater levels of financial security for workers, including offering routes to savings. Implementing this recommendation would be a valuable adjunct to the proposed marketing and promotion campaign, and the recommendation for increased promotion of affordable credit by social landlords.

Recommendation 5: Boost the take up of Help to Save and Prize Linked Savings schemes

Why is this needed?

As highlighted above, analysis by Ipsos MORI Scotland of the 2015 Scottish Household Survey found just under one in four households (24%) had no savings. [38] The 2019 Scottish Household Survey found 60% of single parent households had no savings in 2019.[39] Savings incentive schemes can, if taken up, provide households in Scotland with a level of financial resilience that they would not otherwise have.

a) Help to Save

The UK Government launched the Help to Save account in September 2018, which allows certain people entitled to Working Tax Credit or receiving Universal Credit[40] to get a bonus of 50p for every £1 they save over four years.

Help to Save builds on a previous UK Government savings scheme, Savings Gateway (piloted twice in England, in 2002 and for 18 months from 2004). An evaluation of the second pilot found:

- Seven in ten (71%) account holders made a net contribution in at least 16 of the 18 months.
- Seven in ten (69%) account months saw a net monthly contribution equal to the matchable contribution limit.
- The majority of account holders interviewed said that they intended to save at least some of the money from their Savings Gateway 2 (SG2) account after the account matured: 42% said they would save all the money while 21% said they would save some of the money and spend the rest. [41]

Many of those who took part in the qualitative research, particularly those new to saving, were positive about the incentive for regular saving that the accounts created. They noted that the accounts had encouraged them to get into the 'habit' of thinking more carefully about their finances and looking at what they could afford to pay into the Savings Gateway account.[42] However, while the Savings Gateway 2 scheme succeeded in raising savings in accounts among participants, this came at the expense of other kinds of saving. As a result, the scheme did not bring about overall increases in net worth.[43] It is worth noting that the Savings Gateway 2 scheme was piloted in a limited area (6 local authorities in England), and so the findings from the evaluation may not represent the effects that would be observed across a wider area and cohort.

[38] https://www.carnegieuktrust.org.uk/publications/use-of-credit-and-financial-resilience-analysis-of-the-scottish-household-survey/
[39] https://www.gov.scot/publications/scottish-household-survey-2019-key-findings/pages/8/
[40] https://www.gov.uk/get-help-savings-low-income/eligibility
[41] https://discovery.ucl.ac.uk/id/eprint/18337/1/18337.pdf
[42] https://discovery.ucl.ac.uk/id/eprint/18337/1/18337.pdf
[43] https://www.fincap.org.uk/en/evaluations/final-evaluation-of-saving-gateway-2-pilot

The most recent figures for Help to Save accounts (up to July 2020) show 16,100 Help to Save accounts have been opened in Scotland, with deposits of almost £6 million made.[44] In terms of eligibility, figures from 2018-19 show that in Scotland, 92,000 families with children received Working Tax Credit and Child Tax Credit, and 24,000 households in work with no children received Working Tax Credit only.[45] As of December 2020 there were around 480,000 people receiving Universal Credit in Scotland.[46]

The number of Help to Save accounts open represents only around 3% of households who are eligible through receiving Universal Credit, or around 14% of households who are eligible through receiving Working Tax Credits and/or Child Tax Credits.

These figures demonstrate that there is much more that could be done to raise awareness and significantly boost take-up of Help to Save accounts and their benefits, as part of a package of financial wellbeing measures. There have been no direct advertising campaigns run by the UK Government to highlight the Help to Save scheme.

However, we are aware that a lack of awareness will not be the only barrier to people saving through a Help to Save account. Take-up could also be encouraged through employers whose staff may be in receipt of eligible benefits. Prior to the COVID-19 pandemic, the Treasury had been promoting the Help to Save scheme through events attended by Employers and other stakeholders. A recent report by the University of Edinburgh Business School for Salad Projects found that of the over 9,500 NHS workers in NHS pay bands 1 to 5 who had applied to Salad Money[47] for a short-term loan, 13% were in receipt of Child Tax Credit, 13% were in receipt of Working Tax Credit and 22% were in receipt of Universal Credit.[48]

b) Prize-linked Savings Scheme

The UK Government has also launched a pilot prize-linked savings scheme for credit unions, which aims to simultaneously increase financial resilience of households and boost awareness and membership of credit unions. Under the pilot individuals who save will be entered into a draw to win cash prizes. 15 credit unions from across the UK are part of the pilot, including 1st Alliance (Ayrshire) in Scotland. The pilot is due to end in March 2021.

Statistics provided by 1st Alliance (Ayrshire) on their Prize Linked Savings (PLS) accounts show:

- 174 savers have signed up to an account, of whom 16 are new to the credit union.
- Total savings in PLS accounts is £16,688, of which £3401 belongs to new savers.

[44] https://www.gov.uk/government/statistics/help-to-save-statistics
[45] https://www.gov.uk/government/statistics/personal-tax-credits-finalised-award-statistics-geographical-statistics-2018-to-2019
[46]https://www.gov.scot/binaries/content/documents/govscot/publications/statistics/2021/01/universal-credit-scotland-dashboard-2021/documents/universal-credit-scotland-dashboard-january-2021/universal-credit-scotland-dashboard-january-2021/govscot%3Adocument/Universal%2BCredit%2BScotland%2BBulletin%2B-%2BJanuary%2B2021.pdf

[47] Salad Money uses Open Banking data and not credit reference scores to make lending decisions, and lends exclusively to NHS staff.
[48] https://www.saladmoneymind.co.uk/home/report

- Around 42 of the 158 existing savers are saving more, rather than simply saving in the PLS account and saving less in their standard credit union account.

Actions proposed

a) We recommend that the Scottish Government encourages greater take up of the Help to Save scheme in Scotland. The scheme could be promoted using existing touchpoints with Scottish Government agencies or advice providers, such as information provided by Health Visitors and Citizens Advice Bureaux amongst others. We recommend that the Scottish Government initiates this recommendation by undertaking a mapping exercise to identify routes by which the Help to Save scheme could be highlighted to those who are eligible.

b) We recommend that the Scottish Government examines the options for creating a Government backed scheme for Scottish Credit Unions to offer Prize Linked Savings accounts. This would look at the potential to further increase membership of credit unions and improve financial resilience, review the outcomes of the existing PLS pilot and provide estimates of the cost to the Scottish Government to establish a new PLS scheme in Scotland.

Recommendation 6: Establish a short-term working group with social landlords and affordable credit providers to agree an action plan to strengthen links between the two sectors.

Why is this needed?

Social housing tenants in Scotland are more likely than their peers in owner-occupier or private rented accommodation to experience a range of challenges to their financial wellbeing. Such challenges may leave social housing tenants more exposed to the risks of high-cost credit; and more likely to benefit from improved access to an alternative, not-for-profit affordable credit provider.

At the same time, social housing providers are often key local anchor institutions, interested in the wider wellbeing of their tenants beyond only housing issues. There are a number of potential options where social housing organisations may be able to support improved access to affordable credit; and there are a range of good practice examples and opportunities that may be built upon and taken to a greater scale.

An Ipsos MORI Scotland report analysing the Scottish Household Survey for Carnegie in November 2018 identified that *"the majority of households with no savings were in the social rented sector (316,000),"* noting that *"financial distress was closely associated with having no savings."* The same report highlighted that *"those without savings are 10 times more likely than those with savings of £1,000 or more to say that they don't manage financially. Those with no savings are likely to find it harder to access the mainstream market for credit as they have less tangible assets and are likely to have a much poorer credit history."*[49] Tables 2 and 3 illustrate these points.

Table 2: Whether household has any savings by selected factors (SHS, 2015)

	No savings	Up to £1,000	Over £1,000	Total
All	24.2%	16.5%	59.3%	100%
Tenure				
Owner-occupiers	8.8%	11.4%	79.9%	100%
Social rented	55.5%	22.8%	21.7%	100%
Private rented	35.8%	26.8%	37.4%	100%

[49] https://www.carnegieuktrust.org.uk/publications/use-of-credit-and-financial-resilience-analysis-of-the-scottish-household-survey/

Table 3: How managing financially by selected factors (SHS, 2015)

	Very or fairly well	Getting by	Don't manage well, have some financial difficulties, are in deep financial trouble	Total
All	54.9%	35.5%	9.5%	100%
Tenure				
Owner-occupiers	67.9%	28.2%	4.0%	100%
Social rented	28.6%	49.9%	21.5%	100%
Private rented	44.0%	42.8%	13.2%	100%

In October 2020, the Scottish Housing Regulator reported their findings from the National Panel of Tenants and Service Users 2019/20. In it they say:

"A large majority (70%) of respondents expressed some concern about their future financial circumstances more generally, including 15% for whom their future financial situation was a major concern. This represents a 12% increase since the 2019 survey (58% expressed concerns about their future financial circumstances)".[50]

Poverty in Perspective: a typology of poverty in Scotland highlighted that of those classed as "workless families," "struggling to get by", and "insecure singles," three-quarters lived in social rented accommodation, as illustrated by Figures 3 to 5. [51]

Figure 3: Socio-demographic characteristics of the 'workless families'

[50] https://www.housingregulator.gov.scot/for-tenants/national-panel-of-tenants-and-service-users-research-reports/national-panel-of-tenants-and-service-users-2019-to-2020#section-3
[51] https://www.gov.scot/publications/poverty-perspective-typology-poverty-scotland/pages/7/

Figure 4: Socio-demographic characteristics of the 'insecure singles'

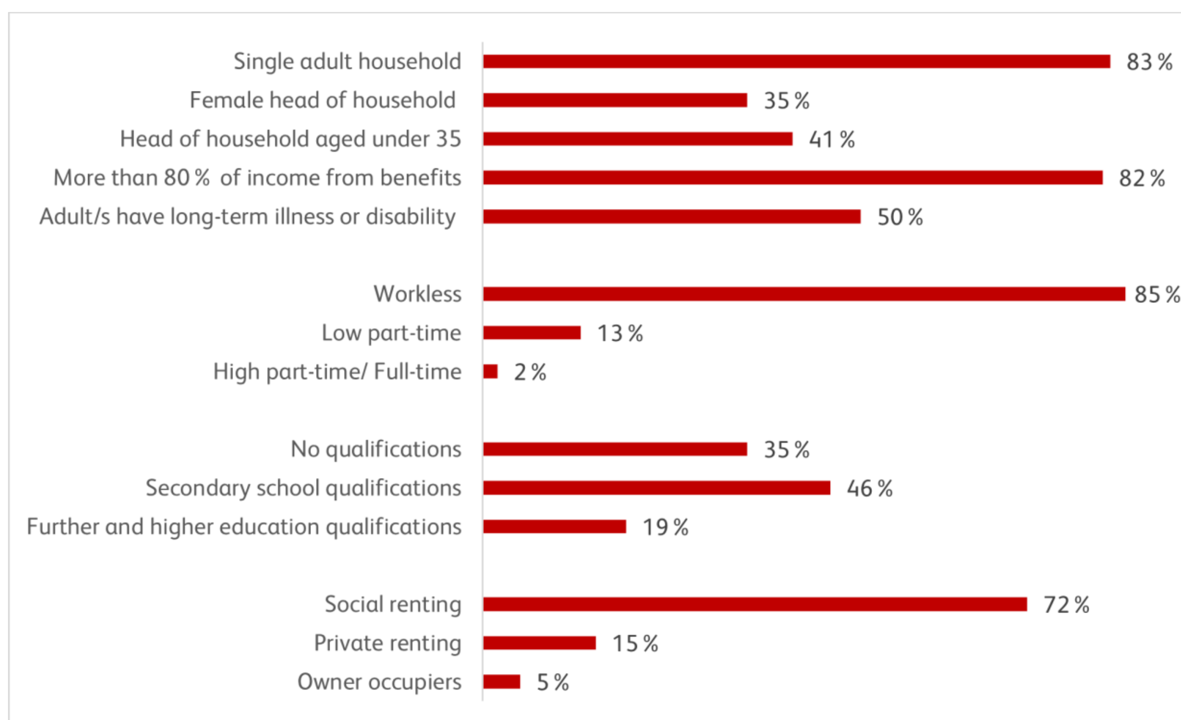
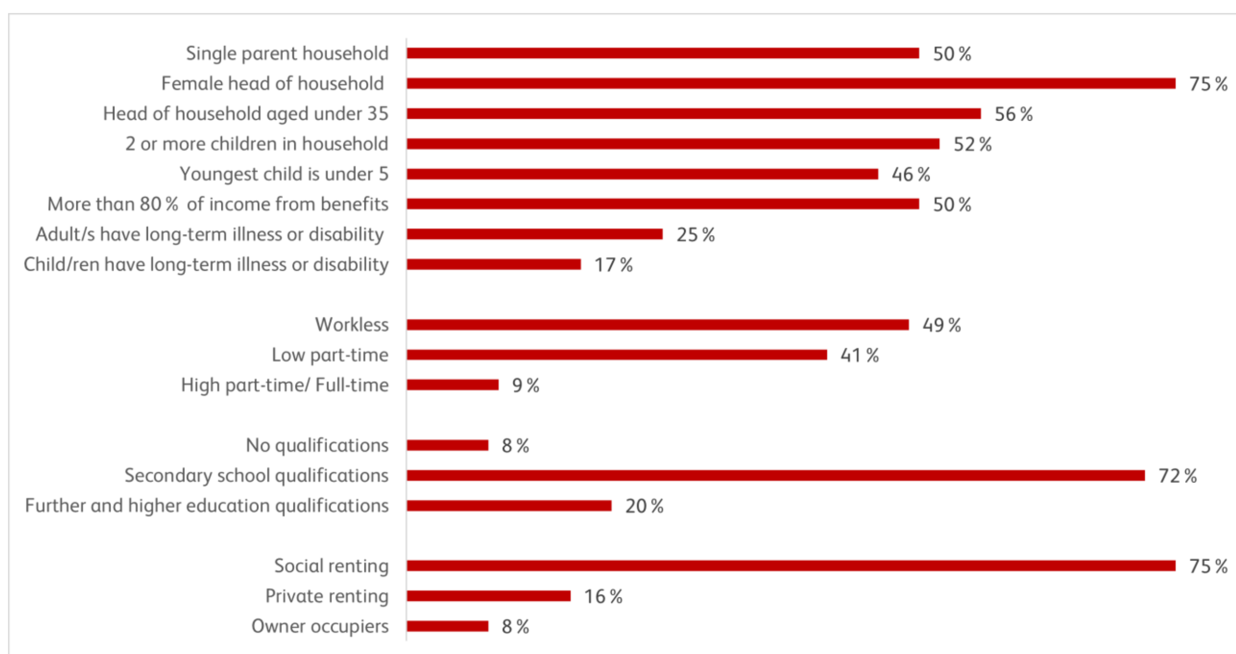


Figure 5: Socio-demographic characteristics of the 'struggling to get by'



The Ipsos MORI report showed that tenure was also a significant determinant of the likely sources of credit that people accessed. Table 4 shows that social housing tenants were significantly more likely than those in other tenures to be users of catalogues, home credit and rent-to-own credit and to access social fund loans.[52]

Table 4: Use of different forms of credit in the last twelve months by tenure (SHS, 2015)

	Owner occupied	**Social renter**	**Private renter**	**Total**
A personal loan, e.g. with Bank, Building Society, Finance House	8.4%	5.0%	6.6%	7.4%
Catalogues or mail order schemes	4.2%	7.9%	4.7%	5.2%
Hire or Rental Purchase Agreements (like Brighthouse)	3.6%	3.4%	1.3%	3.2%
Loan from a friend, relative or other private individual	0.8%	2.7%	2.6%	1.5%
Cash loan from a company that comes to your home	0.1%	2.7%	1.2%	0.9%
Loan from a student loan company	0.5%	0.2%	3.9%	0.9%
Other type of loan	0.6%	0.7%	2.2%	0.9%
Loan from a Credit Union	0.7%	1.0%	0.5%	0.8%
Loan from a Social Fund	0.1%	2.6%	0.7%	0.8%
Student loan from a bank or building society	0.2%	0.4%	2.0%	0.5%
Loan from a pawnbroker/cash converter	0.0%	1.0%	0.2%	0.3%
A loan from a pay day lender	0.0%	0.7%	0.8%	0.3%
Loan from an Employer	0.1%	0.1%	0.0%	0.1%
Any of these	**16.9%**	**21.6%**	**22.7%**	**18.8%**

[52] https://www.carnegieuktrust.org.uk/publications/use-of-credit-and-financial-resilience-analysis-of-the-scottish-household-survey/

None of these	83.1%	78.4%	77.3%	81.2%
Total	2,127	782	443	3,352

Provident Financial annual reports identify typical home credit customers as social renters, while the Financial Conduct Authority consultation paper on rent-to-own regulation highlights that borrowers using Rent to Own firms are predominantly in social rented accommodation (67%), not working full time (66%), on a low income of £12,000 to £18,000 and lone parents (23%).[53] Finally, the Ipsos MORI report highlighted that contrary to a commonly held perception, the biggest proportion of credit union accounts are held by owner/occupiers, as Table 5 shows. As we noted elsewhere in this paper, there is a low awareness of credit unions and other forms of community finance, and this data suggests that there may be particular opportunities to raise awareness of these forms of affordable credit amongst social housing tenants.

[53] https://www.fca.org.uk/publication/consultation/cp18-35.pdf

Table 5: Whether have had a Credit Union account by selected characteristics compared to all households (SHS 2012-2015)

	All household SHS 2012-2015 (N = 42,253)		Breakdown of households with a Credit Union account (N = 473)	
All	100.0%	2.3m	(3.8%)	87k
Tenure				
Owner-occupiers	61.3%	1,410k	62.2%	54k
Social rented	23.4%	538k	27.0%	24k
Private rented	15.4%	354k	10.9%	10k

Actions proposed

We recommend that the Scottish Government should establish a short-life working group, comprising representatives from both the social housing sector and the affordable credit sector, to agree an action plan that will improve access to affordable credit for social housing tenants.

There are two particular actions that we specifically recommend that the group considers and then identifies the next steps for implementation.

Firstly, is to improve signposting from social landlords to local affordable lenders. In 2018, an amendment to the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 allowed registered social landlords (RSLs) to refer tenants, or potential tenants, to some credit activities without requiring credit brokering authorisation from the FCA. Previously some social landlords had been reluctant to signpost to affordable credit services due to concern or uncertainty about the legal position for doing so.

RSLs can only refer without FCA authorisation (known as an exclusion) where:

- the activity concerned is affecting an introduction of an individual who wishes to enter into a credit agreement,
- the introduction is to a credit union, community benefit society, registered charity (or subsidiary of a registered charity), community interest company limited by guarantee or subsidiary of an RSL, and
- the introduction is provided fee-free, i.e. the RSL receives no fee (which includes pecuniary consideration or any other financial consideration).

A full FCA guidance note[54] outlines the detailed requirements.

Despite the regulatory clarification, we understand that such signposting does not yet take place widely. We believe that there is an opportunity, coordinated with other

[54]https://www.fca.org.uk/publications/finalised-guidance/fg18-6-helping-tenants-find-alternatives-high-cost-credit-and-what-means-social-housing-landlords

recommendations outlined in our paper, particularly around marketing and brand awareness, for social landlords to assist tenants with access to affordable credit via not-for-profit social enterprises. The proposed short-life working group should examine the next steps that are required to significantly increase the uptake of this opportunity across the social lending sector.

Secondly, we recommend that further examination is given to the opportunities that may exist for social landlords to provide premises where affordable lenders might offer outreach services to tenants (when such face-to-face delivery again becomes possible). There is good practice of this type of partnership already in Scotland, but, as with many aspects of affordable credit, the challenge is to replicate this at scale. The working group should consider the practical steps that are required to advance that goal and set out an action plan for delivery.

Recommendation 7: Establish a Community Finance Strategic Support Fund

Why is this needed?

In the years prior to the COVID-19 pandemic there had been a gradual decline in the number of credit unions operating in Scotland,[55] however the number of people who are members of credit unions has been on the rise.[56] There are a number of reasons for the reduction in number of institutions, such as a growth in mergers as some consolidation takes place in the sector; the ageing demographic of many credit union boards, leading to organisations finding it difficult identify enough people able to undertake the vital volunteer roles required to run these institutions; and an increase in regulatory requirements, which have placed a considerable burden on these volunteer-led organisations.

The evidence from two Carnegie UK Trust surveys undertaken in 2020 into affordable credit lending during the COVID 19 pandemic - among other evidence about the state of lending in the UK more generally - highlights the pressures facing Scotland's nearly 90 community finance lenders.[57]

The range of challenges that lenders currently face, coupled with the sector trends towards consolidation going into the pandemic, means that there is high likelihood during the next two years that some lenders will cease trading. The pressures that lenders are currently experiencing include, but are not limited to:

- falling loan values,
- reduced income from lending,
- higher customer deposits,
- rising arrears,
- challenges on determining applicant affordability in a highly volatile economy,
- the costs of shifting the IT infrastructure online, and
- the burden on staff and boards.

The Scottish League of Credit Unions noted in their September 2020 presentation to members the impact of this perfect storm:

- reduced borrowing = reduced income.
- increase in arrears = increase in provisioning.
- impinged member financial circumstances = increased level of bad debt write off.
- new system development cost = increase in expenditure.
- lower profitability = reduced ability to pay dividends / interest rebates.
- erosion of capital = reduction in financial health.

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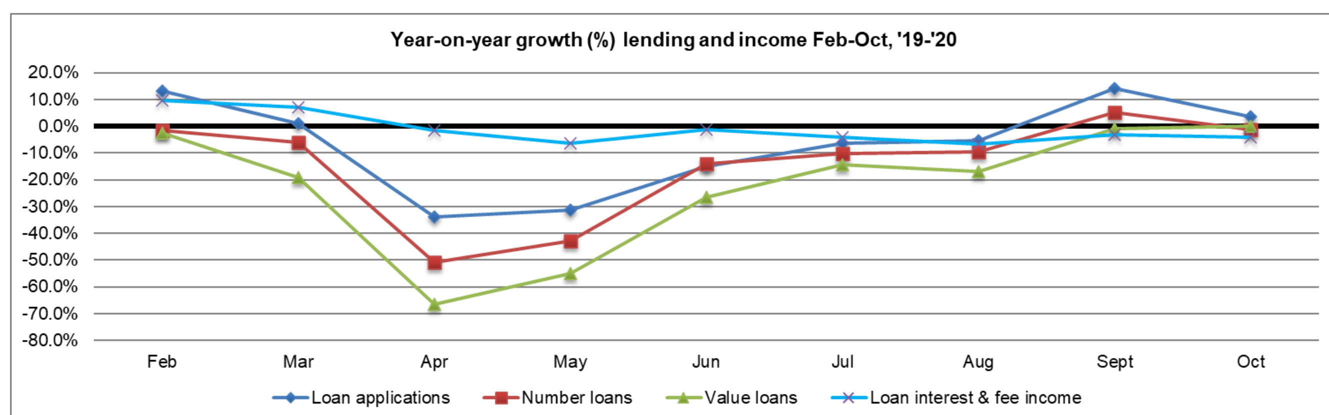
[55] Bank of England Credit Union Annual Returns, 2015-2019, 31st July 2020 reports that in 2015 Credit Unions in Scotland submitted 104 returns for analysis, by 2019 this had reduced to 83, a reduction of more than 20%

[56] Bank of England Credit Union Annual Returns, 2015-2019, 31st July 2020 reports that in 2015 Credit Unions in Scotland had 327,513 adult members, by 2019 this had increased to 368,580, an increase of more than 12%

[57] https://www.carnegieuktrust.org.uk/publications/fear-and-loaning/

Figure 6 illustrates a number of these data points for 2020 compared to 2019.

Figure 6: Affordable Credit Lending in the UK 2019-20



The cumulative value of loans issued by affordable credit providers participating in the Carnegie UK Trust research between April to October 2020 was £33 million lower than for the equivalent period 2019, a drop of 25% (even although month-on-month figures had recovered to near 2019 levels by October last year). Moreover, many providers are experiencing greater arrears, as customers experience greater financial difficulties. Half of the sample in our research reported “higher” or “much higher” proportions of customers not repaying loans, and many credit union managers said that they expected arrears to rise. At the same time, savings in most credit unions have risen. The savings book in our survey sample had increased by £48 million between May and November 2020. Over the past five years the savings and loans dispersed by Scotland’s credit unions have risen as follows:

Table 6: Savings and loans dispersed by Scotland’s credit unions 2015-19

	2015	**2016**	**2017**	**2018**	**2019**
Share balances (£M)	£458.4m	£494.1m	£521.6m	£541.8m	£581.3m
Increase on previous Year (%)		7.79%	5.56%	3.87%	7.29%
Loans to members (£m)	£280.2m	£300.0m	£320.2m	£351.7m	£363.0m
Increase on previous Year (%)		7.06%	6.73%	9.84%	3.21%

Source: Bank of England, Credit Union Annual Statistics 2019, (31 July 2020) extrapolated by Carnegie UK Trust

Normally higher savings are welcomed. However, throughout 2020 a significant increase in savings has not been matched by an increase in lending. In fact, the opposite has happened in many cases. The Bank of England reported that in the period Q3 2019 to Q3 2020 Scotland’s credit unions had seen an 11.1% increase in shares along with a 9.3% decrease in loans.

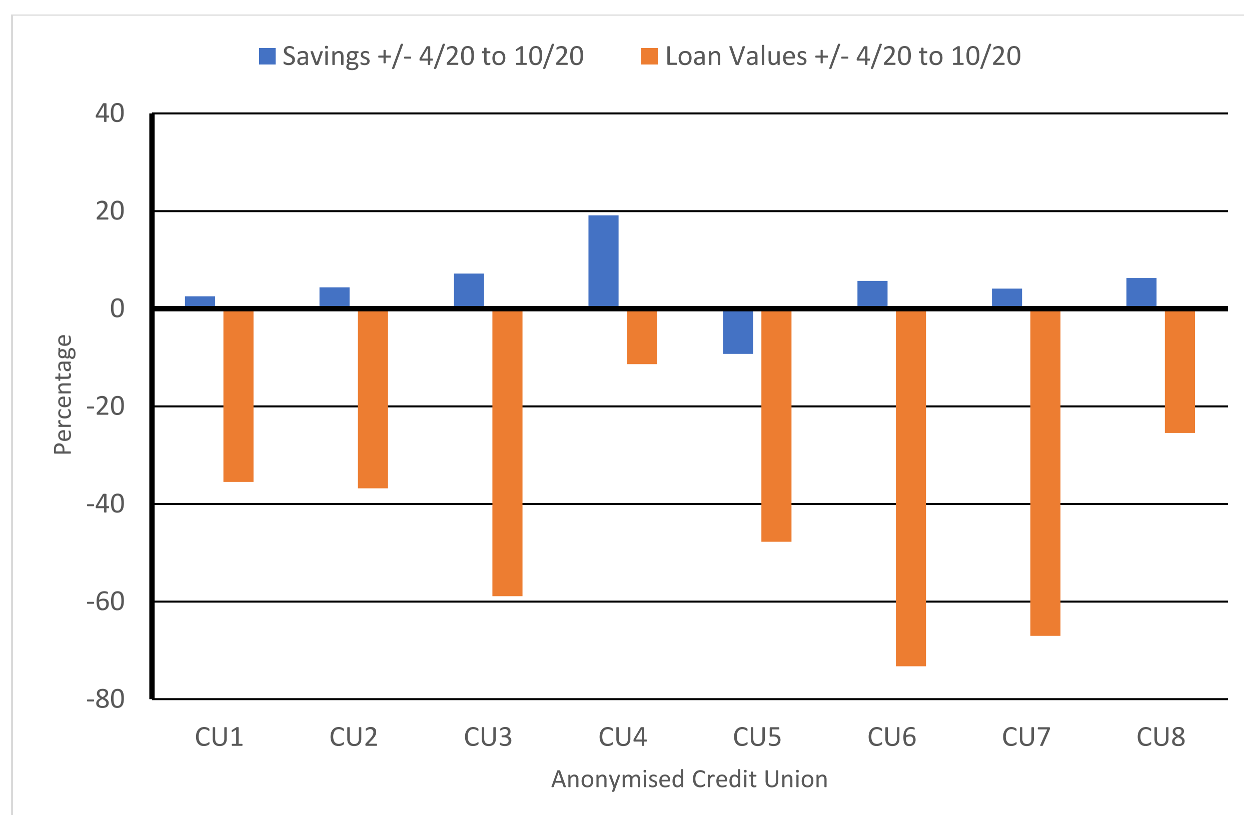
Table 7: Savings and loans dispersed by Scotland's credit unions 2019-2020

Scotland Credit Unions	2019 Q3	2019 Q4	2020 Q1	2020 Q2	2020 Q3
Total Shares (£ thousands)	589,210	594,490	588,455	642,073	654,406
Loans to Members (£ thousands)	368,025	373,402	371,685	339,349	333,795

Source: Bank of England, Credit Union Quarterly Statistics 2020, extrapolated by Carnegie UK Trust

This puts further pressure on the credit union model and is reflected in stretched capital to asset ratios. A credit union will incur higher costs linked to paying dividends on larger savings books. 21% of lenders in our second survey in autumn 2020 had gone as far as introducing share deposit restrictions to counter this rise in saving, while the lower value of lending in 2020 reduces future income from loans. The unpublished data (below) is from the eight Credit Unions in Scotland that participated in both surveys undertaken in May and November 2020 by Carnegie UK Trust in conjunction with University of Salford and Fair4All Finance.

Figure 7: Savings and loans percentage change of 8 of Scotland's credit unions that participated in Carnegie UK Trust, University of Salford and Fair4All Finance surveys between April and October 2020



Mitigation loans and grants dispersed in Spring 2020, whilst welcome, are temporary relief to a critical problem for some, but not all, affordable lenders. We know of increased activity throughout Scotland within Boards of community finance firms to discuss their futures given

the damage delivered by the ramifications for business plans by the pandemic and related restrictions.

CDFIs operating in Scotland such as Scotcash and Conduit Scotland do not have the deposits-rising issue, but they are funded in different ways and the challenges of lending that they face are also significant. Some CDFIs borrow their loan capital, often from social investors, with conditions and covenants on the loan ratios, and consequences if these are breached. In our survey the much smaller CDFI sector saw a 28% drop in loan values (April to October 2019 to 2020) £8.9m issued from £12.3m the previous year[58]. This resulted in a 17% drop in their income. These are levels that tight margin businesses will struggle to absorb. It should however, be noted that these issues are far from restricted to the affordable credit sector. The FCA reported in January 2021 that they foresaw "*up to 4,000 UK financial services firms at risk.*"[59]

As outlined in the introduction to this paper, these pressures create significant challenges for many affordable credit providers in the short-term. However, as Scotland seeks to recover from the pandemic over the coming years, these providers will likely be more needed than ever, to help people and communities in difficult circumstances.

It is therefore important that the sector is supported to deal with and manage the current challenges in a planned and pragmatic way. In particular, it is imperative that community finance firms that decide to stop their operations do so in a way that does not reduce the service to customers and does not create wider difficulties for the sector's reputation. It is also vital that these decisions are taken by well-informed boards who have a clear understanding of the range of options available to them. For example, early decisions on merging with another provider, transferring the loan book to another provider, or closure can help both the party ceasing to trade and the party taking on the loan book as well as, ultimately, the customer.

Actions proposed

We recommend that the Scottish Government establish a £1 million Strategic Support Fund for the affordable credit sector, to enable the further consolidation that is expected across the sector in the next few years to be completed smoothly and timeously, with the best possible results for customers.

Some affordable credit firms may need to merge or close in the next few years. Preparation for closure and transfer of assets and liabilities to another firm is assisted by having clarity early in the process. This can include sight of financial plans and models, and communication strategies within boards and from boards to membership. A strategic sector support fund can deliver expert support to determine loan book quality and the best solution in a given situation. The proposed fund could also support boards with the presentation of the rationale for closure or merger to members and investors – to ensure that the reputation of a sector remains intact even if some of the lenders do not. Mergers are often difficult. A fund to utilise expertise and, if

[58] Carnegie UK Trust / University of Salford survey of community finance firms undertaken in November and December 2020 (raw data sourced 15th January 2020) unpublished.

[59] https://www.fca.org.uk/data/coronavirus-financial-resilience-survey-data and https://www.ft.com/content/fdcfd4db-0eb9-46c2-9918-2f1a5a3e8972

necessary, cover some of the costs of transfer including some liabilities can help the community finance sector to continue to serve the existing and future membership. The ultimate aim is to preserve stronger, resilient, well governed and managed firms to strengthen the community finance sector and have the ability to serve low and lower income households in the future.

We propose that the Scottish Government establish the fund with £1 million, potentially from the Credit Union Investment Fund, with the remit extended to include all community finance firms. It could be managed by Social Investment Scotland (SIS), for example, with additional support, if required, in oversight drawn from sector membership bodies SLCU, ABCUL, NCUF and Responsible Finance. This fund will diminish risk for customers, reputational risk for the sector and provide access to additional capital and revenue to ensure good outcomes for members of merged organisations.

Recommendation 8: Establish a short-term working group to report to the Minister on the feasibility, costs and benefits of a digital debt collection and arrears management social enterprise

Why is this needed?

Like any credit firm, affordable credit providers must have a system in place to deal with situations where customers miss repayments on the loan they have taken out. Without such systems, lenders, even not-for-profit ones, would quickly go out of business. The 90+ affordable credit providers in Scotland each have their own arrangements for processing, handling and collecting arrears.

These current arrangements present a number of difficulties for the affordable credit sector and its customers:

- If providers manage their arrears system in house, then this requires significant investment in staff time spent on phones or emailing customers to reschedule loans, or offer borrowers flexibility to get back on track.

- If the arrangements are outsourced, this also brings cost and traditional collection firms who might undertake this task are generally private enterprises who adopt collection processes which can differ from the style than socially-motivated affordable lenders would wish. Borrowers can find the process of debt rescheduling and debt collection an intimidating and worrying experience.

- It clearly does not represent economies of scale to have so many different systems in place for such a small sector of affordable providers.

Customers in arrears to community finance firms would benefit from the outsourced assistance of trained debt collection staff who have a specific understanding of the ethos of community finance. Staff with bespoke training in mediation skills who would be able to both understand the motivations of the lender, and the needs of the borrower. A debt collector that views the arrears more through a prism of a borrower who needs to get back to regular payments, the "carrot" approach; rather than a loan that needs to be settled through a "stick" approach, complete with the spectre of court or wage arrestment. The aim would be to establish such a service that could engage customers with a 'back on track' message that might deliver:

- higher collection rates and efficiency savings for lenders,
- better CRA file recording and an empathetic understanding for borrowers
- a positive relationship being maintained between borrower and lender, so that the borrower feels able to use the lender again if they wish/need to do so in the future

This is an issue that is becoming more pressing for affordable credit providers and borrowers as a result of the COVID-19 crisis. Carnegie's research of community finance lenders undertaken in May 2020 and November 2020 showed that between the period May 2020 to October 2020

half of the credit unions and CDFIs surveyed reported a worsening arrears position (see Table 8).

Table 8: Direction of travel of arrears in loan repayments to community finance providers

Nonperforming loans	Number	%
Much lower	1	2.5%
Lower	4	10.0%
About the same	15	37.5%
Higher	15	37.5%
Much higher	5	12.5%
N	**40**	

Research by the debt charity Stepchange found that household borrowing and arrears linked to the coronavirus pandemic have soared 66% since May to £10.3bn. The number of people who are in severe debt has risen to 1.2 million – nearly doubling since March – with a further 3 million people at risk of falling into arrears after taking on extra short-term loans."[60]

Actions proposed

There are enough community finance companies in Scotland (circa 90) to justify assessing whether there is merit in establishing a bespoke, digitally driven, relationship based, collections social enterprise that can work to reschedule debts, process payments, mediate between affordable lenders and borrower and, where appropriate, complete court paperwork and liaise with AIB professionals.

Such an enterprise would be a welcome addition to the marketplace, offering paid for services on a non-profit basis to the affordable credit sector, resonating with the Scottish Government's National Performance Framework agenda of wellbeing, kindness and fairness.

The National Credit Union Forum (NCUF) informed us that they have also been exploring the potential for a social enterprise that provides collections services. They represent the largest credit union lenders in Britain including Glasgow CU, Capital CU and Scotwest all based in Scotland.

We recommend that the Scottish Government establishes a short life working group with appropriate resources (between £50,000 and £100,000[61]) to commission a research and development exercise to investigate fully to the feasibility of such a social enterprise. Members of Carnegie's Affordable Credit Action Group, NCUF and the Scottish Government's Social Economy Team among others should be considered as potential members of the group, with a 12-month remit to report to the Minister on the feasibility and timescale, legal structure and the resource requirements.

[60] https://www.theguardian.com/money/2020/nov/12/debt-crisis-warning-uk-records-steep-rise-emergency-borrowing-coronavirus

[61] This is based on our experience of preparing similar tender briefs and costs and benchmarking against the duration, expertise and resources that might reasonably be required for such a piece of work

Recommendation 9: Undertake a trial of rent-flex for social housing tenants and encourage flexibility in Council Tax payments to support households with irregular income

Why is this needed?

Pay volatility is the norm not the exception for most workers, according to Resolution Foundation research.[62] The Foundation's analysis of 7 million bank accounts of workers in October 2018 found that even those in a 'steady job' (an employee who remained with the same employer throughout 2016-17) had pay fluctuations during five months of the year.

The research also found that monthly pay changes are more common for those paid the least, and the low-paid are more likely to experience monthly falls in pay than those on higher earnings. In percentage and cash terms these changes in pay could be significant. The report notes the volatility for poorer households in receiving significantly less than anticipated in many months, putting pressure on regular monthly outlays and bill payments.

The average downwards change for those in the £10,000 to £12,500 pay band was found to be £180 (26%). Such fluctuations for lower income households make the maintenance of regular payments like rent and council tax without savings a significant challenge. The average weekly rent for a 2-apartment social housing unit in Scotland in the same year as the Resolution Foundation report was £73[63], a monthly equivalent of £318[64]. A monthly loss of £180 from employees' pay equates to 57% of monthly rent in this scenario. The average council tax amount per dwelling in 2017-2018 was £1069[65], the monthly equivalent being £89. A loss of £180 would equate to around 8 weeks of Council Tax payments.

There are also certain times of the annual calendar where expenditure is higher than normal, Christmas and Summer being two obvious examples.

Erratic income patterns require flexible payment solutions to maintain goodwill between creditor and debtor. Without support, such income volatility leads to unnecessary, sometimes expensive borrowing leading to consumer harm. Offering flex in regular payments like rent and council tax, allowing citizens the opportunity to make up the difference when their monthly pay is higher, would work for many individuals. It could also make a substantial difference to their planning, mental health and wellbeing.

The Centre for Responsible Credit initiated a rent-flex pilot with social landlord Optivo Housing Association from January 2017 through to the end of March 2018.[66] It provided a sub-group of Optivo's social housing tenants in London and the South East with the opportunity to set up a

[62] https://www.resolutionfoundation.org/app/uploads/2018/10/Irregular-payments-RF-REPORT.pdf
[63] Rounded £73.33 https://www.gov.scot/publications/social-tenants-scotland-2017/pages/7/
[64] Rounded £317.76 https://www.gov.scot/publications/social-tenants-scotland-2017/pages/7/
[65] https://www.gov.scot/publications/council-tax-datasets/
[66] https://responsible-credit.org.uk/trialling-supported-rent-flexibility-social-housing-tenants/

personalised schedule of rent payments – allowing them to under and overpay on their rent at different points in the year.

The pilot, whilst small, had some illuminating results. 59 tenants who had not previously been in contact with Optivo's Money Matters service were recruited. These were recruited from a pool of 258 tenants responding positively to an e-mail survey about financial problems, of which half (129) were offered the opportunity to trial rent-flex, and half were assigned to a control group. Findings form the evaluation[67] included:

- The on-boarding process provided effective budgeting support and helped to maximise tenant incomes. It delivered direct financial benefits worth around £70,000 to forty-two tenants (an average of £1,666 for those taking up this aspect of the scheme).

- The scheme also successfully provided tenants with additional liquidity during a number of 'financial pinch points' in the year. The amount of additional liquidity delivered to individual tenants ranged from around £75 to £650. On average it was £383 and in total it was £22,597.

- This liquidity was utilised quickly by tenants, with over three quarters choosing to under-pay within three months of joining rent-flex. This reflects the fact that finances were tight and, when joining, they either had the summer school holiday months or Christmas/ New Year on their immediate horizon.

- Tenants used the scheme in a wide variety of ways: to smooth out fluctuations in income; provide a 'breathing space' whilst benefit claims and appeals were being sorted out; buy Christmas presents, new clothes, shoes, and school uniforms for children; heat homes in winter; pay for car repairs and insurance; pay down existing debts; replace broken appliances; and pay for family holidays.

- Without rent-flex many of the tenants would have had to borrow, being on the scheme improved their welfare in several ways. Most commonly, tenants reported feeling more 'in control' of their finances, and less stressed and anxious about their rent payments.

- Some tenants reported that the way they had used the scheme had enabled them to cut their ongoing costs of living – for example by reducing laundry costs and food expenditure – whilst others were able to use the rent account to build up savings, and a few overpaid on other household bills to build up a surplus. Welfare impacts included better diets, warmer homes, and improved family relationships.

- For thirty tenants in the scheme, there was also an improvement in rent payment performance. On average, these thirty tenants had rent arrears of £155 when they entered rent-flex, and they improved their rent account balances by £110 over the course of the year.

[67] https://www.responsible-credit.org.uk/wp-content/uploads/2019/12/1261-Rent-flex-evaluation-4.pdf

Council Tax is another fixed monthly outgoing for households. This is generally paid over 10- or 12-month payments, however the ability exists to create a more flexible payment schedule with different amounts paid per month. This flexibility is not well publicised, and the process for people to request this flexibility from their local authority may not be easy or accessible.

Many local authorities allowed for flex and rescheduling of Council Tax payments during the COVID-19 pandemic. If people were encouraged to use this flexibility, it could lead to a payment system that is a better fit for more people and may enable local authorities to spend less time and resources chasing arrears.

Actions proposed

We recommend that the Scottish Government investigate the appetite amongst social landlords to undertake a rent-flex pilot, with the aim of a pilot with two or three social landlords participating in a 12-month trial with up to 1,000 participants. There are costs associated with the trial, including the provision of materials for tenants to forecast flex requirements, training of support staff, modifications to rent management systems. We estimate that a budget of £50,000 would allow for such a pilot.

The flexibility around Council Tax payments offered by many local authorities during the COVID-19 pandemic has shown that this functionality exists. The Scottish Government should work with COSLA and other partners to encourage local authorities to promote the ability to flex council tax payment schedules, as well as review the user journey to ensure the process is easy and accessible.

Offering flexibility for households in socially rented housing to meet their biggest budget expenditure of rent, and for all households to meet their council tax obligations, in flexible ways that fit with their income patterns could be of significant benefit for both payer and payee. If effective, such an initiative may contribute to a reduction in the use of inappropriate and unaffordable credit by those seeking to maintain payments when their income has reduced temporarily; and may enable more resources to be available to institutions who no longer need to divert these to arrears recovery where people intend to pay.

Recommendation 10: Commission new research into the prevalence of online illegal money lending in Scotland

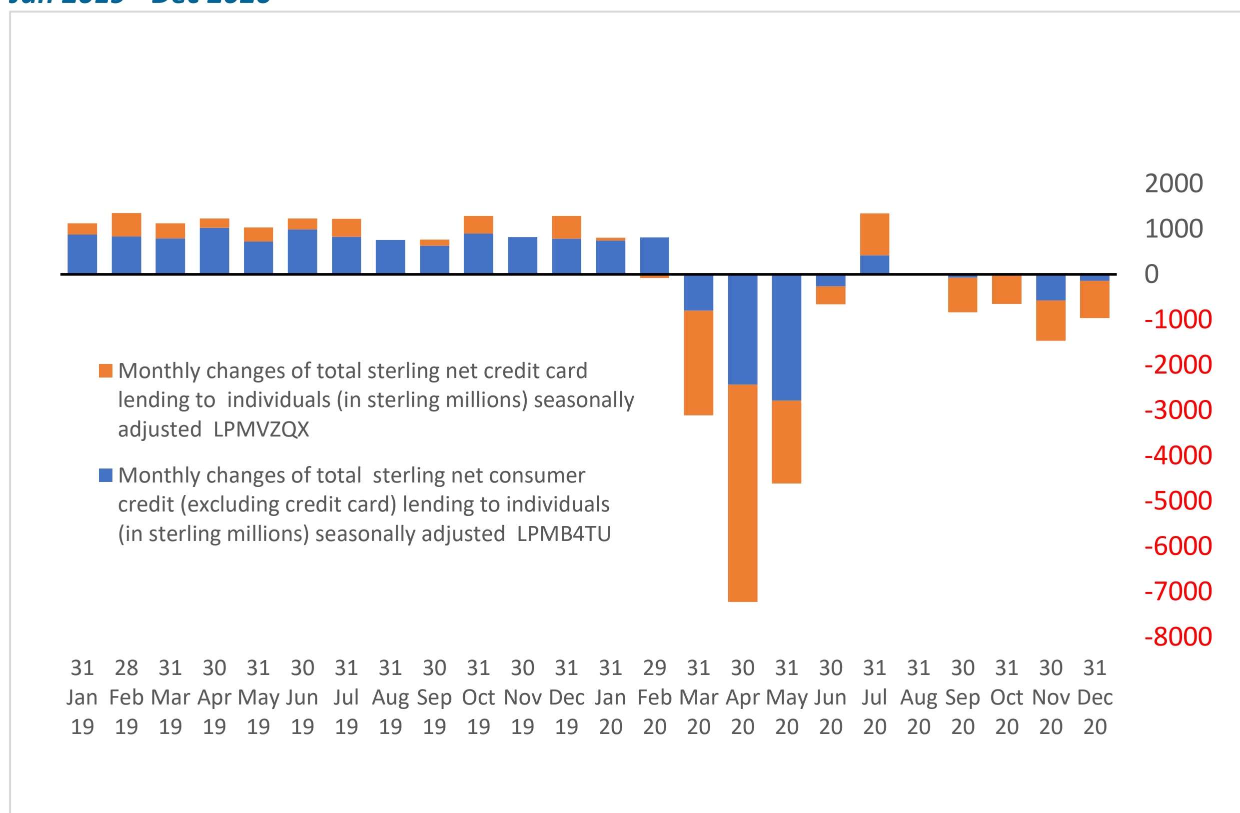
Why is this needed?

Over the past decade UK borrowers have added around £64,000,000,000 net onto household budgets via consumer credit and spent a further £20,000,000,000 net on their credit cards.[68]

The easy access to credit in the UK has generated many views about its use and availability. Many believe it is or was too easily accessible and leads to consumer detriment; others believe it allows households to smooth fluctuations in income and budget for larger item spending making big ticket items more accessible.

Figure 8 shows the net monthly borrowing in each of these categories in 2020 and 2019. Only 5 months in 2020 produced positive consumer credit figures[69] and only 2 months produced positive credit card borrowing (January and July). In 2020 UK borrowers repaid nearly £17 billion of consumer credit having borrowed £13 billion in 2019.

Figure 8: Monthly changes in Consumer Credit and Credit Card lending in £millions Jan 2019 - Dec 2020



[68] Extrapolation of Bank of England stats sourced January 2020 on consumer credit. Monthly changes of total (excluding the Student Loans Company) sterling net consumer credit (excluding credit card) lending to individuals (in sterling millions) seasonally adjusted (LPMB4TU) and Monthly changes of total sterling net credit card lending to individuals (in sterling millions) seasonally adjusted (LPMVZQX) from January 2011 to November 2020 inclusive

[69] Jan, Feb, July, Aug, Oct 2020 were months where net consumer credit was positive

The pandemic has resulted in sharply reduced borrowing, including in the areas of high cost and affordable credit. However, some of these reductions within the high-cost sector were in train prior to COVID-19. The pandemic has accelerated the tightening of credit criteria operated by these lenders, a trend that was already underway.

The FCA has, since its inception after the financial crash, placed the consumer at the heart of lending. In 2013 Christopher Woolard then the Director of Policy, Risk & Research stated that "*the consumer experience is fast becoming the dominant theme for financial services…there is a public expectation – fuelled by big data, transparency, technology, competition and social media – that financial services firms should put their customers at the heart of their business models…From our perspective, we want to ensure we keep a focus on consumer outcomes as we think about regulation*"[70].

As part of this approach, the FCA has made a number of significant interventions in high-cost credit markets during the past decade, which have tackled poor lender behaviour and reduced the exposure of consumers to the harms caused by commercial high-cost credit. Among the many regulatory changes made by the FCA these four are perhaps the ones that have significantly changed the high-cost credit markets for lower and lowest income households the most. In all cases Carnegie has supported these changes as they reduce or prevent harm:

- **The payday loan cap** at 0.8% per day with additional changes to collection practices and default charges
- **The Rent to Own (RTO) loan cap** and additional changes to sales of warranties and add ons.
- **The changes to unauthorised overdraft and authorised overdraft charges** that reduced the excess profit generated by unauthorised overdrafts.
- **The changes to persistent credit card debt definitions** that placed an onus on lenders to monitor, advise and intervene and, in some cases, remove the credit option from borrowers.

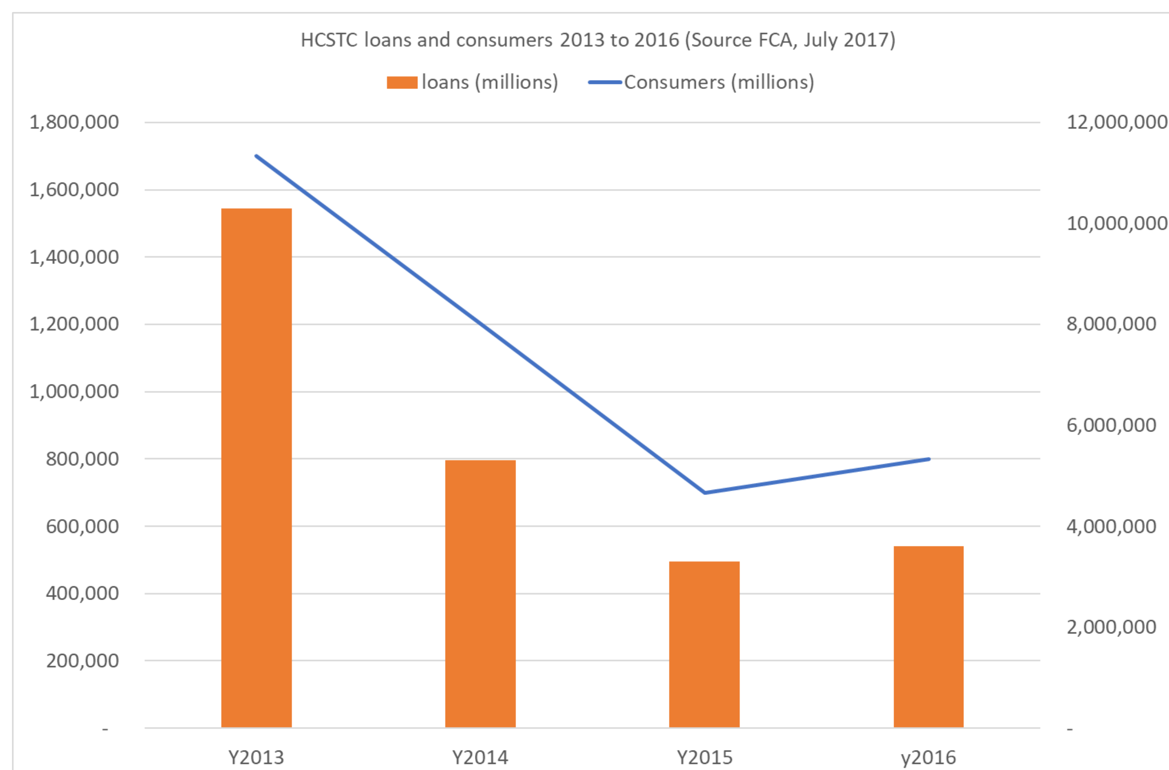
These, and other changes have significantly altered the landscape of high-cost credit lending in the UK over a relatively short time period.

In 2013, the payday loan industry was at its peak in the UK as Figure 8 shows, with 1.7 million customers and over 10 million loans issued. By 2017 this had reduced to 800,000 customers and 3.6 million loans. A slight resurgence was seen in the period to 30th June 2018 with the FCA reporting that there were just over 5.4 million loans originated in the year to 30 June 2018[71]. Since then, data has been hard to obtain although the three main lenders Wonga,[72] Quick Quid[73] and Money Shop[74] all ceased trading after 30th June 2018 reducing the major lenders.

[70] https://www.fca.org.uk/news/speeches/improving-consumer-experience
[71] https://www.fca.org.uk/data/consumer-credit-high-cost-short-term-credit-lending-data-jan-2019
[72] Wonga enrtered administration on 30th August 2018
[73] Quick Quid entered administration on 25th October 2019
[74] Money Shop entered into a Members Voluntary Liquidation on 30th March 2020

Thereafter, with regulation and greater scrutiny, fewer people are using these products, while those who do so are now often in higher income groups[75] and are better protected from poor practices (although all would still be better off if they used a not-for-profit alternative such as CDFI or credit union instead).

Figure 9: Payday Loan industry in the UK 2013-2016



The leading home credit company in the UK continues to be Provident Personal Credit. Over a period of ten years, they have stopped lending on the doorstep to nearly 1.5 million fewer people, having reported a peak of 1.861 million home credit customers in 2010, and now serve a reduced number of c.379,000[76] in June 2020. This reduction in people's exposure to this type of lending is highly welcome, but at the same time, it is reasonable to have some concerns about where these borrowers may now be going for credit. Meanwhile, home credit is still the likeliest non-mainstream, high-cost credit product to be advanced to lowest income households, although as Provident has reduced who they advance money to, they have also increasingly focused on a slightly higher income customer group.

The rent to own (RTO) market, long dominated by Brighthouse, also traditionally targeted the lowest income households. They too had begun to reduce customer numbers and focus on (relatively) more affluent groups before a combination of factors including price capping led to their administration in 2020[77]. The removal of this type of lending from the marketplace is

[75] Half or more of payday loans, high-cost personal loans or guarantor loans are issued to individuals whose income exceeds £24,000.
[76] https://www.providentfinancial.com/media/newsroom/2020/interim-results-for-the-six-months-ended-30-june-2020/
[77] BrightHouse entered administration on 30th March 2020

extremely welcome, but it is again reasonable to have some concern as to where the 200,000 customers[78] who previously used Brighthouse may now access credit.

A 2020 report for FCA by PwC[79] identified the characteristics of those who reborrowed from six high-cost credit product types. The results illustrate the shift in demography that has occurred in these high-cost credit market in recent years, as summarised in Table 9:

Table 9: Summary of demographic profiles in the quantitative sample

Profile	Payday loan	Logbook loan	High-cost personal loan	Guarantor loan	Rent to own	Home collected credit
Male	68%	70%	54%	60%	35%	35%
Female	30%	28%	45%	39%	65%	64%
Age						
18-34	33%	16%	16%	48%	23%	13%
35-54	55%	66%	61%	43%	44%	40%
55+	12%	16%	21%	9%	31%	47%
Household income						
<£12k	4%	15%	1%	6%	27%	44%
£12k-£24k	40%	45%	34%	37%	45%	37%
£24k-£36k	26%	16%	24%	22%	15%	4%
£36k+	24%	13%	36%	28%	4%	2%

A key aspect of the changes that have occurred in high-cost lending in recent years is that for millions of people on low and lower incomes, accessing *any* form of credit legally is now increasingly difficult.

The think tank and consultancy group Policis has studied illegal online moneylending in the USA and Japan over the past decade with analysis of millions of loans. They advised the UK Parliament All Party Parliamentary Group on Alternative Lending in May 2020 about the potential dangers that the UK may encounter as the reforms made by the FCA begin to impact the mass market:

"We would see a reduction in consumer resilience and a fall in the supply and availability of credit. This could lead to a disorderly market and opportunities for criminals to take advantage of the resulting vacuum unless preventative steps were taken by regulators and criminal agencies"[80]

The FCA advise the public on the use of unauthorised or clone websites purporting to be licenced high-cost moneylenders. In 2019 they reported 38 such websites with names like

[78] BrightHouse Group Limited Annual Report for year ended 31st March 2019 reported 195,900 customers
[79] https://www.fca.org.uk/publication/research/relending-high-cost-credit-market-narrative-report.pdf
[80] http://appgalternativelending.com/wp-content/uploads/2020/07/APPG-on-AL-Lending-Post-Covid-Inquiry-Final-Report-15-07-20.pdf

"*Easy Money" "Zip Cash" and "Smart Loans*". In 2020 the number of cloned or unauthorised sites had risen to 81, an increase of 113%. Again, the websites were called "*FastEasyCash" "My Instant Finance" and "Back on track Loans*".

Table 10: FCA website on published warnings, accessed by Carnegie UK Trust January 2020

	2019	**2020**
FCA published warnings on cloned or unauthorised websites	38	81

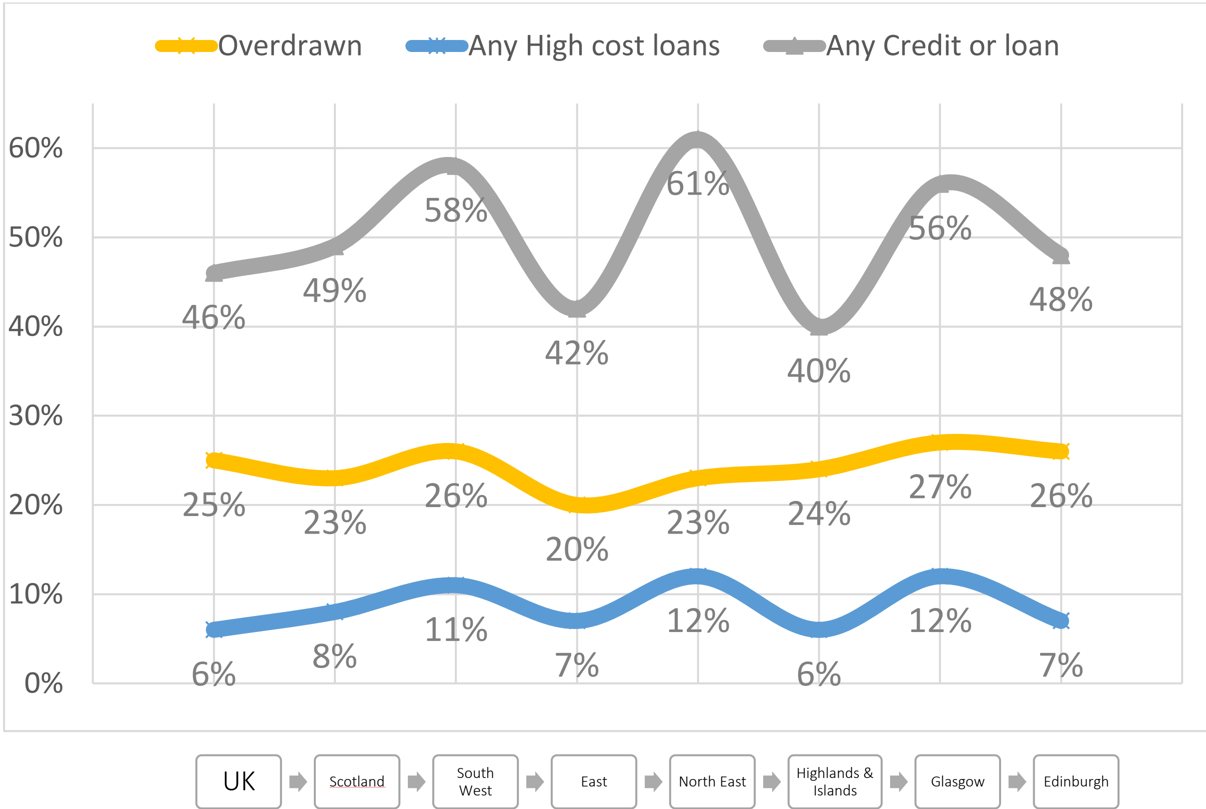
Illegal online lenders will both dupe and prey upon prospective borrowers. These are either unlicenced, or lenders licenced outwith the UK, not party to UK regulation and are likely to be increasingly sophisticated in their operations.

Actions proposed

We recommend that the Scottish Government should provide further support to the Scottish Illegal Money Lending Unit, including funding for new research to examine the specific issue of how online illegal lending may be penetrating communities in Scotland. Identifying the proliferation of these websites will be the starting point to determine the level of harm being caused.

APPENDIX 1 – Credit use in Scotland

Across Scotland between 6% and 12% of adults will have high-cost credit on their credit file, around a quarter will be in regular use of their overdraft and half will be repaying some form of consumer credit.[81]



Source: Understanding the Financial Lives of UK Adults - extracts provided for Carnegie UK trust by FCA 27th March 2018. FCA divisions of Scotland.

[81] Understanding the Financial Lives of UK Adults - extrapolation of Scotland data by FCA for Carnegie UK Trust

APPENDIX 2- Comparisons of cost between Credit Unions, CDFIs and high-cost credit providers

Lender[82]	Not for profit (NFP) or for profit	Loan value	APR %	Repayment Term	Total Cost of Credit[83]	Equivalent monthly payment	Weekly difference from lowest
Credit Union	NFP	£500	12.7	12 month	£533	£44.42	n/a
Credit Union	NFP	£500	42.6 (max)	12 month	£603	£50.25	£1.35
Fair for You	NFP	£500	55.5	12 month	£630	£52.50	£1.87
Conduit Scotland	NFP	£500	99.8	12 month	£713	£59.42	£3.46
Moneyline	NFP	£500	169.0	12 month	£821	£68.42	£5.54
Scotcash[84]	NFP	£500	244.1	12 month	£807	£67.25	£5.27
Provident	For Profit	£500	299.3	12 month	£936	£78.00	£7.75
Satsuma	For Profit	£500	315.7	12 month	£996	£83.00	£8.90

[82] All loans taken from company websites in January 2021 except Scotcash which was supplied by CEO on 21/1/21
[83] Rounded to nearest pound (GBP)
[84] Note: Scotcash APR is higher but the repayment appears lower than some of their peers as the calculation is on £470 not £500. Scotcash remove a £30 admin fee from the principal sum borrowed which has a distorting effect on the way APR is calculated.

APPENDIX 3 – Organisations attending CUKT workshops on emerging proposals

Note: Credit Union Sector bodies (ABCUL, SLCU, ACE, and NCUF) were invited to attend and nominate a selection of their members to join a session to offer their voice to the discussions.

1st Alliance Ayrshire Credit Union

1st Class Credit Union

Association of British Credit Unions Limited

Ace Credit Union Services

BEMIS

Capital Credit Union

CEMVO Scotland

Citizens Advice Scotland

Engender

Fair4All Finance

Falkirk Council

Fife Council

Financial Conduct Authority

Fintech Scotland

Five Lamps Trading Limited

Glasgow and West of Scotland Forum of Housing Associations

Glasgow Credit Union

Grampian Credit Union

Heriot Watt University

HM Treasury

Improvement Service

Inclusion Scotland

Money & Pensions Service

National Association of Welfare Rights Advisers

Nationwide

NHS Credit Union

Responsible Finance

Right Way Credit Union

Salad Money

Scottish Federation of Housing Associations

Scottish League of Credit Unions

Scotwest Credit Union

StepChange

University of Edinburgh

West Lothian Council

Young Scot

APPENDIX 5 - Case Study on Payroll Deduction schemes

The Carnegie UK Trust's Credit Union Consortium pilot is a credit union partnership comprised of 1st Alliance (Ayrshire) Credit Union, Castle Community Bank, East Kilbride Credit Union, Kingdom Community Bank and West Lothian Credit Union, supported by the Trust. The consortium is working together to drive an increase in employer payroll deduction through a dedicated Employee Engagement Officer, with the aim of helping workers in Scotland benefit from credit union membership via their employer.

A forthcoming report from the Trust on the pilot gives the example of a large educational establishment in central Scotland who chose to replace an existing 'saver club' run internally, which was laborious for payroll staff, with a partnership with a local credit union offering payroll saving and borrowing. Engagement through the Credit Union Consortium pilot helped to promote the benefits of payroll savings to the employer and has been successfully taken up by around 40 staff. It also demonstrated how payroll deduction is a simple process with administration largely handled by the credit union or company, not the employer.