

Briefing Paper BP9/2015

Credit Unions in the UK – balancing social benefit with economic viability

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An expanded credit union sector in the UK has been viewed by policy makers as a viable alternative to the high cost credit market (Alexander, White and Murphy, 2015), and as such an instrument in combating financial exclusion (Sinclair, 2014). Accordingly, in July 2012, the Coalition Government announced new funding of £38 million that credit unions could benefit from, if willing to embrace the growth and modernisation agenda. It has been argued that this particular policy is inherently contradictory, considering that targeting the lowest income population might hinder the achievement of CU sustainability (Hayton, 2001).

This briefing paper will firstly present a short overview of credit unions across Britain, providing the latest scale and growth figures and trends. The second section outlines the objectives and recent implications of the Credit Union Expansion Project (CUEP). This leads into a discussion of credit unions' views on the future direction of the movement, which are gathered in the recently issued consultation: *British Credit Unions at 50: Call for evidence* (HM Treasury, 2014) and offer input into the policy debate over CU development.

1. Short overview of Credit Unions in the UK - latest figures and trends

Largely funded by member deposits, credit unions are not-for profit, self-help financial cooperatives geared to providing accessible savings and loan services, and as such contribute

to the achievement of the economic and social goals of their members and local communities (WOCCU, 2015). One of the distinctive features of credit unions is the common bond, which originally restricted membership to associational, community, industrial or geographic groups (McKillop and Wilson, 2011). Referring to organisational life-cycle theory, Ferguson and McKillop (2000) developed a typology of credit union development which comprises distinct growth phases. In terms of assets, membership and population penetration, credit union movements in the UK are at the transition stage of development (Market Line Industry Profile, 2014). However, it should be noted that in practice credit unions can evolve beyond the maturity phase (McKillop and Wilson, 2011), which would imply a transformation to new forms of financial organisations, for example, Community Banks, as suggested by one think tank in the *British Credit Unions at 50* consultation, commissioned by the HM Treasury in June 2014.

At the end of December 2014, there were 362 credit unions across England, Scotland and Wales employing more than 1,500 staff (ABCUL, 2014a). These compare to 375 and 397 for the years ending 2013 and 2012 respectively (WOCCU, 2014). The notably gradual decline in the number of credit unions and the continuously growing membership levels¹ support the claim that a merger process is currently occurring in the UK CU movement (Market Line Industry Profile, 2014). The reasons and implications of this will be discussed in later sections of the briefing paper.

The population penetration rate (using December 2013 figures) equates to 2.78%, which is below average for Europe (3.93%) and significantly lower than the worldwide figure (8.06%) (WOCCU, 2014). In the year to December 2014, British credit unions had total assets of £1.26 billion. This results in a loans/assets ratio of approximately 56.9% which, when compared to the 70-80% suggested by the World Council of Credit Unions' PEARLS management system, indicates that potential liquidity problems are not imminent. Similarly, academics have questioned the possibility of credit unions experiencing cash problems in the near term, highlighting consumers' rising distrust in retail banks and the resultant increase in savings that credit unions experience² (McKillop, Ward and Wilson, 2011). Yet, to achieve sustainable growth and at the same time ensure that affordable credit is made available to

¹ In December 2014 credit unions had a membership of 1,197,293 which equates to a year-on-year increase of 10% (ABCUL, 2014a).

² In the five years to 2013 Credit Union savings grew by 87% (ABCUL, 2013).

the financially excluded, credit unions have relied on government funding. Paradoxically, external subsidies can result in destabilisation and weakening of the credit union movement, as argued by a number of academics in the field (Morris, 1999; Jones, 2004; McKillop et al. 2007 cited in Jones 2008).

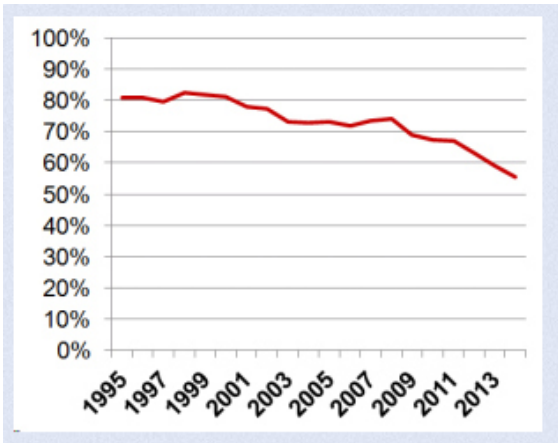
Table 1: Credit Unions across England, Scotland and Wales: Scale and Growth figures (year to 30 September 2014) (Source: ABCUL, 2014a)

Scale figures	Growth figures
1,173,299 members, including 126,676 junior depositors	Membership - 10%
Total assets of £1.23 billion	Assets - 14%
Total loans of £687 million	Loans - 7%
Total deposits of £1.04 billion	Deposits - 15%
Annual turnover of £27 million	Turnover - 10%

Table 2: Credit unions across England, Scotland and Wales: figures (September 2013), (Source: ABCUL 2014b)

	England	Scotland	Wales
Membership	657,737 members	343,437 members – (6.4% of the total Scottish population)	69,151 members
Savings	£506m	£376m	£27m
Loans	£369m	£255m	£15m

Fig. 1 Loan to asset ratio in British Credit Unions fell from over 80% in 1984 to 56% in 2014, (Source: ABCUL, 2015a)



2. Credit Union Expansion Project (CUEP)

Following the results of the Feasibility Study (DWP, 2012), the Coalition Government launched a £38 million Credit Union Expansion Project. The funds would be devoted to supporting credit unions achieve business efficiencies, raise the professionalism of the sector, attract broader membership and become sustainable within five years. The project, which ABCUL is contracted to deliver, started in May 2013 with 30 credit unions joining. As of October 2014 the programme involved 76 credit unions that are serving more than 350,000 members across Britain. It can be claimed that the involvement in the project, or respectively disassociation with it, serves to enlarge the implicit division in the credit union sector: between those wishing to expand and operate more like mainstream financial service providers, and those preferring to preserve a self-help function (Sinclair, 2014). For example, the Scottish League of Credit Unions has objected to the government expansion and modernization agenda, and refused to participate in the '*programme of business and cultural change*' (DWP, 2012a) due to it contradicting the credit union co-operative operating principles and commitment to localism (O'Neill, 2012; Patton, 2012).

The target set of CUEP of tackling the poverty premium (£1,280) and increasing total Credit Union membership by 1 million to 2 million in total by 2017 (and by 500,000 by March 2015), which according to Experian would require credit unions to serve no more than 8% of the lower income population (DWP, 2012), has also proven controversial. As suggested by scholars who consider that the association of credit unions with 'poor people's banks' (Ryder, 2002:425) confines their development, serving the financially excluded and marginalized groups and becoming self-sufficient might be irreconcilable (McKillop et al, 2011). Sinclair (2014) argues that if credit unions are to support more Tier III borrowers, and therefore promote financial inclusion, they would firstly need to attract Tier I and Tier II savers³. This, however, is not without ethical implications since it entails marketing of possibly risky prospects to higher income savers (Sinclair, 2014).

³ Tier I consumers – represent higher income, financially included households (Sinclair, 2014). Tier II consumers - those with incomes in the 11% to 40% bracket, generally with household income below £30K, a record of failed banking transactions, and likely to be in employment but use home credit and live in deprived areas or in social housing (DWP, 2012:9). Tier III consumers - those with incomes in the lowest 10% bracket, the majority of which are benefit claimants (DWP, 2012:9).

A further CUEP objective has been the provision of a broader, more advanced and more competitive range of products and services. At their latest annual conference ABCUL (2015) further emphasised the importance of diversifying and increasing credit union lending, which would positively affect the loans/assets ratio. In this regard, 58 of the credit unions involved in the expansion project have applied to be part of the *Transformation Programme*, which seeks to introduce a new proposition for CU members, with innovative products and new channels to market, built on a new operating model for credit unions (ABCUL). However, turning to evidence from the US (Goddard et al, 2008) and Australia (Esho et al, 2005), it should be noted that diversification that is not incremental and closely tied to current core product offerings might not bring the expected return improvement and risk reduction. The Expansion Project also incorporates plans for growth through collaboration and pooling of certain functions to achieve economies of scale (ABCUL). As of January 2015, the programme has delivered an automated lending decision tool which is said to speed up loan making in over 70 credit unions (Chairman of Cornerstone Mutual Services, ABCUL, 2015). Collaboration in less technical areas is less evident, but ABCUL is currently exploring whether groups of credit unions could cooperate to create secondary cooperatives offering specialist products such as mortgages for members (Roberts and Cahalane, 2014).

3. How might credit unions change?

In the scope of its commitment to '*promote mutuals and foster diversity*' in UK financial services the Coalition government issued a call for evidence on credit unions in June 2014. The consultation ran for 2 months and its objective was to gather views on the future of credit unions and the role of the government in supporting their development (HM Treasury, 2014). The 78 respondents (including credit unions, their representative bodies, individuals, the wider financial sector and the voluntary sector) recognised the need for six fundamental changes.

3.1 Start-Up Capital: In regards to the procedure for setting up new credit unions, concerns were raised that the current start-up capital requirements⁴ and the time it takes to gain approval are limiting the registration of new credit unions (HM

⁴ 3% capital: assets ratio for small credit unions, 8% capital: assets ratio for large credit unions (HM Treasury, 2014: 7)

Treasury, 2014). This can potentially encourage mergers and consolidation of credit unions over creation of new ones. While the practice of acquiring small credit unions is said to facilitate the process of mainstreaming 'progression' (Myers, Cato and Jones, 2012), it contradicts credit unions' initial focus on small local operations.

3.2 New Product Offerings: Although some credit unions regard the provision of payday loan products as an opportunity and have started to offer such services (eg London Mutual Credit Unions; Essex Savers net Credit Union) (Evans, 2014), respondents broadly disagree with the marketing of credit unions as an alternative to payday loan companies. This corroborates Ryder (2002) and McKillop et al (2011)'s argument that the association between credit unions and serving the poor, high-risk borrowers could decelerate their development. Moreover, since the profile of the credit union customer differs from that of a payday loans or home credit user (Alexander et al, 2015), it can be assumed that providing for these customers might be a significant challenge for credit unions, at least in the short-to-medium term. In relation to raising the image of credit unions, it is suggested that the government funds publicity and marketing campaigns (HM Treasury, 2014).

3.3 Government Support: That low income population is largely unaware of credit unions (e.g. 62% in London), can also be attributed to the lack of a single voice and focus for the movement - for example, there are more than 5 CU Trade Associations (NEF, 2014). In this regard, the government is looking into reduction in the number of trade associations (HM Treasury, 2014). There is also agreement around the need for the government to support strategic partnerships with other financial and voluntary organisations (HM Treasury, 2014). An example of such an initiative is the recently committed to savings programme, pairing credit unions with primary schools, and run by the Archbishop of Canterbury's Task Group (Financial Inclusion Commission, 2015).

3.4 Restrictive Regulation: Larger credit unions and trade associations emphasized the complexity which characterizes the existing procedure for changing a credit union's rulebook. They suggested that some of the rule-making responsibility is delegated to the credit union board and not necessarily authorized from the membership (HM

Treasury, 2014). This, however, raises concerns about the democratic element of the CU movement and a potential dilution of member control and goes to the very heart of the debate about credit unions' *self-help identity*.

3.5 Promoting Stability: Respondents' answers clearly indicate their belief that government funding on its own is not sufficient to ensure credit union growth, sustainability and ability to subsidise riskier lending to the financially excluded, which is in line with the recommendation by the Financial Inclusion Commission (2015) report. Accordingly, they call for a removal of the current lending and depositing limits, a relaxation of the rules around credit union investment of surplus funds (through Credit Union Service Organisation) and credit union access to central bank facilities (HM Treasury, 2014).

3.6 Business Links: There were varying views on whether credit unions should pursue corporate members, with some respondents doubting that rewards would outweigh the risks that business lending entails (HM Treasury, 2014). Examples of credit unions that already serve corporate bodies include Darlington Limited, Plymouth Limited and Kent Savers. While some consider the loosening of the common bond, and the expansion to a broader and more anonymous membership base as indispensable for the long-term success of credit unions and their ability to meet public policy agenda (McKillop et al, 2011; Myers, Cato and Jones, 2012), others treat its suitability with more caution. Attracting members across a wider cross-section infers a shift to more transactional relationships and ultimately, to an alternative '*ecology of retail financial services*' (Leyshon et al, 2004: 625 cited in Myers, Cato and Jones, 2012). It also involves security risks related to the need to move to more conventional means of assessing credit-worthiness (Sinclair, 2014). In essence, whether credit unions that expand their membership are more stable would depend on the relative importance of two influencers: reduced informational advantages and enhanced soundness, resulting from serving more economically varied membership (Ely, 2014).

In terms of respondents' call for encouraging greater financial and operational support from the private sector and civil society (HM Treasury, 2014), there is already some evidence from the banking sector. In 2014, Lloyds Banking Group and Barclays

dedicated support packages of £4m and £1m respectively, with Barclays having opened credit union community hubs within some branches (Jones, 2014).

4. **Mergers** – Whereas large credit unions emphasise the importance of driving mergers in ensuring the future sustainability of the sector, smaller CUs and trade associations oppose the consolidation process (HM Treasury, 2014). Evidence suggests that larger credit unions and multiple group credit unions are more cost efficient (Glass and McKillop, 2006) due to increasing returns to scale, which is ever more important against the backdrop of rising technology costs and costs associated with complying with regulation. However, the raised concerns highlight the risks of credit unions losing sight of their original social mission.

Having summarised the views of the consultation respondents, it can be concluded that they mirror two alternative conceptions of the purpose and needs of the credit union movement in the UK. At the one end of the spectrum, there is a pull towards preserving the original identity of credit unions – that is: self-help voluntary financial institutions, providing distinctive service to their members. At the other end, one can recognise a push for credit unions to become self-sustaining financial enterprises, to appeal to customers from wider socio-economic groups. It can be proposed that the UK government initiatives, and more recently the CUEP, encourage a move towards larger organisations that aspire to build a more sustainable business model. Yet, relying on public subsidy as the only way to achieve financial self-sufficiency and sustainability remains questionable since it can leave the credit union sector vulnerable to the withdrawal of support. As already suggested by the Financial Inclusion Commission (2015), greater access to commercial capital and social investment could facilitate the growth of the community finance sector, implying the viability of credit union growth and expansion outside the scope of CU government subsidy programmes like CUEP.

The views expressed in this briefing are the views of the author(s) and do not necessarily represent the views of CHASM as an organisation or other CHASM members.

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