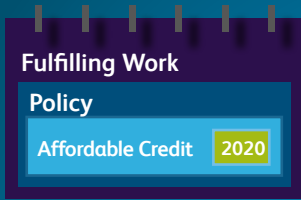




The 10% solution

How to make affordable credit more available to those who need it most

Alistair Grimes, Nick Hopkins and Jos Henson



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Foreword

The ability to borrow money is one that many of us take for granted – whether through credit cards, bank loans, overdrafts or mortgages. Almost half the people in Scotland have some form of credit or loan¹.

However, access to credit is not a level playing field. Those on low incomes, with limited credit or financial product history, are most likely to be excluded from mainstream forms of credit, such as bank loans or credit cards. They instead pay a significant ‘poverty premium’ by borrowing from non-mainstream high cost credit, putting a strain on already under pressure household budgets, or are forced to borrow from friends and families or default on bills. Both of these trends are on the rise. The FCA’s Financial Lives study reported that 8% of people in Scotland hold a high cost credit product, higher than the UK average of 6%.²

The Carnegie UK Trust is working to support alternatives to non-mainstream high cost credit through the provision of affordable credit that is sustainable, and at a scale that can meet demand. These alternatives, such as Credit Unions and Community Development Finance Institutions (CDFIs), have the

potential to save people significant sums in interest payments while also providing a supportive route to other key services such as debt advice, income maximisation and savings schemes. However, these alternatives currently only reach a very small proportion of the people who they could potentially support. Policy approaches to these alternatives in the past have failed to recognise the complex challenges that these models face, or fully consider how their offer might be grown at scale, in a sustainable way, to reach many more people.

The research fieldwork for this report took place before the COVID-19 pandemic, which has caused an economic as well as a health crisis. It is affecting those on lower incomes the most, putting further strain on household budgets and affecting the choices available to those excluded from the mainstream market. While the long term impact of the pandemic on the affordable credit sector is unclear, we are already seeing decreased demand for lending and increased costs related to transitioning to online working. Support for the sector is vital to ensure that options exist for those who will need to borrow in the medium to long term.

Local authorities can be vital catalysts to support the growth of the affordable credit sector. They are linked directly or indirectly to numerous partners who

1 Financial Conduct Authority “Understanding the financial lives of UK Adults” (October 2017)

2 Financial Conduct Authority [available online at [fca.org.uk](https://www.fca.org.uk)] *The financial lives of consumers across the UK*, 2018.

work with, and support, low income households. In addition, as part of the Scottish Government's actions to tackle child poverty in Scotland, local authorities are now required to set out a Local Child Poverty Delivery Plan, which in many cases includes a focus on affordable credit.

We commissioned this research report to examine the current levels of high cost credit use and the provision of affordable credit across seven Scottish local authorities, home to 22.5% of Scotland's population: Aberdeen, Aberdeenshire, Clackmannanshire, Moray, North Lanarkshire, Perth & Kinross and Stirling. The report reveals that almost 50,000 people across the seven authorities obtain nearly 150,000 high cost, commercial loans each year, worth more than £57 million. The report also highlights that the current affordable credit loan provision in these areas is fewer than 10,000 loans, providing stark evidence of the gap between demand and appropriate supply.

To address this gap, we encourage local authorities to increase the availability of affordable credit alternatives in their area, both in the form of credit unions and CDFIs. Increasing the market penetration of affordable credit providers in these areas to even 10%

of local demand could save low income households in the seven areas nearly £5million a year.

Accepting that credit can be part of anti-poverty solutions is not without challenges. These are difficult areas to address, but, as the report highlights, there are a range of interventions available to local authorities that can make a significant difference. Lenders are increasing their online presence, seeking to build relationships with borrowers whilst embracing the advantages of new technology to do so in an efficient way. COVID-19 has further accelerated the pace at which the affordable credit sector was moving towards an online presence. They need support and exposure as much as capital and premises – and local authorities can play a vital role here.

We commend this report as a valuable contribution to the debate about how we address the challenges facing low income households in Scotland, and the ongoing need for more widely available fair and affordable credit.



Sarah Davidson
Chief Executive, Carnegie UK Trust

Introduction: the scale of the challenge and the nature of the opportunity

“If you would know the value of money, go and try to borrow some.”

BENJAMIN FRANKLIN

It is more than ten years since the financial crisis that led to the economic crash and the policy of austerity. Since the research fieldwork was carried out, the COVID-19 pandemic has affected every area of public policy in the UK, with a significant impact on the economy, labour market and welfare system.

At the time of publication, the medium and long term effects of the pandemic are not yet clear.

For many households in Scotland their financial position is fragile and difficult. Real wage growth stuttered during the past 10 years, benefit changes have hit the most vulnerable and many households are not well placed to deal with short-term falls in income or sudden rises in expenditure.³ Around a million adults and 24% of children in

Scotland live in poverty.⁴ These issues are entrenched, few of the solutions are simple, quick or easy and are likely to be significantly worsened by the impact of COVID-19.

Access to affordable, short-term credit can be critical to people on low incomes as a means of managing their finances. Too often, these consumers have to resort to high cost credit, putting a strain on already under pressure household budgets. Even there, as we show in this report, high cost lenders are increasingly moving away from lower income groups, leaving an increasingly large gap to be filled.

Tackling poverty is about more than increasing income. The Scottish Government has recognised this and has been clear in its End Child Poverty Delivery Plan and Fairer Scotland Action Plan that tackling the ‘poverty premium’

3 Corlett, A et al, *The Living Standards Audit 2019*, The Resolution Foundation: London, 2019

4 Scottish Government [accessed online at gov.scot] *Poverty and Income Inequality in Scotland: 2015-2018*, 2019

and reducing the cost of living for those in poverty, including increasing access to affordable credit, is also an important goal. The Carnegie UK Trust, in its 'Gateway to Affordable Credit' report recognised the need to develop and invest in this area through, amongst other things, a 10-year Affordable Credit Loan Fund (also supported by the Scottish Government).

At a UK level, the establishment of Fair4All Finance (F4AF) to support the growth of alternatives to high cost credit, through debt, equity and grant investments, and prominent campaigners such as the actor and activist Michael Sheen who established the End High Cost Credit Alliance, have helped to create an unprecedented opportunity to grow affordable credit alternatives.

Affordable credit providers, such as Community Development Finance Initiatives (CDFIs) and Credit Unions operate in this area. As we show, these lenders are not yet at a sufficient scale to make a significant impact. However, growing them to meet more of the need we identify in the report is both practical and desirable.

In order to support the growth of this sector the Carnegie UK Trust commissioned this report to look at:

- The potential demand for affordable credit in seven local authority areas; Aberdeen, Aberdeenshire, Clackmannanshire, Moray, North

Lanarkshire, Perth & Kinross and Stirling, which cover 22.5% of Scotland's population between them;

- How this demand might be served.

In determining the demand for affordable credit, we focused our analysis on the take-up of four types of commercial non-mainstream credit (Home Collected Credit, High Cost Short-Term Credit, Rent to Own and Pawnbroking) based on the credit ratings, our understanding of the extent of credit choice, and the incomes of typical users. Our analysis was carried out before the onset of the COVID-19 crisis.

Our analysis shows that **at least 49,000 people across the seven areas are taking out 146,600 high cost, commercial loans each year, borrowing over £57 million in doing so.**

In none of the seven local authorities examined do affordable credit providers serve more than 10% of the potential market. In many of them, they serve 2% or less.

We calculate that taking action on the provision of affordable credit can offer a significantly more affordable, ethically provided, alternative for those 49,000 people currently turning to high cost commercial credit. The potential saving on £500 borrowed over six months from a CDFI ranges from £230 to £339 (compared with Provident and with Sunny). Increasing the market

penetration of affordable credit providers in all these areas to between 7% and 10% of the local market could save consumers a total of up to £4.9 million a year⁵. This would make a real difference to their disposable incomes, reduce poverty (including child poverty) and generate other benefits in terms of health and sustaining tenancies. For councils and social landlords it would also improve the payment of council tax and reduce rent arrears.

5 Based on 14,600 (10%) loans each saving £338.

Crucially, this change would also have the important side-effect of leading to an increase in low-income consumers benefitting from other services that affordable credit providers can support them to access, including debt advice, income maximisation, basic bank accounts and savings schemes.

We think that with leadership, commitment and the right support this increase is both desirable and possible.



Some definitions and clarifications

What are non-mainstream and high cost credit?

The Financial Conduct Authority (FCA) identifies nine different types of non-mainstream credit; catalogue credit, retail finance, store cards, high cost short term credit (HCSTC), home collected credit (HCC), rent to own, other running accounts, guarantor credit and log book loans.

We concentrate on four types of credit: HCSTC, HCC, pawnbroking and rent to own, where typical borrowers have low incomes, and low credit scores – indicating restricted choice – and where Annual Percentage Rates (APRs) are high and payment periods short. These forms of credit are ‘high cost, restricted choice credit’, high cost credit for short.

The poverty premium

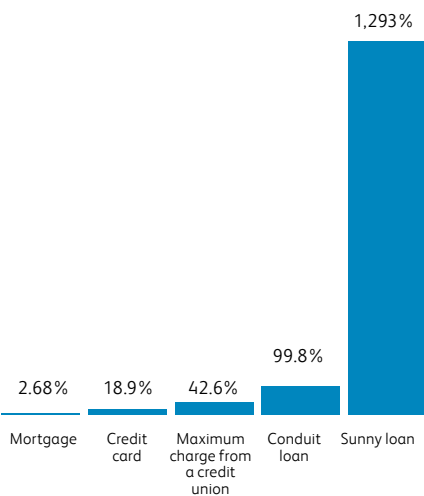
This term denotes the extra cost that households on low incomes incur when purchasing the same essential goods and services as households on higher incomes. The average impact of this on low income consumers may be around £500 per year, in worst case scenarios it might be as high as £1,400 per year^{6,7}.

The cost of money is not the same as the price of money

The **cost** of money is the total paid for a given loan each week or month e.g. £101.48 per month for 6 months on a £500 loan at Conduit, one of Scotland’s CDFIs.

The **price** of money is the APR generated by this – the graph shows the wide range for different types of loans.

The price of money is heavily influenced by the length of a loan. Though the APR is a good way of assessing a 25-year mortgage, it is a much less effective way of assessing a six-month loan for a small amount of money. We illustrate this with an example in the annex to the report.



6 Davies S, Finney A, Hartfree Y, *The Poverty Premium – When Low-income Households Pay More for Essential Goods and Services*, University of Bristol, 2016.

7 Westlake A, *The UK Poverty Rip Off: The Poverty Premium 2010*, Save the Children, 2010. [Amount uprated with inflation].

Understanding the Problem

“Never make anything more accurate than is absolutely necessary.”

ENRICO FERMI (CREATOR OF THE FIRST NUCLEAR REACTOR)

Income Trends

Even prior to COVID-19, wages and incomes for middle to low income groups were still struggling to reach above the levels of the 2008 recession in the UK⁸. In Scotland, median incomes finally rose above pre-recession levels from 2013-16.⁹ Particular pressures have been felt by families with younger children, adults under 30, and social and private renters.

Impact of Welfare Reform

The last decade has seen significant changes to the benefits and tax credit system at a UK level, with:

- The creation of new benefits to replace old, most recently Universal Credit (UC) replacing six income related benefits and tax credits, but also including Personal Independence Payment (PIP) replacing working age Disability

Living Allowance and Employment and Support Allowance (ESA) replacing Incapacity Benefit;

- The ‘salami slicing’ of entitlements through small but significant changes to rules, e.g. the Bedroom Tax and the ‘two child limit’ for Universal Credit;
- The erosion of the value of many benefits through the benefits freeze.

Many of these changes have reduced real and/ or cash incomes, with the benefit freeze responsible for the largest proportion of the overall negative impact. The Equality and Human Rights Commission (EHRC) predicts that in Scotland the income of the bottom 20% will fall by 8% between 2012 and 2022. This prediction will not take into account the impact of COVID-19, which could further increase the income of the bottom 20%. The impact of changes has been worse for households with children, households with disabled members, women and BME communities¹⁰.

8 Corlett, A et al, *The Living Standards Audit 2019*, The Resolution Foundation: London, 2019

9 Scottish Government [accessed online at gov.scot] *Poverty and Income Inequality in Scotland: 2015-2018*, 2019

10 Portes, J., Reed, H., ‘*The Cumulative Impact of Tax and Welfare Reforms*, Equality and Human Rights Commission, 2018.

UK-wide figures make clear that some of the losses for households with children, who make up the main market for some forms of high cost credit, are very large. Over the period 2012 – 2022:

- Lone parents in the bottom 20% of households lose 25% of net income; on average £5,250 per year;
- A disabled lone parent with one disabled child loses 30% of net income – £10,000 per year in cash terms;
- Couples with children would lose £3,000 per year.

Meanwhile, changes will continue, with the introduction of UC not due to be complete until 2023. The impact of COVID-19 will see many more people relying on the social security system, many of whom have not had to do so before. It is not yet clear what the implications of the crisis will be for the future design of the system.

Changes at the UK level have been accompanied by changes at the Scottish level. Initially, the Scottish Government sought to use existing powers to reduce the impact of some of the UK changes, for example through the mitigation of the Bedroom Tax. Secondly, following on from its earlier assumption of power over the Scottish Welfare Fund, the Scottish Government has moved to use its new powers to create a new Scottish social security system focused on defined areas of benefits, largely relating to disability, children and carers under the Social Security (Scotland) Act 2018.

Poverty Levels

In Scotland:

- 20% of people and 24% of children live in relative poverty after housing costs;
- Being employed does not remove the risk of poverty; 65% of children and 60% of adults living in poverty live in a household where someone works;
- 24% of people living with a disabled person in the household are in poverty and so are 39% of lone parents¹¹;
- Poverty can be persistent, in 2011, 11% of the Scottish population were in persistent poverty; including 17% of children¹².

Changes in the labour market

Even before the COVID-19 pandemic, a large number of people were underemployed – willing and available to work more hours but unable to get them. In 2019 the ONS estimated 2.49m people in the UK wanted to work more hours (about 8% of the workforce)¹³.

A large number of people were atypically employed, and likely to have lower wages as a result. The Resolution Foundation reports that from 2008, two thirds of jobs growth was in **atypical employment**; that is self-employment,

11 Scottish Government [accessed online at gov.scot] *Poverty and Income Inequality in Scotland: 2015-2018*, 2019.

12 Scottish Government [accessed online at gov.scot] *Persistent Poverty in Scotland: 2010-2017*, 2019.

13 ONS [accessed online at ons.gov.uk] *Dataset EMP16: Underemployment and overemployment*, 2019.

part time work, temporary work, agency work or zero hours contracts, with women and single parents often those most likely to be in this situation. In 2018 there were 800,000 people in the UK working as agency workers, and just under 800,000 with zero hours contracts¹⁴.

Being short of hours may trigger demand for credit, being in atypical employment may affect people's ability to repay. It is too early to quantify the impact of COVID-19 on the labour market, but it is likely to be significant. Over 628,000 jobs were furloughed in Scotland¹⁵, with this government support likely to be suppressing unemployment while it is in place.

14 Clark, S., Cominetti, N., *Setting the Record Straight- How Record Employment Changed the UK* The Resolution Foundation: London, 2019.

15 UK Government [accessed online at gov.uk] *Figures show UK Government supporting incomes across all nations during coronavirus*, 2020.

Financial pressure on households

The consequences of financial pressure for Scottish households prior to COVID-19 are:

- In 2018, 35% reported that they were 'getting by alright';
- 8% that they don't manage well; and
- 1% that they are in severe financial difficulties¹⁶.

The previous year, 11% reported that they had no savings or investments, and 13% that they were overindebted¹⁷.

16 Scottish Government [accessed online at gov.scot], *Scottish Household Survey 2018*, 2019.

17 Financial Conduct Agency [accessed online at fca.org.uk], *Financial Lives Survey*, 2017.



The UK High Cost Credit Market

Table 1: FCA Data on UK High Cost Credit Market (2017) ^{18,19}

	People with Outstanding Debt (m)	Annual Numbers of Customers (m)	Annual loans (m)	Annual Value of loans (£bn)	Value of Outstanding Debt (£bn)
High Cost Short Term Credit (HCSTC)	1.6	0.8	3.6	1.1	1.1
Home Credit	1.6	0.7	1.7	1.3	1.1
Rent to Own	0.4	0.2	0.6	0.6	0.5
Pawnbroking	N/A	0.35	1.0	0.3	N/A

Table 2: FCA Segmented Customer Data on UK High Cost Credit Market (2017)

	Median Age	Estimated Median Income	Outstanding Personal Debt	Median Credit Score*
HCSTC	32	20K	3.6K	42
Home Credit	42	15.5K	2.8K	41
Rent to Own	36	16.1K	4.3K	38

* These numbers are rebased by the FCA, as individual Credit Agencies operate different scales. A lower value indicates increased credit risk (lower likelihood of repaying debt).

Consumers with lower credit scores are typically unable to access cheaper forms of credit as they pose high risks for lenders.

Typically sub prime scores will be those below 45, and the FCA note “sub prime’ consumers occupy the long tail of the bottom of the credit score distribution”.

It can also be seen that Home Credit users tend to be older and poorer than those using HCSTC.

18 Financial Conduct Authority [accessed online at fca.org.uk], *High-Cost Credit Review Technical Annex 1: Credit Reference Agency (CRA) Data Analysis of UK Personal Debt*, 2017

19 Financial Conduct Authority [accessed online at fca.org.uk], *Pawnbroking sector review* <https://www.fca.org.uk/publications/multi-firm-reviews/pawnbroking-sector-review> 2018.

Changes in the high cost credit market

Impact of Regulation

Payday lending became a new feature of the non-mainstream credit market in the second half of the 2000s, rapidly expanding to a peak in 2013 of 1.7m customers and 10.3m loans worth £2.5bn.

Legislation was introduced in 2014 to curb excesses in the market. As a result the number of customers in 2015 fell to 700,000, taking out 3.3m loans worth £0.8bn²⁰.

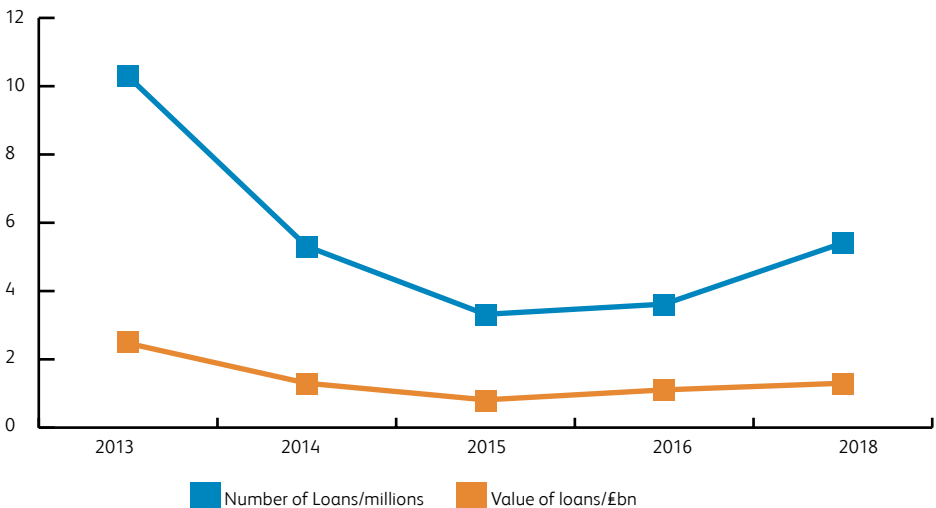
20 Financial Conduct Authority [accessed online at fca.org.uk], *High-Cost Credit Review Technical Annex 1: Credit Reference Agency (CRA) Data Analysis of UK Personal Debt*, 2017.

Some of the main providers of payday lending, in particular The Money Shop and Cheque Centre, have gone from the high street, and major online providers such as Wonga and Quick Quid have gone into administration.

Commercial lenders have responded to regulation in a number of ways, for example, a shift to short term instalment loans, with the loan typically repaid across a three-month period.

FCA analysis tells of more recent regrowth in this market;

Impact of payday lending regulation



- 5.4m million loans were made in the year to June 2018;
- These were worth £1.3 billion;
- An estimated 1.7m customers took out these loans²¹.

The long-term future of this market remains unclear particularly when the impact of COVID-19 is taken into account, but at the time of the research fieldwork it was **changing, not disappearing**. 85% of the market is accounted for by 10 lenders, but there has been a degree of fragmentation. The FCA reports 90 providers operating in this part of the market²².

Rent to Own retailers have also been under regulatory pressure, with significant market consequences. Both of the two main retailers have contracted:

- Perfect Home now only offer online products.
- Brighthouse entered administration in March 2020.

Changing Lender Behaviour

The trend is currently for non-mainstream lenders to consciously move from targeting 'sub-prime' to 'near prime' customers. They are moving away from poorer people (not the other way around). At its peak Provident Financial, the main provider of home credit, had 1.8 million customers.

21 Financial Conduct Authority [accessed online at fca.org.uk], *Consumer Credit — High-cost Short-Term Credit Lending Data*, 2019.

22 Financial Conduct Authority [accessed online at fca.org.uk], *Consumer Credit — High-cost Short-Term Credit Lending Data*, 2019.

Their 2018 figure for home collected credit was around 400,000²³. Though other companies have increased their presence (Morses Club, Non-Standard Finance) the overall figures in this part of the market are still much lower than when the market was at its peak.

Customer Response to Market Changes

The reduction in the volume of commercial high cost, short term credit and improvements in lender practices brought about by regulation, is on the whole a very positive development, reducing exposure to unaffordable levels of debt for many vulnerable consumers.

However, one of the concerns about the introduction of legislation on high cost short term credit was where people would turn to meet their need for credit in the absence of commercial providers.

The FCA explored the experience of customers rejected by pay day lenders and former pay day lender customers,²⁴ finding that people either turned to family/friends (who may themselves be on low incomes), found a new provider or stopped borrowing. They did not find much evidence of turning to illegal / unregulated sources of credit.

23 A further 117,000 use an on-line product, Satsuma; Provident Financial Group [accessed online], *Annual Report 2018*, 2018.

24 Critical Research [accessed online at fca.gov.uk], *Price Cap Research Main Report*, 2017

The conclusion in relation to illegal / unregulated sources of credit received anecdotal support from research for Trading Standards Scotland, which found little or no evidence from advice and other organisations pointing to a significant increase in the usage of illegal moneylenders²⁵, though there may be many reasons why such evidence is hard to come by.

25 Hopkins, N., [Illegal Moneylending in Scotland](#), Trading Standards Scotland, 2018.

These are early days and this may change, as turning to family/friends is not a sustainable long-term solution if they too have limited finances, and low-income groups will continue to face one-off emergencies that they cannot meet except through borrowing. The COVID-19 crisis may also lead to a greater need for borrowing, with alternatives such as turning to family or friends ceasing to be an option.



High Cost Credit: Current Local Market Size in each area

We have generated a set of estimates for the size of the segments of the high cost credit market selected (HCSTC, Home Credit, Rent to Own, Pawnbroking) in each of the seven local authority areas using:

- Postcode district lending data relating to High Cost Short Term Credit loans²⁶;
- FCA data from 2017 on the UK home credit and Rent To Own market;
- Proxy measures of poverty in each local authority area based on those claiming a number of benefits²⁷;
- Brighthouse PLC's most recent annual report, and the number of Brighthouse stores in each local authority area²⁸;
- FCA research from 2018 into the pawnbroking industry²⁹.

These are summarised in the table 3 and 4. These figures were calculated before the COVID-19 crisis.

Table 3 sets out the mid-range estimate of **total current market size** for people using high cost credit in each of the local authority areas.

26 Financial Conduct Authority, [accessed online at fca.org.uk] FOI 6305 information provided, 2019

27 Financial Conduct Authority [accessed online at fca.org.uk], High-Cost Credit Review Technical Annex 1: Credit Reference Agency (CRA) Data Analysis of UK Personal Debt, 2017

28 BrightHouse Group Limited [accessed online at brighthousegroup.co.uk], Annual Report for the year ended March 31st 2018, 2018.

29 Financial Conduct Authority [accessed online at fca.org.uk], Pawnbroking sector review, 2018.

Table 3: High Cost Credit Use by Local Authority Area

	Total Customers Using High Cost Credit per year	Total loans per year	Total Value of loans per year
Aberdeen	10,000	31,500	£11.5m
Aberdeenshire	5,600	17,700	£6.9m
Clackmannanshire	2,600	7,400	£3m
Moray	3,250	9,600	£3.75m
North Lanarkshire	19,300	56,000	£22.5m
Perth and Kinross	5,150	15,400	£5.75m
Stirling	3,200	9,000	£3.6m
TOTAL	49,100	146,600	£57m

Table 4: Potential Customer Base for Affordable Credit

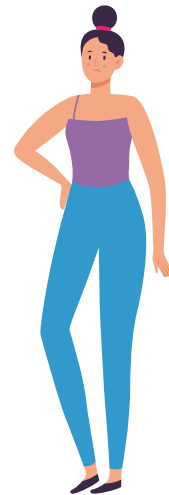
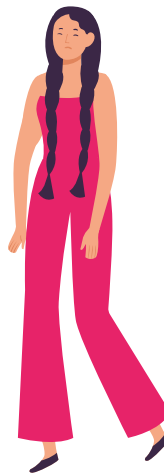
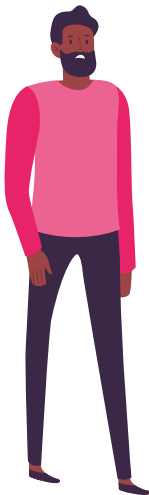
	Customer Base for Affordable Credit
Aberdeen	20,500
Aberdeenshire	11,500
Clackmannanshire	5,300
Moray	6,700
North Lanarkshire	39,600
Perth and Kinross	10,600
Stirling	64,600
TOTAL	100,500

Table 4 sets out the estimate of the **potential customer base** for affordable credit, based on our estimate of the number of people in each area who have recently used at least one form of high cost credit.

Individual tables for the different types of credit; HCSTC, HCC, Rent To Own and pawnbroking, which make up the total market; are included in the full report.

Using these figures, we calculate that the **current market segment we have specified across the seven areas is around 49,000 customers, taking out 146,600 loans worth £57 million.**

Based on our calculations, the **potential market is around 100,500 customers.**



Alternative sources of loans: credit unions and CDFIs

We have already seen that alternatives to borrowing from high cost lenders include going to family and friends, reducing expenditure and seeking out other sources of credit. In amongst other sources of credit are affordable lenders such as credit unions and CDFIs. Our point in promoting them as alternatives in this report is that they offer a number of tangible benefits – they are **cheaper, not driven by profit maximisation and can offer a gateway to other services such as savings, insurance and money advice.**

Credit unions

In 2018, there were 89 Scottish Credit unions with 414,000 adult members. These made 118,000 loans (£350 million) at an average of £3,000 per loan. This hides a wide variation, with some credit unions having 50% of their loans below £1,000.

At the time of the research fieldwork, there were 24 credit unions of differing sizes and capacities operating across the seven local authority areas, including 17 in North Lanarkshire.

Credit unions have been developing a number of relevant products and services aimed at lower income groups and to encourage savings. A number have come together to work with

employers to develop payroll savings schemes for those in work. Others offer small loans which are quasi-secured against child benefit or other benefits. These are both important developments in meeting the needs of low-income groups.

We discuss credit unions in more detail in the individual local authority sections. **Credit unions are not the only answer, but they have an important role to play.**

CDFIs

There are ten personal lending CDFIs in the UK.

- In 2018 they lent £26 million in 46,000 loans to individuals (average loan of £550);
- 50% (23,000) of those taking out loans from a CDFI had previously borrowed from a high cost lender.

Three CDFIs provide personal loans in Scotland – Scotcash, Five Lamps (Conduit) and Fair for You.

- Scotcash was established in 2007 with support from Glasgow City Council, Glasgow Housing Association, Communities Scotland and RBS. In 2018/19 it delivered around £2 million in small loans a year to 5,000 customers, a figure

which grew substantially in 2019. It has opened up operations in Inverclyde and Edinburgh.

- In 2016, Five Lamps (Conduit) entered an agreement with Fife, Falkirk and West Lothian Councils to deliver loans and gateway services across the three local authorities. They have delivered (mainly online) over 2,300 loans (at a value of £1.2 million, average loan of £520) to low income consumers and helped a number access other financial and debt services from local authorities and third sector organisations.
- Fair for You was established in 2015 and offers an online product only. It made around 7,500 loans in Scotland last year, worth £2.48 million (average loan of £331).

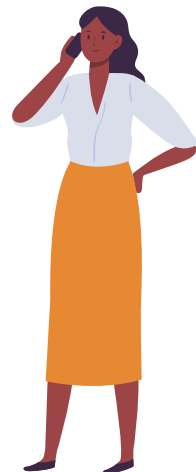
These CDFIs are effective at targeting people on low incomes.

- 60% of Fair for You customers are female lone parents;

- 50% are in employment, with over half of these in part time employment, 10% of these in low paid self-employment, and 3% on zero hours contracts;
- 33% have long term health conditions, and 28% are caring for someone with a health problem or disability³⁰;
- Over 40% of Scotcash customers are single parents, and 40% single adults;
- Five in six Scotcash customers rent from a social landlord, the vast majority of the remainder from a private landlord;
- 45% have a long-term condition affecting their life; about the same proportion can't work, or can only work limited hours because of caring responsibilities³¹.

30 Gibbons, D. *The Social Impact of Fair for You* Centre for Responsible Credit: 2016.

31 Scotcash [accessed online at scotcash.net] Financial Inclusion in the Community - Evaluation Report for the Big Lottery, 2017



Combined credit union/ CDFI lending in each area: Size of the provision gap

Table 5 sets out our estimate of the number of loans made by affordable credit providers in each of the local authority areas, alongside the number of loans we estimate are made by high cost credit providers in those areas.

What does this mean?

- The gap between the number of loans made by affordable credit providers and the number of high cost credit loans in each local authority area is very large.
- The impacts made by the alternatives to high cost lending are small, even in Aberdeen, North Lanarkshire and Perth and Kinross.
- The exceptions are in areas in which there is either a mature and extensive base of credit unions (North Lanarkshire) or credit unions are offering loans to low income customers secured against benefits (Aberdeen and Perth and Kinross).
- There is some 'leakage' from the areas in which Five Lamps (Conduit) and Scotcash operate with the

Table 5: Current Affordable Credit Market by Local Authority Area

	Estimated Number of Loans by Affordable Lenders per year	Estimated Number of High Cost Credit Loans per year	Loans by Affordable Lenders as Percentage of High Cost Credit Loans
Aberdeen	1,960	31,500	6.2%
Aberdeenshire	190	17,700	1.1%
Clackmannanshire	130	7,400	1.7%
Moray	160	9,600	1.7%
North Lanarkshire	5,780	56,00	10.4%
Perth and Kinross	1,020	15,400	6.6%
Stirling	175	9,000	2.0%
TOTAL	9,510	146,600	6%

support of a number of local authorities; particularly in areas which border Glasgow, Falkirk, Fife and West Lothian, but this is not significant so far.

- Fair for You have made significant progress in a relatively short timeframe. They have successfully harnessed relationship style lending with transactional IT systems, including by building their customer base using social media and receiving impressive testimonials on Trustpilot, thereby keeping the cost of loans down without the need for a local bricks and mortar presence.

What Might Investment in a CDFI Offer?

Looking at the performance of Five Lamps (Conduit), which provides affordable credit in Falkirk, Fife and West Lothian, we can see the number of loans that it has made against the potential size of the high cost credit market.

Five Lamps (Conduit) came to operate in the three areas through a tender the local authorities put out jointly, a process supported by the Carnegie UK Trust.

Table 6 sets out figures on lending by Conduit in those areas in their first two of years of operation. The annual savings for customers across the three areas total nearly £400,000.

Table 7 sets out the level of market penetration by Conduit. The performance of Conduit provides evidence that a new organisation can build up a customer base over two or three years and sets a benchmark for what might be achieved in the other areas.

Alongside this, Conduit acts as a gateway to other financial inclusion services. Our figures do not include the thousands of referrals on to other organisations and benefits, but these are significant.

We suggest that if CDFIs like Scotcash, Conduit and Fair For You could hit a stretch target of between 7% and 10%, then the gains would be nearly £5 million to customers each year. Coupled with the expansion of some credit unions into sustainable low-income lending, the figures would be bigger still.

Table 6: Conduit Scotland Lending Data for 2017-2019

	Number of Loans made January 2019 to start of September 2019	Value of Loans made January 2019 to start of September 2019	Number of Loans made since start of lending in August 2017	Value of Loans made since start of lending in August 2017
Falkirk	261	£136,000	445	£226,000
Fife	555	£314,000	1,148	£618,000
West Lothian	325	£192,000	684	£374,000
TOTAL	1,141	£642,000	2,277	£1,218,000

Table 7: Penetration of Conduit Scotland into High Cost Credit Market in Years 1 and 2

	Number of Loans Made by Conduit Year to start of September 2019	Estimated Number of High Cost Credit Loans per year	Loans Made by Conduit as % of High Cost Credit Loans
Falkirk	261	23,500	1.1%
Fife	555	45,000	1.2%
West Lothian	325	27,500	1.2%
TOTAL	1,141	96,000	1.2%

Next Steps

There is a need for action

- Prior to COVID-19 there was a significant demand for small sums of credit from low income groups in all seven areas: a market of at least 49,000 people, potentially 100,000 people.
- COVID-19 could further increase the demand for credit from low income groups.
- Commercial supply is both changing and reducing as lenders move to less risky and more profitable groups.
- Affordable lenders are doing valuable work but so far at too small a scale to make a significant difference.
- Both credit unions and CDFIs can meet the needs of people on low incomes: credit unions particularly when they offer loans secured against benefits, CDFIs as their core business.
- Both face constraints on growth. Credit unions recognise that financial sustainability requires a balance between smaller loans to people on low incomes and larger and longer-term loans to higher income customers. It requires realism about how far they can grow their volunteer base or staff complement. CDFIs face the challenge of accessing capital to lend, and setting their interest rates at levels which ensure both sustainability and sufficient financial gains to customers. The COVID-19 crisis presents significant challenges to both credit unions and CDFIs and they will likely need support in the short to medium term.
- The benefits of supporting activity by credit unions and CDFIs to increase penetration in their respective market areas are considerable;
 - The potential saving on £500 borrowed over six months from a CDFI is £230 to £339 (compared with Provident and with Sunny);
 - A delivery model that is fair and designed to meet the customers' needs rather than to maximise the size of the loan they take out;
 - Access through the lending gateway to other services including financial, benefits and debt advice, insurance and savings schemes.
- Policy from the Scottish Government is positive and they are investing £10 million in supporting credit unions. There is an opportunity to broaden their support to cover the wider field of affordable credit provision.³²

32 Scottish Government [available online at gov.scot], *Increasing access to affordable credit*, 2019.

The nature of the opportunity

We would argue that there is a significant opportunity for the seven local authority areas, with support from the Carnegie UK Trust and the Scottish Government to:

- Give a new focus to the provision of affordable credit as part of efforts to respond to and recover from the COVID-19 crisis.
- Use affordable credit as a spearhead to engage with low income consumers who need small scale loans and provide a gateway to:
 - Link them to other services (savings, insurance)³³;
 - Link them to other types of support (including longer-term solutions to poverty);
 - Have a direct impact on disposable income of people struggling, especially families with children.
- Provide an additional dimension to the fight against poverty and child poverty.
- Generate wider benefits in terms of:
 - Reducing customers' stress and improving their mental health,
 - Helping customers change their financial behaviour, and sustain their tenancies, and

→ Improving council tax and rent payment.

- Be a focus for joining up services in a better way.

The challenges and how they might be overcome

We are clear that delivering successful and sustainable outcomes which have a lasting impact is achievable, but also difficult. There are a number of challenges:

- The range of many other urgent, important, competing priorities brought by the COVID-19 crisis and the capacity of services to respond to these demands;
- The need for affordable credit providers to develop new delivery models that meet the requirements of COVID-19 restrictions;
- The need for political will to see this as a priority and to bring about collaboration within local authority and third sector services;
- The need to focus individual organisations on what they can do well and effectively – horses for courses;
- The need for partners to be realistic about sustainability and the sort of investment required to make a difference;

33 Unlike Credit Unions, CDFIs are unrestricted in the forms of protection insurance that they can offer.

- Understanding that affordable credit partnerships work best when a number of specialists collaborate, perhaps co-locate, and focus on their area of business expertise. CDFIs ostensibly sell money (and know their customers' needs) but pass on people who shouldn't be borrowing money to a CAB or to other debt or money advice services;
- Recognising that finance is a volume business and that scale is important. It is likely that any affordable credit lender will have to work across council boundaries and not be constrained by them. However the rewards are significant. **If a market penetration of 7% could be achieved, it should be possible to be delivering 9,500 loans, worth £4.75 million a year, saving customers up to £3 million. If a 10% share could be achieved, this would be 13,800 loans worth £6.9 million and saving up to £4.7 million.** This would be a sound base for further growth.
- Recognising that lending money is a trust-based service. Ambrose Bierce defined an acquaintance as "someone you know well enough to borrow from, but not well enough to lend to". Lenders need to trust customers (and vice versa) and those supporting affordable lenders need to build trust. This takes time to develop. In our experience, it takes between two and three years for an effective local service and partnership to be in.

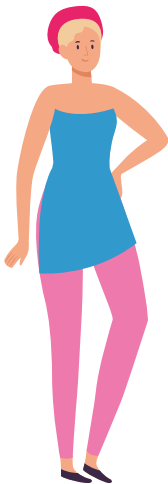
These challenges can be overcome because:

- There are existing and effective delivery mechanisms. The right expertise and track record is there; be that with existing CDFIs or credit unions, to tackle specific aspects of financial exclusion.
- There are potential partners. Non-financial organisations are present in sufficient scale with expertise in each of the local authority areas; be they housing associations, CABx, money advice services or welfare rights organisations.
- There are willing sources of funding and other support, such as the Affordable Credit Loan Fund (ACLF) established by Carnegie UK Trust and the Scottish Government, Fair4All Finance and, potentially, the End High Cost Credit Alliance.
- The policy framework being developed by the Scottish Government is a positive one.

An effective local authority response

How local authorities and others respond to these opportunities and challenges depends on local factors. Our view, based on our findings, is that the responses can be 'layered'; in the following way:

- **Do nothing** – though the findings of this research may be interesting and informative, they are not a priority over the next three to five years because of other, more pressing local issues;
- **Do a little** – existing initiatives and powers can be used in a more effective way. For example, local authorities, housing associations and third sector organisations could use existing channels to promote affordable credit alternatives and to support credit unions to develop payroll savings schemes in their area.



- **Do more** – local authorities could take a decision to look at how best to create and deliver affordable credit products (and complementary products) in their area, or in partnership with other areas (following the precedent set by Fife, West Lothian and Falkirk). This means:
 - Identifying the specific roles for credit unions and CDFIs, and how these might develop over time;
 - Identifying what they would want from affordable credit providers in terms of how many loans made and who to, and commissioning accordingly;
 - Identifying non credit outcomes they want, for example referrals through affordable credit providers acting as a gateway to other services;
 - Identifying internal services that could support affordable credit providers in kind, through referral, marketing and premises;
 - Identifying key external partners, including housing associations, third sector organisations and banks;
 - Identifying external sources of finance and other support.

Our recommendations

For local authorities

We recommend that each of the seven local authorities covered in this report considers the conclusions in the report at a strategic level and decides where it wants to be on the spectrum from ‘do a little’ to ‘do more’.

We recommend that every local authority develops an action plan aimed at increasing the availability of affordable credit in their area. Post COVID-19 there will be an increased demand for credit, and local authorities can support people to access to affordable credit rather than high cost alternatives.

Action plans should:

- Consider the contributions that both CDFIs and credit unions can make to promoting access to affordable credit, and involve them in development and delivery;
- Outline clearly the level of in kind and financial investment local authorities and other partners will make in increasing affordable credit;
- Set realistic targets for increasing the availability of affordable credit in their area and monitor them;
- Involve those organisations engaging with low income residents around issues relating to money, including council tax payment teams, social landlords, and welfare rights and money advice organisations.

Those local authorities deciding to ‘do more’ should scope out a prospectus for commissioning an affordable credit provider. We provide a template for this in the full report.

For Carnegie UK Trust

Carnegie is already playing a leading role in this area through the Affordable Credit Loan Fund, and its activities supporting the policy work within F4AF and the End High Cost Credit Alliance, along with its support for payroll savings and loans with credit unions.

We recommend that CUKT:

- Seeks a discussion with the Financial Conduct Authority about how the information it holds on high cost credit use might be made more accessible to local authorities as a way of encouraging them to take action as well as a planning tool. This will depend on the legal and regulatory powers of the FCA;
- Considers how the methodologies used in the full report can be used to develop a picture of high cost credit lending in Scotland;
- Considers the value of further research into both positive and negative experiences of low income credit union customers using loans where a prerequisite is lodging benefit payments into a credit union account as a condition of approval;

- Works with the Scottish Government, ABCUL, the Scottish League of Credit Unions and the CDFIs operating in Scotland to develop a common set of social impact measures against which progress on tackling financial exclusion can be made, and financial indicators on which all affordable credit providers in receipt of public funding are expected to report;
- Considers how to deepen its existing offer by looking at other ways in which affordable credit can be delivered;
- Considers how to broaden its offer by promoting the conclusions in this report to other local authorities;
- Considers how best to use its unique ‘convening’ power in Scotland to bring together other actors who may want to supply finance or organisational support to affordable credit providers.

For the Scottish Government

We note the Scottish Government’s commitment to promoting the agenda on affordable credit, including its financial support for the Affordable Credit Loan Fund and investment in credit unions. We recommend that:

- It continues to invest in affordable credit providers and broadens this beyond credit unions to look at how all affordable credit providers can meet market needs.

For Affordable Credit Providers

Credit Unions

Credit unions can have an important role to play in increasing the availability of affordable credit and savings to people on low incomes, though this may not be their main business. We think that they should concentrate on the market areas they are most effective in and can build a sustainable future from. We recommend that Credit Unions in each of the seven local authorities:

- Consider how best to develop loan and savings schemes with employers (linked to CUKT work in this area);
- Consider their appetite for delivering and capacity to deliver loans backed by benefit payments. Where they are doing so already, think about their appetite and capacity to expand this provision.
- Consider how developing their offer to low income customers affects their long term financial sustainability, and how they can maintain balance in their customer base by attracting other customers;
- Look at how to improve their marketing to reach and attract the right customers;
- Look at significantly improving their IT and data systems;
- Look at how best to collaborate with CDFIs in their area.

CDFIs

We recommend that the three personal lending CDFIs working in Scotland:

- Consider extending and developing their offer in each of the seven local authority areas, including looking at the balance between shop-based and online delivery;
- Consider the five action areas contained within the Fair4All Finance “Transforming Affordable

Credit in the UK” report³⁴ and the University of Salford “Scaling Up the UK personal lending CDFI sector” report, both published in February 2020, particularly those in relation to marketing, IT and back office development, and opportunities for greater coordination among CDFIs.

34 Fair4AllFinance [available online at fair4allfinance.org] Transforming Affordable Credit in the UK [italics, hyperlink to https://fair4allfinance.org.uk/wp-content/uploads/2020/02/Fair4All-Finance-Transforming-affordable-credit-in-the-UK-Final-Feb20_v2.pdf], 2020



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