HOUSE OF COMMONS LIBRARY

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Credit Unions

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Summary

Credit unions are mutual financial institutions with a strong community focus; providing simple financial services to their membership such as loans and savings accounts. This note describes their operations, their regulatory structure and outlines the history of initiatives in the UK to encourage their development.

1. Introduction

Credit unions are non-profit making financial institutions based on co-operative values. A credit union is a group of people who save together and lend to each other at a favourable rate of interest. Each union is separate and autonomous although there are some national organisations which act as promoters and supply expertise, training and model rules.

The Co-operative society provides the following description of the movement:

> Credit Unions are financial co-operatives owned and controlled by their members. They offer savings and great value loans plus they are local, ethical and know what their members want. Each Credit Union has a common bond which determines who can join it. The common bond may be for people living or working in the same area, people working for the same employer or people who belong to the same association, such as a church or trade union. As financial co-operatives, credit unions are part of the long established and fast growing co-operative movement in Britain.[1]

The co-operative element means that credit unions are owned and managed by their members. In the UK, the credit union movement is relatively small and, traditionally the administration was often done by unpaid volunteers. As a result, a high degree of commitment amongst at least some of the members is required for a union to be successful.

Although credit unions have only been a feature of the UK financial scene for about 25 years, they have clear kinship to other mutual, self-help organisations such as industrial and provident societies and friendly societies. This self-help ethos is underpinned by the legal obligation for members of a credit union to share a 'common bond'.

The common bond may be geographical (all the members live in the same local area), associational (they belong to a particular group such as a Church) or occupational (they work for the same employer).[2] The existence of the common bond strengthens the community element but is also seen as adding security to the union since as well as the financial relationship, the members are bound together by non-financial bonds. This may be a protection against default or dishonesty.

Credit unions offer saving facilities and loans only to members. To become a member, a person needs to demonstrate that they satisfy the common bond. A membership/admission fee might be charged, but the most important element is the purchase of shares. The minimum initial shareholding is usually very small. Shares are synonymous with savings at credit unions. Since the object is to save, most members will have higher shareholdings than the minimum. The advantages that credit unions offer also depend upon the level of shareholding, since the amount of the loans made - which are made at modest rates of interest - reflect the size of the member's shareholding. Savers receive life

1 Definition from Co-Operatives UK website
2 These bonds can to some extent be combined now.

insurance in proportion to their shareholding, and members with loans have an appropriate amount of loan protection insurance. Both these insurance elements are provided free.

Interest may be paid to savers in the form of a dividend and borrowers pay interest on their loans. The credit union finances itself by investing the savings of members and charging interest on loans. How much a union pays out in dividends to members, or retains to build up reserves, will vary greatly. Expenses will usually be quite low at a small credit union since staffing levels are typically low, some staff are volunteers and premises are often shared with other organisations or are at low cost.

The main public advantage of credit unions is the fostering of thrift within a community environment. Individuals are assessed on their savings record before a loan is made and this encourages responsibility. Loans can be made for small amounts and for variable periods: these options are often not provided by mainstream financial institutions. Loans are made at very competitive rates, and this particularly helps those with poor credit profiles who may have difficulty obtaining credit from mainstream sources. The availability of low cost finance to such people may also prevent them from seeking loans from high cost credit lenders or 'loan sharks'. Typical experiences of the role and starting stimulus are set out in an academic Report quoted later in this Note. It said:

> It was this experience of poverty in low income neighbourhoods, particularly during the 1980s and 90s that led hundreds of community volunteers, inspired by a strong sense of social justice, to see in credit unions a solution to poverty, and to the financial needs of disadvantaged communities. This was the case in Toxteth in Liverpool, where a group of 28 women came together in a community with 38% unemployment to found, in 1989, a credit union in front room of a terraced house (Jones 2001a). The same was true in Bridgeton, Calton and Dalmarnock in Scotland, where, in 1991, the credit union was established with the express aim of tackling poverty (Scottish Executive 2001). It was true also, in 1994, when Millom Credit Union was created to serve the low-income population of a former mining town in Cumbria (Parkinson C and Chadwick M. 2006). In fact, by 1999, 83% of community credit unions had been formed as community development projects to tackle poverty or to provide services for disadvantaged people (Jones 1999).[3]

Members control their own credit union. The Annual General Meeting elects the officers of the society including the Board of Directors; the Credit Committee which considers loan applications (although increasingly this is now a paid post); and the Supervisory Committee, which audits the books of the credit union and evaluates its operation.

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3 *Promoting financial inclusion - an analysis of the role of British credit unions in tackling poverty and over-indebtedness in low income communities*. J. Jones Liverpool John Moores University
http://www.entreprises.coop/UPLOAD/mediaRubrique/file/204_paperjones.doc

Over, at least, the past quarter of a century, credit unions have been seen by successive governments as the archetypal 'good thing' in financial services and often as the 'answer' (in part at least) to a number of diverse policy challenges. They have been seen as the answer to small firm and self employment support; community regeneration, financial inclusion, the saviour of the post office and the means to undo the high cost credit sector.

Successive governments' policies have encouraged the growth of credit unions, both in terms of their national coverage and the services they can offer. This pressure to get bigger and to do more has in turn put pressure on the traditional organisation structure. The development of a more professional service is unlikely to be predicated on an army of community volunteers. Broadening their reach without at the same time loosening their local ties and bonds is a difficult balancing act.

2. Credit union growth

Market growth

The Association of British Credit Union Lenders (ABCUL) gives a brief historical introduction to the start of the movement:

> The ideas and values which are central to how credit unions work were developed in the 19th century; in Britain by pioneer co-operators such as Robert Owen; in Germany by innovators such as Herman Schulze-Delitzsch; and in North America, where Alphonse Desjardin was mapping his vision of co-operative credit. The credit union movement grew quickly throughout America and Canada and quickly became an influence for the rest of the world.

Historical figures about the development of the sector are available from the Bank of England. A brief overview is shown below.[4][5]

Credit Union Statistics

			excluding	including
			Northern Ireland	
	2005	2008	2012	2012
Number of:				
All Credit Unions	568	520	421	595
Number of version 2 credit unions	11	13	10	19
Adult members at year end (000's) *	529.5	659.3	917.5	1,405.6
Staff employed	777	1,144	1,501	2,226
Balance Sheet Items £000s				
Total assets	466,728	595,142	956,614	2,178,246
Gross loans	341,152	441,694	605,787	1,103,907
Loans as a % of total assets	73%	74%	63%	51%
Total capital	45,779	69,718	116,970	270,154

Source: Bank of England

**Figures are for the period from 1 October in previous year to 30 September*

The table above reflects the importance of the N. Ireland credit union movement. Other regional figures are shown below:

Credit Unions' Membership by Country

	Total		England		Scotland		Wales	
Based on data taken from Annual Returns submitted for financial periods ended in the calendar year.								
	2006	2007	2006	2007	2006	2007	2006	2007
Total Annual Returns submitted	521	504	376	362	115	113	30	29
Percentage of credit unions	100	100	72.2	71.8	22.1	22.4	5.8	5.8
Total number at year end of:								
adult members	553,892	604,945	319,632	364,915	198,093	203,534	36,167	36,496
juvenile depositors	79,190	89,811	49,531	57,667	23,945	25,865	5,714	6,279
non qualifying members	10,275	9,640	5,980	6,794	4,215	2,738	80	108

Source: FSA Annual Returns Statistics 2008

** At 30th June 2008, there were 661,640 members of credit unions*

4 Bank of England, credit union statistics

5 An ABCUL press release November 2013 showed that UK credit unions now had 1 million members

By international standards credit union penetration in the UK, despite some recent growth, is fairly low. Ireland, Australia Canada and the US have far higher levels of participation. Credit unions in Ireland and Northern Ireland have a much greater presence than they do in Britain and are often cited as an example that should be followed. In Ireland there is an established network of over 500 credit unions with 2.9 million members - almost half the population. In Northern Ireland a Treasury/Department of Enterprise Trade and Investment consultation paper notes:

> Credit unions in NI date back to the early 1960s. There are 180 credit unions, with over 400,000 members, serving 50 per cent of the adult population. In addition to the two main trade bodies, the Irish League of Credit Unions (ILCU) and Ulster Federation of Credit unions (UFCU), the Tyrone Federation with 13 members and several other independent CUs complete the total.[6]

The reasons for different development paths are various, but one main one is the structure and integration of the financial services sector in each country. In the UK, the high street banks and building societies, supplemented by access to internet services and other institutions such as post offices, provide an exhaustive range of services, and the need for credit unions and other alternative financial institutions is sometimes seen as a marginal one only. Historically, the activities of credit unions have been tightly constrained by legislation and participation typically demands a higher level of personal commitment from members than the relationship between a bank and its customer.

6 Proposals for regulatory reform of credit unions in Northern Ireland; HMT / DETINI, March 2010

3. Growth of services and capability

The 1990s saw a series of publications and reports calling for changes to the law restricting the work of credit unions. In 1994 the Joseph Rowntree Foundation and the National Consumer Council both published reports recommending future reforms. A 1996 deregulation order made some of these changes, including expanding the maximum shareholding and modifying the common bond requirement. The 1996-97 annual report of the Chief Registrar had noted that it was the larger and more ambitious societies which felt the need for legislative reform:

> The restrictions in the 1979 Act are increasingly considered by many credit unions and the main promoting bodies as a serious constraint on the future development of the movement in general and the larger and more ambitious credit unions in particular.

Two further reports called for more use of credit unions. The Report of the Commission on Social Justice, initiated by the late John Smith MP, called for credit unions to play a part in developing community capital.[7] Later, the National Consumer Council issued a report, Savings and Investments for Low-income Consumers (1997). Highlighting the role of credit unions in offering financial support to those on low incomes, the main recommendation in this report was for the credit unions to work towards the formation of a national representative body to allow the movement to speak with one voice. Although the regulatory authorities were known to favour this, as they felt it would make the movement more effective overall in its relations with the government, the representative bodies were less keen on amalgamation and no central, governing, body has yet been created.

At the risk of simplification, these efforts culminated, in July 1998, when a credit union taskforce was established in the Treasury. Its aim was

- to look at ways in which the banks and building societies could work more closely with the credit union sector;
- at how the range of services offered by credit unions could be expanded;
- and at how to encourage further expansion of the credit union movement.

3.1 Credit union taskforce & PAT 14

After the taskforce had been set up, with the deputy chief executive of the Royal Bank of Scotland as its chair, a body with a partly overlapping area of interest, Policy Action Team 14, was established as a result of the cabinet office’s work on social exclusion. The credit union taskforce was therefore asked to produce an initial report (which was not made public) to feed into the work being done on social exclusion by the action team.

[7] See *Social Justice* (1994) pp.10-11; 335-340

In its Report, published in November 1999, the taskforce described the then regulatory structure and range of activities open to credit unions.

> CUs are registered and regulated by the Registry of Friendly Societies under the Industrial and Provident Societies Acts 1965 to 1968 and the Credit Unions Act 1979. Members save by subscribing for non-transferable shares deposited with the credit union; and may take out loans, at a maximum rate of interest of 1% per month.
>
> 3. The objects of credit unions, as defined by the 1979 Act, are: the promotion of thrift among the members by the accumulation of savings;
>
> the creation of sources of credit for the benefit of the members at a fair and reasonable rate of interest;
>
> the use and control of the members' savings for their mutual benefit; and
>
> the training and education of the members in the wise use of money and in the management of their financial affairs.
>
> 4. Membership is restricted to those who meet the qualification - the common bond - for a particular credit union. This may be one of four main types: residence in a locality; being a member of, or having an association with, an organisation; working for a common employer or in a locality; and following a particular occupation. The common bond is unique to CUs and is based on the simple idea that members will know each other and will be able to exert moral pressure to ensure that loans are repaid. Its effectiveness is demonstrated by bad debts being, on average, less than 1% of loans. Most credit unions are largely run by unpaid volunteers, providing services to people who may have no dealings with the commercial banking sector.
>
> 5. Each share in a credit union is fixed by statute at £1. The maximum saving permitted is £5,000 or 1½% of the total shareholding of a credit union, whichever is the greater. A credit union may accept deposits only as subscription for its shares. It may pay a dividend on shares, not exceeding 8%, after all expenses and taxes have been accounted for. The normal range of dividend payments among employment-based CUs is between 3 and 5%. Community CUs typically pay dividends in the range 1-3%, once established; many pay no dividend at all for the first three years, or indeed ever.
>
> 6. In most credit unions loans may be made to members up to a maximum of £5,000 in excess of their share capital. So a member with the maximum of 5,000 shares may borrow up to £10,000. Loans are repayable over two years if unsecured, and over five if secured. Most loans are under £1000. Interest charged on loans may not exceed 1% per month on the reducing balance (12.68% APR maximum). Credit unions may borrow short term from other credit unions and from authorised banks, and may hold their surplus on deposit subject to restrictions. (Broadly they are restricted to current and deposit accounts with building societies and banks). Credit unions may apply to the Registrar for a certificate under Section 11C of the 1979 Act which allows them to lend greater amounts to individual members over a longer period. The Registrar needs to be satisfied that there are appropriate policy manuals documenting the systems, and

> committees in place to manage the functions - in particular loans and internal audit/supervisory committees.[8]

The taskforce case for expanding credit unions was that they could assist in combating financial exclusion, which it saw as both a cause and a result of social exclusion.[9] In particular, it saw a role for credit unions in providing credit to those who would not otherwise find it easy to obtain credit, either because of low income or a poor credit history.

Whilst the taskforce saw that credit unions could make an important contribution towards increasing the access of those on low incomes to financial services, it warned that to be successful in this, credit unions would need to have a broadly-based membership. In other words, where a credit union is merely seen as a poor man's bank, it is unlikely to attract the right balance of borrowers and savers to allow it to develop properly.

The taskforce noted that many community-based credit unions were too small and un-dynamic to be viable, whilst recent growth in the sector had been largely created by employment-based credit unions. However, the factors which it identified as keys to success were not predicated on a particular type of 'common bond': they included suitable premises, paid staff able to offer sensible opening hours, a common bond which allowed for growth, and management skills.

Noting the possibility of further deregulation – trailed in the Treasury's 1998 consultation document – the taskforce warned that such measures might be ineffective if they did not form part of a programme of positive encouragement of growth. A move towards larger credit unions, with more effective management, and offering a wider range of products was advocated. Such changes should be backed by enhanced regulation which should incorporate a share protection scheme. The taskforce envisaged more emphasis being placed on a 'front office' service, and more collaboration with other financial organisations, perhaps to help deliver some of their services at a community level.

The Treasury set out the key features of a growth strategy for the unions:

> 31. The key elements in a growth strategy include:
>
> - larger individual CUs;
>
> - professional management;
>
> - capacity to offer a wider range of services;
>
> - enhanced regulation;
>
> - a viable share protection scheme;
>
> - customer/member care;
>
> - a better matching of CUs to areas of need[10]

8 Credit Unions of the Future, chapter 1, November 1999, HM Treasury
9 Ibid
10 Ibid

Policy Action Team 14

Policy Action Team 14 (PAT14) based in the Treasury, addressed access to financial services, as part of the follow-up work to the Social Exclusion Unit's 1998 report on deprived neighbourhoods.[11] Its substantial report on financial exclusion was published on 16 November 1999. Its 40 proposals ranged over a field wider than credit unions, but were all are aimed at removing existing barriers preventing or discouraging people, especially those in deprived communities, from obtaining access to financial services. These barriers included, difficulties in obtaining a bank account (because they lack the required proofs of identity, or have poor credit status), or an inability to obtain credit or essential insurance cover.

The taskforce believed that credit unions could be helpful in combating financial exclusion, because they

- are open to low income groups
- encourage small scale savings
- provide low cost credit, and
- can be a bridge to other financial services[12]

PAT 14 made four key recommendations designed to assist the credit union movement develop from its current very low penetration to the point where it could deliver potential benefits more widely and effectively:

> [Department of Environment Transport and the Regions] and the [Local Government Association] should work together to ensure that credit union development work at local level results in healthy and sustainable growth;
> HM Treasury should continue to promote its proposed deregulatory measures, to allow credit unions with growth potential to go for it;
> the proposed Central Services Organisation (CSO) should promote itself to all sections of the credit union movement; and encourage broad based development, with due emphasis on credit unions serving deprived communities;[13]
> the FSA should ensure that, in devising the future regulatory system for credit unions, the principle of proportionality is duly observed; and that the fee scale applied to credit unions is in accord with a reasonable view of affordability.[14]

This important period in the development of credit unions coincided with the introduction of a completely new financial regulatory system ushered in by the *Financial Services & Markets Act 2000.* This was a ready-made opportunity to change the legislative regime under which the unions had to operate.

[11] HM Treasury, *Access to financial services*, Report of PAT 14, November 1999; see also Cabinet Office, Bringing Britain together: a national strategy for neighbourhood renewal, September 1998 [Cm 4045]
[12] *Access to financial services*, p 1
[13] A CSO was never established
[14] *Access to financial services*, p 2

3.2 Deregulation proposals: operational deregulation

The then Economic Secretary to the Treasury, Melanie Johnson, announced a series of measures designed to assist credit unions on the same day that both the taskforce and PAT 14's reports were published.[15] The deregulation initiative was started by a consultation paper issued in November 1998 by the Treasury.[16] Both the taskforce and PAT 14 were cautious about the extent to which these deregulatory measures could, in themselves, encourage credit union growth; stressing that credit unions had to be in a position to exploit the opportunities they offered. This comment echoes their recommendations for encouraging such exploitation.

The proposed changes removed some of the legislative restrictions which credit unions then faced. They included:

- increases in the maximum repayment periods for loans
- greater flexibility in the common bond requirements
- aligning the maximum amount that can be held in youth accounts with that for adults
- removal of the maximum membership limit
- allowing credit unions to charge for ancillary services
- greater flexibility on disposing of re-possessed collateral
- further consultation on increasing the sources from which credit unions can obtain credit, and
- greater flexibility on dividend accounts [17]

Some of these changes were made by the *Financial Services and Markets Act 2000*. Extensions to the maximum loan repayment periods and an increase in the maximum sum permitted in loan accounts came into force through secondary legislation on 1 April 2001.[18]

It was possible to increase the flexibility of the common bond requirement without specific legislation. The Chief Registrar of Friendly Societies reported in his 1999-2000 Annual Report that an additional common bond had been introduced using his existing powers under 1979 Act:

> Residing in a particular locality or being a member of a bona fide organisation or group of organisations (or otherwise having a continuing and active association with one or more such organisations) existing within that locality for a purpose other than that of forming a society to be registered as a credit union.

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[15] HM Treasury, 'Enhanced role for credit unions', HM Treasury press release 191/99, 16 November 1999

[16] HM Treasury, *Proposed amendments to the Credit Unions Act 1979: A consultation document by HM Treasury*, November 1998

[17] HM Treasury, 'Enhanced role for credit unions', HM Treasury press release 191/99, 16 November 1999

[18] *Credit Unions (Increase in limits on deposits by persons too young to be members and of periods for the repayment of loans) Order* SI 2001 No 811. See 'Credit unions get improved powers to tackle financial exclusion', HM Treasury press release 31/01, 12 March 2001

The legislative reform orders

Several outstanding areas of possible deregulation remained and these were addressed in a further consultation exercise that began in 2001. A consultation document was issued on 16 October 2001*: Proposed amendments to The Credit Unions Act 1979: A consultation Document by H M Treasury.* Seven measures were put out for consultation:

Allow credit unions to borrow money from external sources, other than authorised banks and other credit unions

The Government argued that this change would allow credit unions to shop around for loans at more competitive rates, and in particular to take low cost loans from local authorities who already provide finance to many credit unions. Credit unions which are strongly capitalised at an early stage have much better chance of becoming successful.

Allow credit unions to differentiate between certain accounts by paying dividends at different rates, and to pay dividends more than once each year

Some credit unions already offered different types of accounts to their members but they could not reflect this by paying different rates of interest ('dividends') on them. The new power could allow credit unions to pay a higher rate of interest to those who only wish to save, but pay lower rates to those who want to use budgeting accounts (which offer bill payment facilities but which have higher operating costs).

Allow credit unions to provide additional basic services and charge fees (e.g. bill payments)

At the time when credit unions had started to offer a wider range of services - including for example providing foreign currency, money transmission and bill payment services - they were unable to charge separately for them. By allowing these services to be charged for on a cost recovery basis, more credit unions were expected to start offering them.

Make the common bond requirements more flexible

It proposed allowing the associational bond (which might for example be used by a church-based credit union) to be combined with other types of common bonds (for example workplace or community-based unions).[19]

Establish appropriate regulation on the use of the name Credit Union

It was thought that the existing wording of the 1979 Act could prevent overseas credit unions (for example those for American service personnel) from operating in the UK. Section 3 of the Act would therefore be amended to ensure that legitimate credit unions from overseas were not caught by the prohibition.

[19] s.1(4)(e) *Credit Unions Act 1979*

Change the minimum coverage requirements for fidelity bonds

Credit unions have to carry insurance against fraud and dishonesty by their employees and officers. The level of cover that must be carried is specified in secondary legislation. There are three bands (related to the total share value): credit unions with larger share capital have to obtain insurance for a progressively lower proportion of that capital. The government argued that the current requirements were too severe, particularly for the largest credit unions. It proposed a new fourth band for credit unions whose share capital exceeded £1 million. In addition, no credit union would have to obtain cover in excess of £2 million for a single claim, or £4 million for claims in a single year.

Allow credit unions to offer accounts that may be held in the name of more than one member

While joint accounts are not explicitly prohibited by the Act, the terms on which such accounts can be offered are unfavourable. Credit union accounts may not hold more than a certain sum, £5,000 or 1.5% of the total shareholding. For joint account holders, this limit is in effect halved. The government proposed to double the limits for joint accounts and to make it clear that joint account holders will be jointly and severally liable for liabilities on the account.

The reforms derived from the consultation were included in the *Regulatory Reform (credit Unions) Order 2003 SI 2003/256.* The explanatory note to the SI sets out the main changes effected by it:

> **Article 3 amends section 1 of the Act so as to permit credit unions to combine the qualification for admission to membership specified in section 1(4)(e) (the associational common bond) with any one of the other qualifications specified in section 1(4), so long as in consequence there exists common bond between members of the society.**

> Article 4 amends section 3 of the Act. The effect of the amendment is that a body corporate (or an officer or employee of such a body) which has its head office outside England, Scotland or Wales and which is either authorised under the Financial Services and Markets Act 2000 to accept deposits, exempt from section 19 of that Act (the general prohibition) in relation to that activity or subject to legislation that is similar to the relevant legislation that relates to credit unions, may use the title "credit union". In addition, the Financial Services Authority may give approval to any person or unincorporated association to use the name "credit union".

> Article 5 inserts a new section 9A in the Act. This permits credit unions to charge their members a fee to recover the cost of providing services that are ancillary to the activity of accepting a deposit or making a loan.

The Treasury produced a further document detailing proposals for more change, based on consultations held in 2007. In December 2007, it published Review of the cooperative and credit union legislation in

Great Britain. The key Government commitments are set out in the table below:

Issue	Government response	Implementation options
Q 17 Expansion of membership.	Accepts the view that credit unions need to embrace wider sections of society	No requirement for change.
Q 18 Use of the term "credit union".	No case for change.	
Q 19 Change to "community banks"	No case for change.	
Q 20 a. expansion of Common bond	Accepts the need for liberalisation. Work on housing Association tenants underway.	Further changes would require amendment to the act by a Legislative Reform Order (LRO) or primary legislation.
b. Non qualifying member rules	Agrees non-qualifying member rules can be abolished without undermining common bond concept	Would require changes to the Act via LRO or primary legislation.
c. Minimum age	Is of the view that there should be conformity with Company law	Amend via LRO or primary legislation
d. Restriction on number of members	No case for change.	
e. Prohibition of corporate membership	Accepts the case for corporate membership. Believes this should be subject to a limit.	Would require amendment to Act or primary legislation.
Q 21 Interest on savings.	Accepts the case, subject to safeguards.	Would require amendment to Act by LRO or primary legislation.
Q 22 Auxiliary services	Accepts the need for some flexibility.	Would require amendment to Act by LRO or primary legislation.
Q 23 Electronic communications	Accepts the case. Work underway	Amend using the Electronic Communications Act 2000.
Q 24 Proxy voting.	Accepts the case for larger credit unions.	Would require amendment to Act or primary legislation.
Q 25 Restrictions on transactions with directors.	Accepts the case for aligning with company law.	Amend legislation to allow power to assimilate the law for companies to credit unions, similar to the "Gareth Thomas" power currently available for IPSs.
Q 26 Company Directors Disqualification Act.	Accepts the case for application to credit unions.	Amend legislation to allow power to assimilate the law for companies to credit unions, similar to the "Gareth Thomas" power currently available for IPSs.
Q 27 Assimilation of company and building societies law	Considers such a power should exist.	Amend legislation to allow power to assimilate the law for companies to credit unions, power currently available for IPSs.
Q 28 Copy charges.	Agrees charges should ideally be limited to cost recovery, with provision for credit union membership to decide the figure	Should be at society's discretion and democratic vote.
Q 29 Audited accounts.	Believes audited accounts should be compulsory for all credit unions.	Would require amendment to Act by LRO or primary legislation
Q 30 Reporting issues of concern	Agrees with the sector's views about auditor's ability to report directly to registrar.	Would require amendment to Act by LRO or primary legislation

Source:*Review of the cooperative and credit union legislation in Great Britain.*

This document set the framework for the future legislation to come.

A further consultation paper was published by the Treasury in July 2008. It proposed a further raft of changes to the law, some of which were first outlined in the 2007 document.[20] The proposals and responses and government conclusions are shown below. Where there is no

[20] Proposals for a Legislative Reform Order for Credit Unions and Industrial & Provident Societies in Great Britain, HM Treasury, July 2008

"respondents' views" section, it indicates broad assent with the proposal.

Proposal B1: Replace the "common bond" requirement for credit unions with a "field of membership" test.

3.4 Under current legislation membership of a credit union is based on the concept of a "common bond". Section 1 of the CUA 79 provides that a society may be registered as a credit union if it is shown, to the satisfaction of the FSA that, among other things, admission to membership is restricted to certain specified membership criteria "and that in consequence a common bond exists between members of the society".

3.5 The Government considers that in today's modern society this definition is overly restrictive and, in addition, creates administrative burdens for the FSA, which must apply the common bond test to any application for registration as a credit union.

3.6 The Government proposed to simplify the membership criteria by integrating the "appropriate membership qualification" and the "common bond". This would create a field of membership requirement, which will be called the common bond, (in keeping with common usage).

3.7 The Government further proposed to alter the requirements relating to membership qualifications to allow for more combinations of membership qualifications (to be known as common bonds), to enable credit union membership to be open to more people.

3.8 As a safeguard for ensuring that credit union membership and size still stayed within appropriate limits it proposed a new "field of potential members test" under which the FSA would have to be satisfied that the field of potential members was appropriate to a credit union.

3.13 The Government notes respondents' views and agrees that a 2 million membership limit would strike an appropriate balance between giving greater access to credit unions while ensuring that there would be a genuine connection between members of an individual union. The Government agrees that the limit should only apply to credit unions with geographical common bonds and not to those with common bonds based on association or employment. The 2 million limit will also apply where there are different types of bond, and any of them is geographical. In effect where other common bonds are combined with geographical common bonds the overall potential membership limit will be 2 million.

Proposal B2: Reform the requirements relating to membership qualifications and rename them "common bonds"

3.14 The Government sought views on two options for amending the requirement relating to membership qualifications:

• Option A: to allow the combination of only two membership qualifications, unless a further addition of a membership qualification was necessary to allow amalgamation or transfer of engagements (i.e. merger)

• Option B: to allow a combination of any number of membership qualifications. This would allow for instance a credit union to serve a geographical area along with tenants of two housing associations and employees of two companies.

3.17 The Government notes respondents' concerns in relation to Option B, but considers that there are adequate safeguards in the proposed membership qualifications. It also notes that a majority of respondents favoured Option B. The Government considers that deferring a decision would unacceptably delay access to credit union services for a wider section of the population. It therefore intends to implement Option B in the LRO.

Proposal B3: Reform restrictions on non-qualifying members of credit unions.

3.18 The CUA 79 restricts the number of non-qualifying members a credit union may have to a maximum of 10 per cent. Non-qualifying members are members who cease to fulfil the qualifications for admission to membership: for example, they are no longer resident in the locality or employed by the relevant employer.

3.19 The Government considered that this artificial restriction was unhelpful especially due to the high mobility of labour. The Government proposed repealing the 10 per cent limit on non-qualifying members and instead allowing credit unions to set their own limits on non-qualifying members via their rules.

3.21 The Government will use the LRO to repeal the 10 per cent limit on non-qualifying members, leaving credit unions free to set their own limits via their rules.

Proposal B4: Allow credit unions to admit bodies corporate, unincorporated associations or partnerships to membership.

3.22 Under current legislation only individuals can become members of a credit union; bodies corporate cannot become members. Allowing credit unions the flexibility to admit bodies corporate, unincorporated associations and partnerships ('corporate members') to their membership would boost the involvement of organisations such as boy scouts/girl guides and other community groups and small businesses, as well as engender community cohesion. The Government therefore proposed to remove the current restriction and make related changes:

• Repeal the prohibition on bodies corporate becoming members at the discretion of individual credit unions, subject to a maximum of 10 percent of the total membership;

• Allow unincorporated associations and partnerships to become members of credit unions at the discretion of individual credit unions; and

- Create a new class of deferred shares that only bodies corporate would be able to subscribe to, and provide limits on the amounts corporate members may deposit with, and borrow from, a credit union.

Respondents' views

3.23 Respondents were divided on this proposal. Some welcomed the potential for corporate membership. Others took the view that credit union membership should at all times be based on individual membership and that the inclusion of corporate members would create a burden on societies and detract from the core principles of one member one vote.

3.24 A number of respondents were concerned that only allowing credit unions to offer deferred shares to bodies corporate would limit their ability to offer services to corporate members. They argued that many local community groups and charities were incorporated and so would be unable to use the credit union for day-to-day banking and other services. They pointed out that a significant number of credit unions would like to be able to provide services to small, incorporated businesses and social enterprises. A number of respondents suggested that credit unions should be able to choose whether to offer ordinary shares or deferred shares to corporate members.

3.25 Respondents were generally supportive of proposals to limit the proportion of corporate members in a credit union compared to individual members, and to limit the proportion of shares and loans held by these members. They saw this as an important safeguard to prevent corporate members from wielding undue influence over the operations of the credit union.

3.26 The Government intends to use the LRO to allow credit unions to admit corporate members. The Government accepts the case for allowing flexibility for credit unions to be able to choose to offer either ordinary shares or deferred shares to corporate members.

3.27 The Government agrees with the views expressed by some respondents that there is a risk that corporate membership could crowd out individual member involvement. The Government therefore intends to cap the proportion of membership which is not individual to 10% and to limit the proportion of total assets, and of lending, which may be held by corporate members. The limits in the legislation will be variable by order made by the Treasury. It is the Government's intention to give the FSA the power to amend credit union permissions unilaterally to permit both corporate and private members. This will save credit unions from having to apply individually to seek a variation of their permission.

Proposal B5: Allow credit unions to offer interest on deposits, provided certain requirements are met.

3.28 Under current legislation, credit unions cannot offer interest on members' deposits. They can only offer a discretionary dividend. The Government considered that this put credit unions at a disadvantage in comparison with banks and building societies, which do not have this restriction.

3.29 The Government proposed to allow credit unions to be able to offer interest on members' deposits, subject to certain safeguards such as a requirement to hold reserves of £50,000 or 5 per cent of its total assets, (whichever is higher) as well as demonstrating that it had adequate systems in place to manage the greater risk of offering interest. Credit unions would then be able to offer both dividend and interest bearing share accounts (although individual accounts would only be able to offer interest or dividends, not both). The figures of £50,000 and 5 per cent will be capable of being varied by an Order made by the Treasury and subject to the negative resolution parliamentary procedure.

3.31 The Government will implement this proposal in the LRO, allowing credit unions wishing to retain the dividend to do so. This way only credit unions which wish to pay interest on members' deposits and which can show that they have the financial strength and operational ability to offer interest will be able to do so. In addition, the FSA will consider whether rules covering, for example, systems and controls and liquidity would need strengthening to address risks arising from the contractual obligation to pay interest on an individual's account. The Government recognises that it is important to distinguish between the legislative framework of credit unions and FSA rules that maintain appropriate regulatory safeguards.

Proposal B6: Abolish the 8 per cent per annum limit on dividends.

3.32 Credit unions are prevented under the current legislation from paying a dividend in excess of 8 per cent per annum.

3.33 The Government proposal sought to remove this restriction and to allow credit unions the flexibility to award an appropriate dividend.

3.35 The Government notes respondents' views and will as proposed abolish the 8 per cent per annum limit on dividends and allow societies the flexibility to award an appropriate dividend.

These proposals are more radical than those for other elements of this 'third sector" in terms of their operational impact and the opportunity they give for credit unions to move away from their traditional structures and operations. ABCUL, the main representative body of the sector was very enthusiastic. It said:

> It's great news that, following a comprehensive consultation to which we and our members responded, the Government has now finalised proposals for a Legislative Reform Order to update credit union legislation in Britain," says Mark Lyonette, Chief Executive of ABCUL. "This reaffirms the Government's commitment to updating credit union legislation, which is badly needed by the sector if we are to fulfil our true potential in Britain.
>
> "In particular, we are delighted that the Government has listened to our calls to increase the limit for a common bond (which determines who can join a credit union) to two million people for geographical common bonds only and not to impose a numerical limit on common bonds which only cover people with an employment or associational link. This will enable credit unions to meet the needs of many more people.

> "We are also very happy that the Government has decided to allow credit unions to choose whether to offer ordinary shares or deferred shares to corporate bodies. This means that companies and social enterprises, as well as unincorporated bodies and partnerships, will be able to become full members of credit unions, allowing large numbers of organisations to benefit from credit union services for the first time."[21]

The legislative reform order comprising these proposals was published on 19 July 2011. It was debated and approved by the Lords on 20 October 2011.[22] The Order itself (SI 2011/2687) can be found here.

Apart from the significant changes ushered in by the two legislative reform orders mentioned above, another important change to the operational freedom of credit unions came in June 2006 when the interest rate cap was doubled from 1% to 2% a month. This was brought in by *The Credit Unions (Maximum Interest Rate on Loans) Order SI 2006/1276, effective* from 1 June 2006. The argument for this change was that by raising the amount that credit unions could charge, it enabled them to lend to a broader range of borrowers, including those with a poor credit history who might otherwise have had to borrow from other non-mainstream sources at much higher rates of interest (the riskier is the borrower the higher the rate of interest must be to compensate). Credit unions were also enabled to set up ISA accounts and to offer child trust fund accounts.

Private Members legislation

Certain other changes to credit unions have been introduced by the procedure of a Treasury supported private members bill.

Co-operative and Community Benefit Societies and Credit Unions Act 2010

The bill was introduced by Mr Malcolm Wicks. Its purpose is to update and improve governance of these societies and to enable legislative change for credit unions by permitting the assimilation of building society legislation into credit union law, without it being permitted to alter the constitutional elements of credit unions, such as the common bond. More information on the Act can be found in the Library Research Paper covering the Bill.[23]

3.3 Deregulation proposals: regulatory change

Hand in hand with plans to give credit unions more operational freedom was the question of how they should be regulated under the, then, proposed new financial regulation system to be introduced by the *Financial Services and Markets Act 2000*.

In November 1999, the Treasury announced that credit unions would be brought within the mainstream regulatory scheme administered by the FSA. An issue which arose immediately was how the cost of this

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21 ABCUL press release 15 April 2009
22 HL Deb 20 October 2011, cc443-450; SI 2011/2687
23 HC Library Research Paper 10/6

regulation would be met. The FSA normally works on a full cost recovery basis, but credit unions were not expected to be able to meet this cost. The FSA indicated that smaller credit unions (e.g. with assets below £500,000) might expect to pay no more than £200 in annual regulatory fees, including the cost of participation in the Financial Ombudsman Service and the Financial Compensation Scheme.[24] The cost of registering as a new credit union was likely to be around £500 for the simpler type of union (seeking a 'Version 1' permission) and £2,000 for more complicated unions (seeking Version 2 permission).

Announcing its approach to credit union regulation, the then FSA Chairman said:

The FSA's supervisory regime for credit unions will be based on an assessment of the risks associated with the business and controls of credit unions - in line with its general approach that supervision should be proportional to the risks carried by different types of financial organisation and the varying controls they have in place. We will have regard to the particular nature of credit unions which are mainly run by volunteers and which provide services only to their members. The FSA will work closely with the credit union movement to develop a regime which meets the needs of credit unions and their members.[25]

In December 2000, the FSA consulted on its main proposals[26] which included:

> **Registration, authorisation and permission** In addition to the existing requirement for registration, credit unions will in future need to be authorised by the FSA in order to carry on business. They will become authorised by obtaining a deposit taking permission from the FSA.
>
> **Approved persons** The FSA considers that all credit unions should be required to comply in full with the FSA's Approved Persons regime. This should present no difficulties for new credit unions and for larger credit unions. However, recognising the possibility that existing smaller credit unions may be in a different situation, the FSA is also consulting on alternative approaches for these credit unions.
>
> **Systems and controls** Credit unions will be required to comply with the rules on systems and controls contained in the FSA's general Handbook. These will require a credit union to have in place systems and controls that are appropriate and effective in its particular circumstances.
>
> **Lending** Credit unions will continue to be subject to restrictions as to the amounts which they can lend and the periods of such loans. The FSA's rules will however introduce increased flexibility for credit unions on these matters.
>
> **Capital and liquidity** The FSA proposes new requirements for credit unions on capital and liquidity. These requirements are

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[24] See *Credit Unions: Feedback statement to CP 77*, FSA, July 2001. The FSA consulted on the application of the ombudsman and compensation schemes to credit unions in *Credit unions: consumer compensation and consumer complaints*, FSA CP 94, May 2001.

[25] Howard Davies (FSA Chairman), 'The FSA to develop practical regulation for credit unions', Financial Services Authority press release PN/118/99, 16 November 1999

[26] *The regulation of credit unions*, CP 77, Financial Services Authority, December 2000

> designed to be sufficiently flexible and proportionate to give appropriate protection to members' savings without imposing an undue burden on the credit union. There will be different requirements depending on a credit union's size and activities.
>
> **Fees** The FSA's overall approach to fee-raising has still to be finalised but it is expected that credit unions, in line with other FSA-authorised firms, will pay an annual fee related to the size of its business. Banks and building societies have indicated that they may be willing to subsidise the regulatory fees of smaller credit unions: discussions on the details continue.[27]

Following consultation the FSA maintained the model of a two tier approach, under which smaller and simpler 'Version 1' type credit unions would be subject to less onerous requirements than 'Version 2' type credit unions. However, the activities of the union and not just its size determined whether it was a Version 1 or Version 2 union. Credit unions of any size can choose which permission they seek but there is a sliding scale of capital requirements related to size. This means that whilst a large credit union will not be under an obligation to seek a Version 2 permission, if it has capital above a certain limit it will face very similar regulation to a Version 2 union. This reflects the view that increased risk comes with size as well as from the nature of activities undertaken.

In November 2009, the FSA began a review of its credit union rule book.[28] It reported on the result of the consultation in July 2010.[29] The latter explained the rationale for the review:

> In CP09/27 Review of the Credit Union Sourcebook (CRED), we proposed replacing CRED with a new Credit Union Sourcebook (CREDS), in part to reflect the new provisions of the Credit Unions Act 1979, to be introduced by a Legislative Reform (Industrial and Provident Societies and Credit Unions) Order 2010 (the LRO). We also proposed that CREDS should include amendments designed to strengthen prudential standards for credit unions, and should contain the remaining CRED material, streamlined to make it more user-friendly.[30]

The FSA might also have added the knock on effect of the post financial crisis review regulation and supervision which inevitably trickles down to all sectors.

The current FSA rules are contained in the Credit Union Specialist Sourcebook, part of its regulatory Handbook.[31] Printed out, the rules run to about two hundred pages, and are subject to frequent modification by the FSA. Key requirements under the rules are:

- Unions can only invest surplus funds in UK and EU banks, or government securities of less than a year's maturity. A union may only hold land or property as a place from which to transact business.

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[27] 'FSA regime "to increase confidence in credit unions"', FSA press release PN/149/2000, 4 December 2000

[28] A review of the Credit Union Sourcebook, CP09/27, FSA, November 2009

[29] A review of the Credit Union Sourcebook,PS10/11, FSA, July 2010

[30] Ibid p5

[31] FSA Handbook http://fsahandbook.info/FSA/html/handbook/CRED

- Restrictions exist on the source of borrowing by a credit union and on the amount. A version 1 credit union may only borrow up to 20% of its share capital. A version 2 union up to 50% of its capital.
- Membership. Only individuals may be members, each member must have at least one share. Juvenile (under 16) members may deposit funds (but not buy shares) with a credit union.
- Common bond. A common bond is "fundamental to the regulatory regime for credit unions".[32] It cannot be extended indefinitely; beyond 1 million members, the assumption is that there can be no bond. The handbook states that:

> It is apparent from the Parliamentary debates on the Credit Unions Act 1979 that persons who had a common bond were envisaged as having some degree of shared identity, a sense of belonging or a collective interest. The FSA considers that the bond should be sufficient to encourage members to do some or all of the following:

- play an active role in the credit union (for example, by volunteering);
- save regularly;
- repay loans promptly.

> The sense of obligation to save and repay among the members of credit unions would be greater than among persons dealing with an ordinary commercial provider.

The determination of a common bond has loosened; however, it remains a complicated matter for the FSA to determine. The Handbook continues:

> Since the Regulatory Reform (Credit Unions) Order 2003, it is possible for a credit union to adopt a membership qualification combining association and one of the other qualifications set out in section 1(4)(a), (b), (c), (d) or (f) of the Credit Unions Act 1979, as amended (without the need for the FSA to approve an additional qualification for each combination, under the power in the tailpiece to that subsection - see CRED 13 Annex 1B). For example, a credit union may now adopt a membership qualification under which some members reside in the locality (but do not belong to a bona fide organisation there) and other members belong to a bona fide organisation in the locality (but do not reside there).

- Credit unions are subject to the determinations of the Financial Ombudsman and must co-operate with him.
- Loans. Version 1 unions may only lend for less than five years unsecured and ten years secured. No member of a Version 1 union may borrow £15,000 more than their shareholding. The equivalent figures for Version 2 are ten years and 25 years and £15,000, or 1.5% of its total share capital in excess of the borrowing member's shareholding, whichever is the greater.

The July 2010 proposals will make the following changes:

Financial stability

32 Ibid Cred 13 Annex 1A 1

- An increase in the initial capital required to set up a credit union to £10,000 for version 1 credit unions and £50,000 for version 2 credit unions. The current requirements are £1,000 for version 1 and £5,000 for version 2 credit unions
- Introduction of a 3% capital-to-assets ratio to provide a buffer against insolvency. The proposals will be phased in: from 30 September 2011 – 1% capital-to-assets ratio; from 30 September 2012 – 2% capital-to-assets ratio and; from 30 September 2013 – 3% capital-to-assets ratio
- A requirement on all credit unions to hold liquid assets of at least 5% of total relevant liabilities, but not falling below 10% on two consecutive quarters, consistent with the current requirement for version 1 credit unions. This change represents no change for version 1 credit unions, and a small increase for version 2 credit unions. Again the changes will be phased in: from 30 September 2011 – 5% liquid assets and on no two consecutive quarters must liquid assets be below 6% of total relevant liabilities; from 30 September 2012 – 5% liquid assets and on no two consecutive quarters must liquid assets be below 8% of total relevant liabilities and; from 30 September 2013 – 5% liquid assets and on no two consecutive quarters must liquid assets be below 10% of total relevant liabilities

Governance.

- The FSA indicated a desire to improve the overall standards of governance within the movement not by changing the governance rules "but to focus our supervisory action on securing compliance with governance, prudential and reporting requirements".[33] It should be recalled, that there is a substantial voluntary commitment within the credit union movement. Whilst this has advantages, it does not necessarily result in management and administration of the highest quality. The FSA note "For the year ended 2008, 38% of annual returns (CY forms) were submitted late. For year ended 2007, 33% of CY forms were late and for the year ended 2006, 32% of CY forms were late. Until now the FSA relied on a mixture of reminders and formal notifications to ensure compliance. But:

  > Starting with the December 2009 CY – due end of July 2010 – letters will be sent, reminding credit unions that their CY is due. Credit unions that do not send in their CY on time will be issued a £250 late return administration fee. Failure to pay the fee, or continued failure to submit the return, could result in us taking enforcement against the credit union, including removing permissions.[34]

- A significant reduction in the period allowed for submitting financial returns to the FSA. The new rules require credit unions to submit their annual returns within six months of the year-end.
- Loan provisions: guidance that credit unions should (in addition to existing requirements to make provision for 35% of a member's net liability when a loan is more than three months in arrears, and 100% when it is more than 12 months in arrears) also make

33 Ibid p10
34 Ibid p11

provision for 60% when the loan is six months in arrears and 80% when it is nine months in arrears.

Some of these proposals such as the tighter reporting proposals and the increased capital requirements, have been criticised by credit unions as imposing too big a burden on their organisations. Others arise directly from the experience of those credit unions which have grown and expanded beyond their traditional spheres and have discovered new economic realities, such as higher loan default rates.

4. Government help

4.1 Labour government initiatives

Introduction

As well as the operational and regulatory changes noted above, government has provided financial support for credit unions by way of its support for a wider group of social lenders and social enterprises – which includes things such as community interest companies and Community Development Finance Initiatives. The main initiative for credit unions has been the growth fund, part of the Financial Inclusion Fund (FIF).

The growth fund

The Labour government set out its strategy to tackle financial exclusion in its Report 'Promoting financial inclusion' published at the time of the 2004 Pre-Budget Report. The report included measures in three priority areas - access to banking, access to affordable credit, and access to free face to-face money advice.

The FIF is one strand of this broad policy. The original allocation of funds was £120 million. Part of its work was to fund the creation and work of the Financial Inclusion Taskforce (FIT). FIT was formally launched in February 2005, chaired by Brian Pomeroy. Under its original terms of reference it had a life of two years. One part of its work was to establish a £36 million growth fund to support the coverage, capacity and sustainability of third sector lenders.

The fund was administered by the Department of Work and Pensions. Grants were made to third sector lenders to fund additional lending to those who are financially excluded, i.e. loans without the normal prerequisite of savings required by credit unions (although not CDFIs), and also the capital to finance the loans given. At the end of a credit union's involvement with the funding, the capital becomes a part of the credit union's assets.

It is generally accepted that growth fund money has had a significant impact on credit unions' ability to lend. A FIT report before the 2009 Budget highlights this:[35]

> 23. The Taskforce is advising on, and monitoring, the Government's financial inclusion Growth Fund. This aims to expand the capacity of third sector lenders, such as Credit Unions and CDFIs, to serve low-income borrowers in their local communities and offer them an alternative to high cost credit. However it will take significant time to build adequate capacity and coverage among third sector lenders.
>
> 24. In the short term, wholesale market pressure on both mainstream lenders and sub-prime lenders has decreased the number of people to whom they are able to lend. At the same time, sub-prime lenders and Growth Fund lenders report a significant increase in demand for their services. With many households facing a reduction in income, their capacity to take on

[35] Financial inclusion more important than ever; FIT, Report for Budget 2009

further debt will become more limited. As a result, more and more potential borrowers are being turned away on the basis of risk.

25. The impact of these changes has been especially visible in the last 12 months in the home credit market, which serves approximately 2.5 million customers in poorer households. Some lenders are struggling in the current climate. London Scottish, has gone into administration and Cattles, the parent company for Shopacheck, has reported continuing financial difficulties. Other home credit providers appear to be moving away from their most vulnerable and highest risk customers as demand increases among better off borrowers, who can no longer find mainstream loans: the latest Bank of England credit conditions survey reports that mainstream unsecured lenders have reduced the amount of credit they made available to households through credit cards and unsecured loans in every quarter for the last two years, due to concerns about the economic outlook and a reduced appetite for risk.7

26. This leaves many vulnerable people, whose payment patterns are probably too irregular for existing Growth Fund lenders to accept them, without access to credit. While some people will be able to reduce their borrowing, this may not be possible in cases of immediate, pressing hardship. Where these people cannot access credit from regulated providers we anticipate increasing pressure on Social Fund loans and grants and a risk of more widespread illegal lending. Where even these last resorts are inaccessible, then in the worst cases people may compromise vital spending on food and fuel, placing themselves or their families at risk.

Progress

27. The Taskforce's Third Sector Credit Working Group (TSCWG) reported to the Government in December 2007 on options for achieving a step change in third sector lending and capacity. Key recommendations of the report were to extend the Growth Fund into the 25 highest priority areas identified by the Working Group's research, and to double current Growth Fund capacity for lending to the financially excluded to 150,000 loans, totalling £60 million, per annum.

28. The Government committed £42m to the Growth Fund between 2005 and 2008, and a further £38m for the period from 2008 to 2011. The Growth Fund has been operational since July 2006 and since then almost 160,000 loans totalling £70 million have been made to low-income customers. The Growth Fund has demonstrated that third sector lenders can effectively serve much of the low-income, higher risk customer base.

29. As part of the Growth Fund procurement process, DWP have worked with existing contractors to extend coverage to as many of the 25 "red alert" and 56 "amber alert" areas identified by the Taskforce as possible. As a result, of the 81 areas, there are now:

• 56 with some Growth Fund coverage;

• 12 with Growth Fund coverage planned by March 2010; and

• 13 with no Growth Fund coverage currently planned.

30. The Taskforce is encouraged that, as a result of the DWP's efforts, over 80% of the high priority areas identified by the TSCWG report will have some level of affordable credit provision by mid 2010. However, at this stage, there are no further

> resources to support Growth Fund delivery partners who could extend their services into the outstanding high priority areas, leaving thirteen areas still with inadequate coverage.
>
> 31. Following the TSCWG's report, in late 2007 the CEOs of the major high street banks made a commitment to the Chancellor that they would support the third sector in providing affordable credit to the financially excluded, and in particular that they would support actions to develop new provision in the high priority areas.
>
> Next Steps
>
> 32. The Taskforce recently reported to the Government on the progress made so far towards the TSCWG's recommendations. Recognising the changed situation of the banks since they committed to support the expansion of third sector credit, we have put forward a range of options for non-financial assistance, alongside those that would involve financial support, that could be used to fulfil the banks' commitment. We encourage the Government to push for a clear work programme by the banks over the next two years.
>
> 33. Action needs to be taken to deal with what appears to be a significant gap in the provision of credit for the growing number of people who will struggle to access loans from a mainstream provider. We urge the Government to consider further measures to make sure this group of people are not put in a more vulnerable position through lack of access to credit.

FIF was always a time limited programme and, in the light of its general review of public expenditure, the Coalition government decided not to renew it as the answer below from the minister, Mark Hoban, indicates:

> The Financial Inclusion Fund will close at the end of March this year. The Government will work closely with industry and other stakeholders to ensure that tackling financial exclusion remains a high priority.[36]

A few days later he said:

> The Financial Inclusion Fund has always been due to close in March 2010(sic). The Government have not yet taken a decision on the future of the projects currently funded from the Financial Inclusion Fund. The Government remain committed to helping poorer households to access appropriate financial services, to improve their financial resilience and to avoid falling into unsustainable levels of debt.[37]

An assessment of the success of the Growth Fund was published by the Treasury in January 2011.[38]

However, in a different guise, it would appear that financial support for credit unions will continue. As was stated early in this note, credit unions have been the 'answer' to several policy questions. Recently their contribution to ensuring the viability of post offices has been to the forefront. It is argued that one of the difficulties in relying on the existing credit union movement to provide financial services is their lack of scope nationwide. One limiting factor is thought to be the provision

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[36] HC Deb 19 January 2011; c836W
[37] HC Deb 31 January 2011, c580W
[38] Evaluation of the Financial Inclusion Growth Fund, HM Treasury, January 2011

of suitable premises. Thus, permitting credit unions to share space with an under used post office network is seen as a mutual win-win. A recent ministerial statement outlined how this was being taken forward with government help:

> We also see real opportunities for the Post Office network in building closer links with credit unions. Credit unions have made great progress in recent years in bringing affordable financial services to people who would not otherwise be able to access them. I want to see credit unions-in partnership with the Post Office-providing more services, more efficiently, to more people.
>
> I am therefore pleased to announce this Department's continuing support for credit unions, building on the existing growth fund, and providing the new funding required for further expansion. This modernisation fund, worth up to £73 million over the next four years, will support those credit unions who are ready and prepared to step up to the plate-to expand their service to benefit more customers.
>
> My Department [DWP] will work with the credit unions to look at ways in which the future progress of this sector can best be supported. This includes the possible development of a shared banking platform, for which funding has already been set aside. Subject to successful feasibility studies, this will open up opportunities for many more people to access credit union services, including through the Post Office network.
>
> Making credit union services available to more people who could benefit from them is an important part of our welfare reforms: making work pay; reforming crisis loans; making people better off for every pound they earn through universal credit; and simplifying the benefits system.[39]

4.2 Coalition government initiatives

The attractiveness of the credit union movement carried over with the change of government in 2010. The new government did not carry the Growth Fund initiative on (see above) however two initiatives were promoted instead.

Credit union expansion project

This project is being rolled out by DWP, it involves £38 million of funding over the next three years to help credit unions expand and modernise.

It was announced on 27 June 2012 by the Department for Work and Pensions Minister Steve Webb. He said:

> On 10 May 2012, the Department for Work and Pensions published the credit union feasibility study looking at the sustainability of credit unions. It also examined what more can be done to expand them to serve many more people on lower incomes. The study has been well received by the sector and a range of stakeholders.
>
> Credit unions are doing a good job offering access to credit and other financial services for people on lower incomes. They provide a real alternative to higher cost credit available from the commercial sector and illegal loan sharks. Therefore, if credit

[39] HC Deb 3 March 2011, 43WS

> unions are ready for the challenge of modernisation and expansion we are willing to support them. Today, I am announcing that the Government will take forward the findings of the feasibility study. In particular, the DWP will make a further investment of up to £38 million over the next three years in credit unions. This investment, which is in addition to the £13 million we invested in 2011-12, will be conditional upon the credit union industry meeting a number of agreed milestones for collaboration, modernisation and expansion. Our aim will be to ensure the industry's financial sustainability by the end of the project.[40]

The project is being delivered through the Association of British Credit Unions (ABCUL) which was awarded the contract in April 2013.[41] In a speech given to the all party credit union group to coincide with this the Minister mentioned the previous government aid:

> DWP supported credit unions with £113m between 2006 and 2012. Government invested in over 150 credit unions, which made over 610k loans with a value of £274m, and saved people over £250m in interest charges[42]

One might note two things. First the rather low help multiplier – on a rather generous estimate the government subsidy was only just under half the total benefit of interest saved.

Secondly, there has been very little indication so far as to how ABCUL intends to spend the money.

Statutory rate of interest.

The other development is the proposal to raise (again) the maximum rate of interest that credit unions can charge from 2% to 3%. The rationale and the announcement for it can be seen below in the statement by the then Economic Secretary to the Treasury, Sajid Javid:

> The Government have today published a consultation on raising the maximum interest rate cap for credit union loans. This consultation seeks views on the proposal to increase the maximum interest rate that credit unions can charge, from 2% per month to 3% per month.
>
> The rationale for this proposal was explained in detail in a feasibility study commissioned by the Department for Work and Pensions (published in May 2012), which found that credit unions are currently unable to break even on small, short-term loans. This leads to a lack of stability in the sector, which is damaging for the long-term future of credit unions.
>
> Allowing the maximum rate of interest to increase will enable credit unions to become more stable over the long term. This means that low-income consumers will have greater access to reliable, affordable credit, without having to resort to more expensive means, such as home credit or payday lenders, or worse, illegal lenders. Even with a 1% increase in the monthly rate of interest, credit union loans will still be substantially cheaper than the alternatives for consumers with no mainstream options. It is important to note that this increase in the interest rate would be permissive; it does not require credit unions to increase the interest rate they charge but simply permits them to do so if they

40 HC Deb 27 June 2013 c19WS
41 HC Deb 16 April 2013 29WS
42 Speech to All Party Group on Credit Unions, Lord Freud, 22 April 2013

> judge that the benefits outweigh the costs. As such, the measure eases an existing regulatory burden on credit unions.
>
> Many credit unions are strongly embedded in their local communities and are committed to assisting those on low incomes. Research shows that credit unions often appeal to low-income consumers as bodies which are local, accessible and convenient, and which are community based. Giving credit unions more flexibility in their lending will enable them to recruit new members, and further establish their role in helping the financially excluded.[43]

Unsurprisingly, the outcome of the consultation, published in June 2013 was that the limit should be raised. Announcing the decision the Treasury said:

> The Treasury received 43 responses to this consultation, and the majority of responses were in support of raising the interest rate. Therefore, the government intends to introduce legislation in the autumn to raise the interest rate to 3 per cent.
>
> The new 3 per cent interest rate will be introduced alongside the Credit Union Expansion Project, which is run by the Department for Work and Pensions (DWP), and will enable credit unions to reduce their running costs and become financially sustainable. DWP aims for the sector to serve one million more people by 2019.
>
> Under the current cap credit unions often make a loss on the small, short term loans. These losses are part of the reason that eight credit unions go under each year. This change is designed to mitigate losses, making the sector more stable, and remove reliance on government support.
>
> The extra income will allow credit unions to:
>
> use the extra income to consider lending to members with a higher risk profile, which they currently turn away
>
> reduce their losses
>
> reduce cross subsidisation with larger loans and
>
> offer a wider variety of products
>
> The rise in the interest rate cap is not compulsory and credit unions will be able to choose whether or not to increase their rates. The new, higher cap will come into effect on 1 April 2014.[44]

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[43] HC Deb, 18 December 2012 c82WS
[44] HM Treasury press release 12 June 2013

5. Future Reforms & challenges: the eternal contradiction?

The key challenge for credit unions today is whether they are able to deliver the policy outcomes which politicians expect of them, and for which they receive public money and significant legislative help; whether they can flourish amidst the tighter regulatory framework announced by the FCA; whilst at the same time retain their traditional advantages of localism, voluntary commitment and low costs.

There is an extensive bibliography of reports into the sector. One by the John Moores University, Promoting financial inclusion - an analysis of the role of British credit unions in tackling poverty and over-indebtedness in low income communities, outlines the growth of what it calls the 'new model' credit union development. This was based on a view that to survive and grow, unions had to be more professional, business based organisations which serve the needs of the whole community and not just the poor and disadvantaged within them – in a sense a different approach from the government policy which is poor-focussed. The development of new model unions was based on seven principles:

This major correction was based on seven key elements, often regarded as seven "doctrines of success" (Richardson 2000a). The first was serving the financial needs of the population at large, rather than focusing solely on the poor and disadvantaged. The new model was clear that, in order to serve the poor effectively, a credit union need to appeal to all sections of the population both to generate income and to ensure the less well off were not left feeling stigmatised. The poor persons' bank appeals least to the poor most of all. The second was the maximisation of savings by offering attractive interest rates. Traditional British anti-poverty credit unions had concentrated primarily on offering low-cost loans and only marginally on promoting savings. In fact, many did not pay interest on savings. The rationality was that the poor were unable to save and that reducing interest payments to extortionate high interest lenders directly combated the poverty of individuals and improved the local economy. The new model focused on prioritising savings which was, for many, a sea change in how the credit union operated and how it marketed its services in the community. The fourth element was portfolio diversification or offering a range of financial products rather than a sole single loan and savings account identically to all segments of the market. The next three were operating efficiency, financial discipline and self-governance. The seventh was assimilation. By assimilation, Richardson meant the capacity of bringing the poor and those marginalised from financial services "into the mainstream economy by providing them with access to comparable financial products and services" (Richardson 2000a). [45]

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[45] *Promoting financial inclusion - an analysis of the role of British credit unions in tackling poverty and over-indebtedness in low income communities* , John Moores University, p2

The impact of this 'correction' on credit union activity has been marked. It continues:

Around the country, professionally organised quality credit unions, a term that has now replaced new model in the British context (Jones 2006), are beginning to offer financially excluded groups access to flexible savings accounts, instant and accessible loans, bill payment accounts, affordable home and contents insurance and access to money advice and debt counselling services. Southwark Credit Union, for example, in London which has 5,169 members, of which around 500 use a Benefit Direct Account. This enables them to have their welfare benefits paid directly into the credit union which they can withdraw in cash at any one of the credit union's three branches. Southwark also provides flexible savings accounts, access to a money advice service, affordable general insurance products as well as a range of affordable loan products. [46]

It goes on to describe an initiative that might make an enormous difference to the impact of credit unions and their market penetration:

Given that banking and transaction accounts are fundamental to promoting financial inclusion, the development of modern electronic transaction services has become a key strategic goal within ABCUL's approach to developing services for low income credit union members. No British credit union, up to the present time, has been able to offer banking transaction services or the equivalent of current accounts. However, this has now been achieved through a pioneering banking partnership arrangement between ABCUL and The Co-operative Bank which offers a co-operative solution to the development of credit union banking services. Throughout the world, credit unions and banks are often rival competitors. But as Stephan Pater, Executive Director, Distribution and Services, at CFS stressed at the launch of the banking partnership,

> "At The Co-operative Bank we see things differently. The co-operative movement has a long history of tackling financial exclusion. We recognize that Credit unions play a crucial part in the provision of affordable savings and loans; accessible in workplaces and communities often not served by mainstream financial services providers".

The banking partnership enables both credit unions to offer banking services to members and, at the same time, contributes to The Co-operative Bank's social goal of enabling activity promoting financial inclusion in low income communities.

ABCUL's arrangement with The Co-operative Bank is a genuine partnership, based both on co-operative principles and on commercial terms. About a dozen large credit unions funded the research and development of the partnership project and all entrants to the scheme will have to prove a business case to meet the required costs and charges. But unlike some other proposals for banking arrangements between credit unions and banks, in which credit unions merely offer

46 Ibid p4

the bank's services to its members, in The Co-operative Bank arrangement, the banking services offered by credit unions will be the credit unions own banking services and accounts, fully under credit union control. Simply put, the credit unions will rent space on The Co-operative Bank's mainframe. This will allow, from November 2006, credit unions to offer members a bank current account, with Visa and debt ATM cards and functionality for direct debits, standing orders and money transfer. These will be genuine credit union accounts on The Co-operative Bank platform.

This co-operative solution is a major step forward in the development of quality credit unions in Britain. Elsewhere in the world, where banking services have been introduced, whether in Poland or New Zealand, credit unions have grown significantly. In Britain, it offers the potential to credit unions to make a significantly increased contribution to tackling financial exclusion. In November 2006, the banking services project will be piloted by a group of about nine credit unions but already ABCUL is working with 30 more on the business case for their participation in the scheme.[47]

The important question, do all credit unions want to expand and become businesses, is also addressed:

Research has argued consistently that credit unions will best serve those on low incomes when unions are situated within the financial services industry and have the commercial capability to act strategically to promote financial inclusion (Regan and Paxton, 2003; Whyley and Brooker, 2004). The transition from small borrower-oriented organisations to more business-like and commercially-oriented financial institutions, having a capacity to offer the range of products and services required by people on low incomes, has, however met resistance within certain sections of the British credit union movement. Brown, Conaty and Mayo (2003), for example, were sceptical of new model credit union development on the grounds that

> "success indicators are largely based on passing the breakeven point on the balance sheet, so that social objectives do not form an explicit component of the new model".

The National Association of Credit Union Development Workers also maintained that the new model focus on economic reality undermined credit union identity as a community and socially driven organisation (NACUW 2002). This approach was sometimes supported by academics who keen to retain notions of genuine locally alternative financial institutions untainted by association with mainstream institutions, whose actions were regarded as the cause of financial exclusion in the first place (Fuller and Jonas 2002) These concerns reflect, to a certain extent, a fear of the 'degeneration thesis' that has surfaced regularly in the history of the co-operative movement and which maintains that, in their search for success, co-operatives tend to adopt the same practices as capitalist businesses and, in so doing, lose their particularity and distinctiveness. In fact, the debate between

47 Ibid p5

"business-minded institutionalists" and *"social-minded welfarists"* (Richardson 2001) exists throughout the microfinance industry and, certainly, WOCCU has encountered resistance throughout the world to the development of more commercially-oriented credit unions (Jones 2002).

Yet, in fact, new model methodology arose directly out of a desire to effect poverty alleviation, through sustainable credit union development, in Latin America and the third world (Branch and Cifuentes 2001). The paradox, that many British credit unions had to face, was that, if they were to be able to act strategically to combat financial exclusion, they had first to have the organisational capacity that economic and financial stability is able to bring (Richardson and Lennon 2001). There is no doubt that only new model quality credit unions are able to offer a path to financial inclusion, as iterated by Alternatives FCU and as identified by HM Treasury.[48]

The Joseph Rowntree Organisation revisited the sector in 2006 in their Report: *Building Better Credit Unions*.[49] This report also highlighted the development of the new model unions:

Another trend in GB post 2001 has been the formation of new 'fast growth' credit unions. In general, these credit unions have received significant levels of support from their local authorities, which has enabled them, from the outset, to have in place high-specification premises and a team of paid employees. This hothouse approach to credit union establishment contrasts with the more traditional/ethical volunteer-focused and evolutionary nature of credit union establishment and development. These new credit unions are concerned, and rightly so, with providing a service to those who might otherwise face financial exclusion, with aspects of their funding dependent on providing this service. However, in the long term, success for these credit unions is dependent on attracting a cross section of members from their local communities.

Sustainability is an issue for merging, 'fast growth' and credit unions generally. Failure to achieve sustainability runs the risk of creating a dependency culture. Credit unions are founded on the principle of self-help and outside funding weakens and dilutes this principle. Outside funding may also encourage a credit union to take decisions which might not be undertaken under normal growth conditions and which, in the longer term, may be detrimental to the stable development of the credit union. At some stage, the ability of certain credit unions to access grants and subsidies may well come to an end. Replacing a supportive environment with one of no support is, however, unacceptable. An alternative, which would not damage the principle of self-help nor hamper normal growth, is that grants should only be accessed when credit unions were undertaking work in, say, the area of financial

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48 Ibid p10

49 Building Better Credit Unions, Joseph Rowntree Foundation, 2006

inclusion, and had predicted that the ensuing revenue streams were unlikely to cover overhead costs.[50]

The development of the new-model unions has been helped significantly by growth fund money.

A report commissioned by the Friends Provident Foundation (a charity "working for improved access to appropriate financial services for those who are currently excluded")[51] makes the point that the credit union movement in the UK, rather than expanding is currently contracting. The difficulty in 'scaling up' despite official support is described below:

> A major purpose of the credit union movement is to encourage savings and promote the 'wise use of money'. This is often reflected in the requirement for individual members to save before being entitled to apply for a loan. As part of the co-operative movement there is an ethos of helping to providing affordable loans to those who mainstream providers may turn away or otherwise discourage. Since 2005 credit unions in Great Britain have been able to charge a maximum of 2 per cent per month on loans (previously 1 per cent), and pay dividends of up to 8 per cent.
>
> [...]
>
> Given the need to cover administrative and other expenses, offering short-term affordable credit in amounts often in the range £100–£1,000 creates serious challenges to those managing individual credit unions. Small, volunteer-run credit unions have in the past been viable given sufficient individual commitment and a limiting common bond to help reduce the risk of loan default.
>
> As individual credit unions have grown in size and increasing numbers of paid staff are required to run day-to-day operations, major issues arise as to what can be expected from third sector lenders in terms of development towards becoming self-sustaining organisations. The questions around the best way forward for the movement if there is not to be a quasi permanent state of dependence on grants, and other external forms of finance, may have become more rather than less acute given the impact of the policy agenda in recent years.[52]

The Report finds that the main driver of any growth in the movement since 2000 has been the influence of growth fund capital support. This has dramatically increased the scale of those credit unions which used the funds and thus has polarised the sector significantly between the traditional small, and relatively expensive and inefficient lenders and a few bigger unions with substantial loan books. However, what has not happened is that the growth fund money has not generated increased deposits or membership by anything like the same amount. Therefore, the biggest unions are heavily dependent on state grants for their continued lending. There are signs that there is a loan book of about £2 million which, once reached, gives a credit union a chance of cost effectiveness and self sustainability. Even the best example of a growing credit union – Bristol – is only approaching this figure:

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50 Ibid p48

51 Friends Provident Foundation website

52 Promoting the effectiveness and efficiency of credit unions in the UK p14, Steven Hope , Roehampton University

> A similar pattern is repeated elsewhere among those that have grown more quickly – Bristol credit union, with a loan book approaching £1mn and more than 1,200 loans at the end of 2008, is one of the most rapidly growing credit unions in England and Wales following mergers in the middle of the last decade. In 2009 the city-wide credit union had developed to the point that it employed a total of 13 staff and is seen as one of the major forces promoting financial inclusion nationally.
>
> While the scope of its work continues to expand and partnerships are developed with social landlords and others, its own website pertinently comments that scale economies are helping to develop 'a more sustainable credit union'. The acute question of how far towards sustainability the credit union will move and when it might be achieved is, as elsewhere, an open one. In 2002, Bristol Inner City credit union made 59 loans to its members and had an income of £16,000, of which 75 per cent was grants; by the end of 2008 while the credit union's loan income was growing dramatically, more than half of its total income was still coming from grants.[53]

The author sees cost containment; management of bad debts and the provision of central services as being key issues to be addressed if the credit unions are to become self sustainable and capable of growing to the extent that they could provide a real alternative for borrowers currently using high cost credit companies.

The perception that credit unions face a difficult future is shared abroad. Even in that bastion of credit union land, Ireland, one commentator pointed out:

A number of challenges face this volunteer dominated industry. Financial products are growing far more complex, as are regulations governing them. As Irish incomes rise, so too have the expectations of financial service providers. Credit unions are finding themselves confronting increasing membership and decreasing voluntary participation. This is combined with increasing resources and increasing pressure to homogenize, regulate and modernize their systems, particularly given the financial integration from the European Union. A key question arises from this tension: can credit unions remain locally driven, locally responsive and still meet the standards of technology and service required by consumers and, increasingly, the state?[54]

Banks in Ireland had become increasingly open in their criticism of credit unions. Why, they asked, if credit unions are acting more like banks and competing with banks on a broader range of products, were they given special business incentives? It is this sort of decision from which the UK sector may soon be able to put off no longer. Another commentator noted that:

At present there are over 500 credit unions in Ireland - it is generally accepted that this number will be at least halved over the next ten years. Credit unions are having to move from the old style administrative boards to more policy driven models. More professionalism is required bringing with it a sense of loss of some of

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53 Promoting the effectiveness and efficiency of credit unions in the UK p22
54 *Social Movements or pseudo banks?* J. Mcarthur, Simon Fraser University p11

the old ethos of the movement which was very much centered on volunteers.[55]

To take the argument a stage further, just at the time when credit unions are being promoted as vehicles for financial inclusion, capability and to overcome all manner of social injustice, the developments that put them there might signify the end of their traditional existence. MacArthur again, talking about Ireland, but equally of the UK:

> Historically, credit unions were indeed part of a larger grassroots anti-poverty and anti-elite *movement*. There was a high degree of co-operation both nationally and internationally. In addition, the structures were relatively non-hierarchical, based on rotating leadership constituted by local volunteers. Credit unions had mandates that focused not only on financial goals but expanded this to education, training, affordable housing and a number of other developmental goals. Though some of these characteristics remain in both countries, they vary significantly from union to union. Furthermore, the life cycle metaphor outlined above highlights a trend away from these characteristics and towards critical irrelevance and professional mainstreaming.
>
> This paper has taken a sceptical position on the ability of these organizations to identify as a social movement under current circumstances. Though some may serve social goals, there is an increasing shift, for the reasons described above, to more hierarchical structures, an older and more middleclass constituency, and decreasing levels of community participation and volunteering. Along with large consumer and producer co-operatives worldwide, credit unions- particularly in Canada but increasingly in Ireland- suffer from low levels of member participation in decision-making.
>
> Democracy as historically practiced in credit unions requires a direct participatory base to keep it vibrant. In addition to this lack of participation the composition of the credit union boards has been getting older and wealthier over time (Daly 2007). This is particularly marked in the last decade as the requirement for strategic directions, funding business plans, and advance technological and accounting skills become part of the mix. Credit unions are edging toward maturity and thus irrelevance as a social movement.

The prospect of yet further, future, rounds of legislative reform rose in December 2014 when the Treasury published British Credit Unions at 50: response to the call for evidence. The evidence presented and the arguments used to buttress calls for more reform will be familiar to readers of this Paper. The specific pledges from the Coalition government in the document are:

> 3.15 The government will respond to the call for evidence by:
>
> • committing to fund the pilot savings programme established by the Archbishop of Canterbury's Credit Union Taskforce
>
> • tasking the PRA and FCA to use the evidence gathered by the government in their review of the Credit Union Sourcebook
>
> • actively considering legislative amendments to be pursued in the next parliament

[55] Ibid, p17

- ensuring that all credit unions are engaged as the Credit Union Expansion Project begins to deliver more products[56]

A report published in July 2014 for the Welsh government *An Evaluation of the Access to Financial Services through Credit Unions Project* looks at the result of almost five years of European, central and regional government support and subsidy for the movement and its results. Its final summary, of a lengthy Report, is:

> In our view, the project has succeeded in increasing the number of financially excluded people accessing financial services through credit unions, but has had much more mixed results in terms of encouraging financial sustainability (as shown by the PEARLS and other performance data). Given this, we do not believe the project has been an unqualified success, although it has met many of its targets.[57]

More than once the authors refer to the (possibly) unrealistic and challenging targets made of credit unions and the often volunteer staff that run them: t'was ever thus.

56 HM Treasury; British Credit Unions at 50: response to the call for evidence, p19
57 Nia Bryer; An Evaluation of the Access to Financial Services through Credit Unions Project, March 2014; p87

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