The Improvement Service

ELECTED MEMBER BRIEFING NOTE

Affordable Credit

Carnegie UK Trust
CHANGING MINDS • CHANGING LIVES

improvement service

What is the purpose of the briefing note series?

The Improvement Service (IS) has developed an Elected Members Briefing Series to help elected members keep pace with key issues affecting local government.

Some briefing notes will be directly produced by IS staff but we will also make available material from as wide a range of public bodies, commentators and observers of public services as possible.

We will use the IS website and elected member e-bulletin to publicise and provide access to the briefing notes. All briefing notes in the series can be accessed at www.improvementservice.org.uk/elected-member-guidance-and-briefings.html

About this briefing note

This briefing note:

- defines what is meant by affordable credit and why it is important
- highlights some examples of affordable credit that are currently being supported by local authorities
- summarises why this is a relevant issue for elected members and outlines some issues that elected members may wish to consider regarding this subject.

Being able to access a short-term loan at a time of need or in an emergency is something that many people take for granted. In the current financial climate, household savings are at a near record low of 4.4% of disposable income (Q2, 2018[1]) and unsecured credit has reached a record high of £213bn (Q2, 2018[2]).

With households struggling to meet their financial needs, saving for a rainy day is a challenge. Additionally, low - and middle - income households increasingly cannot access fair credit. There is evidence that to access the cash they need, people are increasingly borrowing from friends and family[3] or defaulting on household bills including council tax[4] and rent.[5] Without access to fair credit,

1 https://www.ons.gov.uk/economy/grossdomesticproductgdp/timeseries/nrjs/ukea
2 Bank of England Statistics table LPQBI2O
3 FCA Financial Lives Survey 2017 report 3.6m people using friends and family for credit
4 Step Change CEO reported to Carnegie UK Trust Affordable Credit Action Group in September 2018 that the percentage of Step Change clients that were eligible to pay council tax but were in arrears was 45% in September 2018. In 2010 the percentage of clients in arrears on their council tax was 18%
5 http://www.improvementservice.org.uk/2016-17-report.html

these practices could lead to damaging consequences for communities, councils and society.

Elected members should consider which options are available to individuals living in their communities who need to borrow a small amount of money for a short term to cope with a crisis or life event, such as a child's birthday, and who may not be able to access mainstream lenders, such as banks. Are there any existing socially responsible lenders locally, where the needs of the borrower align with the motivations of the lender? If not, how can they be supported to operate — some social lenders could do so at low or no cost to local authorities.

What is the issue and why does it matter?

Tighter regulation means people with poor or thin credit histories cannot borrow money for essential items such as a replacement fridge or cooker; fix the car or meet unexpected bills.

Poor treatment of consumers is not simply the domain of payday lenders and rent-to-own firms, although poor practice there is being addressed. The Financial Conduct Authority recognises persistent credit card debt exists for 3.1m adults,[6] stating:

> *"persistent debt can be very expensive – costing customers on average around £2.50 for every £1 repaid – and can obscure underlying financial problems. Because these customers remain profitable, firms have few incentives to intervene".*

They also note a strong link between unarranged overdraft use and consumer vulnerability:

> *"We see that consumers living in the most deprived areas are 70% more likely to use an unarranged overdraft than those in the least deprived areas".*

Catalogue and store cards too saw c620,000[7] customers paying more in interest, fees and charges than the original amount borrowed.

There is clear lender knowledge of the consumer harm that is caused where repayments are not making a dent in the principal sums borrowed.

The FCA is addressing issues around irresponsible lending which has resulted in closures, collapses and changes in high cost credit providers (e.g. the collapse of Wonga,[8] and the decision of The Money Shop[9] to stop issuing loans). However, this leaves few alternatives for vulnerable households. People have to look elsewhere and to make other choices such as:

- borrowing from family and friends - this is a finite solution
- defaulting or delaying payment on non-priority debts such as rent and council tax, or utility bills
- getting goods on credit and then selling them for less than the price paid to get cash.

All of the above may result in an increased use of illegal moneylending, as the need for cash remains yet the sources from which it can be gained reduce and ultimately cease to exist. These circumstances create the conditions in which illegal moneylenders operate.

6 https://www.fca.org.uk/media/cp17-43-helping-customers-persistent-debt
7 FCA CP18/12 High-cost Credit Review: Consultation on rent-to-own, home-collected credit, catalogue credit and store cards, and alternatives to high-cost credit Discussion on rent-to-own pricing Page 48
8 https://www.bbc.co.uk/news/business-45359395
9 https://www.themoneyshop.com/short-term-loans/

Tightening affordability rules on credit and a clampdown on payday lending will reduce irresponsible lending and is welcome news, but this approach limits people's credit choices. The benefit of stemming high-cost credit only helps if alternative, ethical / more affordable options are available.

Scotland's credit unions alone cannot fill the void. Around 100 credit unions are owed £320m by 120,000 borrowers,[10] all of whom are accessing fair credit, but not all of whom are low income borrowers - credit union demographics broadly reflect Scotland in terms of tenure, working status and household income.[11]

The interest charged in Credit Unions is capped at 3% per month (equivalent to 42.6% APR) and this makes it difficult to lend smaller unsecured sums. For example, the cost of administering any loan from a credit union is estimated to be between £100[12] and £108.[13] The income from lending on short term small sum credit at credit union rates will rarely generate net income above these costs. Loans from credit unions are not designed to offer a small sum over a short period.

Some social lenders are not bound by a price cap and can therefore properly price their loan costs for risk and target their product offer to focus on lending to lowest income borrowers. Their APRs will be higher than credit unions but, without subsidy, they are priced to cover the costs of lending. Whilst the interest they charge for loans is relatively high compared to that which many in secure jobs, with good credit history could access, they offer a realistic and safer alternative to other sources of money individuals may seek. These providers include Scotcash and Conduit Scotland, and online retailer Fair for You. All these companies are bona fide social enterprises and social lenders.

The table below illustrates the interest charged on a £500 loan borrowed over a 6-month period.

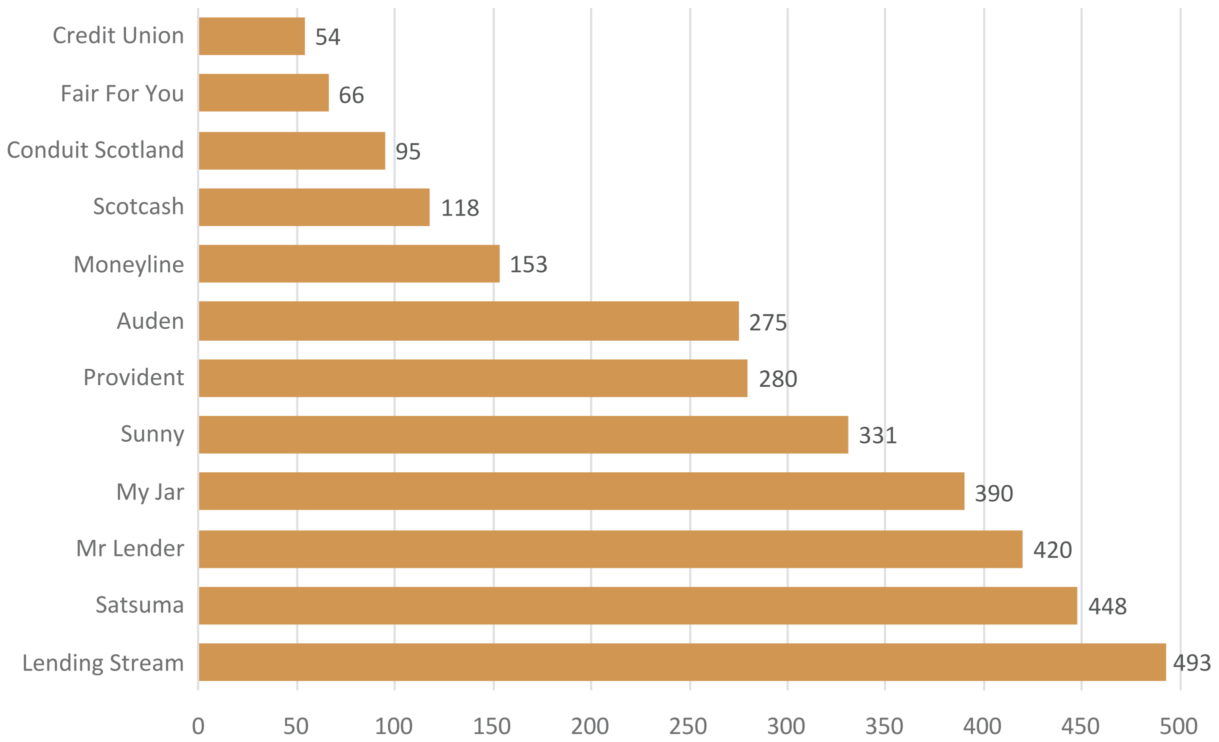
10 Bank of England credit union annual returns, July 2018

11 Use of credit and financial resilience. Analysis of the Scottish Household Survey, Chris Martin, Ipsos MORI Scotland (Carnegie UK Trust)

12 Scottish League of Credit Unions Codifying Lending Presentation Spring conference, 2018

13 Ratnam Maheswaran Policy Manager at DWP's Credit Union Expansion Project (CUEP) 2013

Chart 1: Interest repayable on £500 loan over 6 months



There is a danger that, without the credible, fair alternatives to high cost credit providers, which are offered by these social lenders, people will face additional hardship and this may have wide ranging economic and social consequences. The social lenders that do exist, like Conduit Scotland, Fair for You and Scotcash are few in number and lack visibility. These firms need assistance to raise their profile. They offer realistic, fair loans for low income households.

What does this mean for elected members?

The Fairer Scotland Action Plan[14] seeks to make "affordable credit more easily available" in a recognition of the role it can play in alleviating poverty and addressing income inequality. The Child Poverty Action Plan[15] recognised that affordable credit is part of an anti-poverty solution and contributed £1m to the Affordable Credit Loan Fund established by Carnegie UK Trust.

Being able to access affordable credit can make a real difference to reducing household costs and maximising incomes for the most disadvantaged groups, who are often living in vulnerable communities. The impacts of unmanageable debt are both negative and wide ranging. These include potential eviction, household disruption caused by stress, loss of social networks through increased isolation caused by an inability to play a full part in community life,[16] poorer mental health and increased absenteeism from work.

As well as enabling individuals to access affordable credit in a way which best meets their needs, it is critical to offer individuals seeking credit access to advice services. By offering advice at the point of contact, opportunities are offered for earlier intervention. Money advice can reduce the negative impacts of debt by both increasing individual financial capability and maximising household incomes.

This can be achieved by ensuring that affordable credit providers exist and offer direct advice services or have robust and accessible referral gateways to existing local authority funded – or similar – independent advice providers.

14 https://www.gov.scot/Resource/0050/00506841.pdf

15 https://beta.gov.scot/binaries/content/documents/govscot/publications/publication/2018/03/child-chance-tackling-child-poverty-delivery-plan-2018-22/documents/00533606-pdf/00533606-pdf/govscot:document/

16 Social connections between individuals that offer positive benefits

What does good practice look like in this area?

Good practice requires ethical, affordable credit to be more widely available to low income households in a way in which the motivation and operation of the lender matches the needs of the user.

This means that situations in which credit is inappropriate are recognised and, in those circumstances, customers are offered a dignified and respectful solution which includes access to a range of gateway services such as debt and money advice, fuel advice, insurance, or opening of bank accounts.

Affordable credit is also about encouraging savings, either linked through loan repayments or as part of a simple, straightforward solution to meet future needs.

An individual's circumstance may change as a result of something out with their control so it is important that this is considered. The needs borrowers may have around financial shocks might necessitate occasional payment holidays and could require sensitive debt arrangement and collection approaches.

At least six local authorities in Scotland directly support two community development finance Institutions (CDFIs[17]). These are organisations which provide loans and support to those who find it hard to access finance from mainstream sources. Support from local authorities to CDFIs has been provided in both cash and in kind. In 2017 these two CDFIs lent c £2.25m to low income households - saving borrowers c £1m when compared to high cost credit alternatives.

CDFIs' customers overwhelmingly live in the most disadvantaged circumstances and experience the inequalities associated with the 'poverty premium'[18] or the extra cost of being poor. In addition to not being able to buy many goods and services, people in poverty also end up paying more for the ones they can buy.

One CDFI lender, Conduit Scotland, has operated for just over one year, their typical borrowers are:[19]

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17 CDFIs are licenced social lenders that are not bound by geographic or price restrictions. They are not licenced to hold deposits and raise their loan capital from social and commercial investment. They operate throughout the UK and are licenced by the FCA. In 2017 personal CDFIs advanced £22m to c40,000 low income borrowers.

18 The Poverty Premium was a term originally coined by Save the Children to highlight the annual additional costs that they said were accumulated as a result of simply being poor. These included the costs of food, fuel, paying by prepayment meters, or accessing loans. The University of Bristol calculated the revised cost of the poverty premium in 2017 for average UK households at £490 per low income household a year. https://www.bristol.ac.uk/media-library/sites/geography/pfrc/pfrc1614-poverty-premium-key-findings.pdf

19 Conduit Scotland Management Information

- female (61%)
- living in social housing (44%)
- lone parents (30%)
- living in households with a total income of:
  - less than £12,000 (40%)
  - less than £18,000 (76%)

An evaluation of another CDFI, Scotcash, carried out in 2017 identified that:[20]

- 74% of their customers lived in the most deprived areas of Scotland (highest 15% in the SIMD)[21]
- 67% of their customers were unemployed
- £13,371 was the average income of each customer

Both organisations do not only offer loans they also support individuals to access advice and other services. Scotcash has two embedded CAB debt advisors and offer a wrap-around service providing loans, money advice and bank accounts. As a result of this approach, in 2017 c200 customers were supported to open bank accounts and millions of pounds were secured via client financial gain.

Conduit Scotland do not provide direct access to advice services but make referrals to existing locally based services.

Scotland's 94 credit unions offer access to savings and loans across all 32 local authorities. Many credit unions offer a wide range of financial capability support including: assistance with budgeting; school saver clubs; and innovative funeral poverty loans.

In 2017 Scotland's credit unions had loans outstanding with a value of £320m and members deposits amounted to £520m;[22] Scotland's Credit Unions have c339,000 adult members across all income groups and tenure types and they do not exclusively lend to low income households. They come in many forms: community based credit unions typically seek to offer small sum credit and employer-based credit unions are more likely to offer salary payroll facilities. They are ethical, affordable lenders, but as their loans are capped it makes it difficult for them to provide the type of loans being sought by borrowers of high cost credit, namely for small sums over a short term as they cannot generate sufficient income from interest to cover the costs of such lending. In short, the income from small sum, short term lending cannot exceed the cost of issuing many short term, small sum loans.

Scotland has c£17.2billion[23] of unsecured credit. According to the FCA's definition of high cost credit, an extrapolation would suggest some £1.2bn will be owed to high cost credit firms by Scottish

20 Big Lottery Fund Financial Inclusion in the Community – Evaluation Report May 2017

21 The Scottish Index of Multiple Deprivation (SIMD) identifies concentrations of deprived areas across Scotland

22 Bank of England Credit Union annual statistics released 31 July 2018

23 Figures extrapolated from FCA UK figures of outstanding high cost credit debt

households.[24] By way of illustration, four times as much is owed to high cost credit companies than is owed to credit unions in Scotland, and that is before the poor practices around unauthorised overdrafts, and credit cards are taken into account.

24 Figures extrapolated from Bank of England consumer credit totals assuming Scotland's adult population has an equal distribution. (It is likely to be higher).

Key issues/questions to consider

Demand for unsecured credit in every community in Scotland is at an all-time high with UK unsecured borrowing at £213bn.[25] Welfare reform, increases in the cost of living and wage stagnation are making lower income households' need for fair credit even greater. Demand remains high, and whilst welcome scrutiny and tighter regulation has curtailed the worst excesses of unscrupulous lending, access to loans is limited for lowest income households with the thinnest and poorest credit histories. Whilst some reduction in supply, like pay day lenders, is to be welcomed, it is important that the alternative, fair credit sector is able to fill the vacuum this has created and to take its place. In the absence of affordable options, the alternative to reduced supply for low income households is often increasing 'non-priority' debt, such as council tax, overuse of friends and family and a rise in illegal moneylending, with detrimental consequences for households and communities.

Offering access to credit is not enough, responsible social lenders can also support access to advice and information services which improves individual financial capability and ultimately community resilience.

Ensuring that vulnerable individuals have access to affordable credit should form part of locally based anti-poverty, fairness and equality strategies.

25 Bank of England statistical database LPMBI20 monthly amounts outstanding of total consumer credit lending to individuals in sterling millions (£212,978,000,000 as at 30th June 2018)

Summary

It is essential that people are able to access affordable credit in a way that meets their needs. If credit is appropriate, in that the borrower is not burdened by the repayments, and meets the affordability assessments then it can be offered; where it isn't then people need to be supported into a range of gateway advice and support services.

Access to affordable credit is a critical component in delivering the 'Fairer Scotland Action Plan' and Child Poverty Action Plan and will require consideration, at both national and local levels, of how it can best be supported.

Elected members may wish to consider which options, to offering affordable credit, such as credit unions and CDFIs are most suited to, and effective for, their local communities and to think about how these could be incorporated into their council's anti-poverty, fairness and equality strategies.

Further support and contacts

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