Credit Unions & Loan Guarantee Schemes

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a study into the development of financial services for the over-indebted

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Executive Summary

Loan Guarantee Schemes

A loan guarantee scheme involves the accumulation of a fund, usually through grants from external donors, which is then used as a reserve to cover any losses arising from specified categories of high risk loans. With the support of a loan guarantee scheme, a credit union feels able to make instant or debt redemption loans to low income people without putting its own members' savings at risk. The operation of these schemes, both in theory and practice, forms the central theme of this research report.

A strategy for serving the over-indebted

Loan guarantee schemes can help credit unions manage some of the risk involved in lending to people already over-indebted to other lenders. However, loan guarantee schemes alone cannot be seen as the solution to the problem of high risk lending. This research indicates that ad hoc responses to debt problems, based solely on making externally guaranteed debt-redemption or "rescue" loans, achieve limited success.

Serious, multiple debts are seldom the result of poor money management alone and cannot be solved with an instant loan. Credit unions that wish to serve over-indebted people need to develop strategies aimed at responding appropriately to their multi-layered and multi-faceted needs. An effective and strategic response is likely to include one to one personal support involving money advice, help with budgeting, an element of financial education and, in addition, access to affordable credit.

The economics of serving low-income consumers

It is not easy for British credit unions to develop appropriate services for over-indebted, low-income groups out of their own resources. Without the ability to charge market rates on loans and to achieve cross subsidy within the credit union's own range of financial services, many British credit unions are dependent on external financial subsidy in order to serve over-indebted and low-income groups. It is this economic reality that has led many credit unions to seek external financial support to develop loan guarantee schemes within low income communities.

A business decision that reflects social commitment

Credit unions become involved in serving over-indebted people for philosophical reasons. Whether community or employee-based, credit unions prioritise responding to the needs of people in financial difficulty as an important social goal. However, credit unions need to approach the development of services for over-indebted and low-income groups as a business rather than as a charity.

Developing strategic partnerships

Credit unions developing loan guarantee schemes in the interests of low income, over-indebted members are attempting to take on a major social responsibility within society. Rather than taking on this task alone, credit unions need to be working in partnership with other agencies and funders and to be establishing co-operative and collaborative solutions to tackling indebtedness within society.

Funding loan guarantee schemes

63.2% of loan guarantee schemes are established with funds of less than £10,000 used mostly to establish loan loss provisions. However, the loan loss provision is not the most significant, nor the most expensive, element of a loan guarantee fund. The greater costs are more related to the effective management of the scheme. If schemes are to achieve maximum impact, they need funding partners who are interested in establishing longer term, strategic initiatives. Single one-off grants of a few thousand pounds are able to achieve very little.

Loan guarantee schemes do normally require a dedicated loan loss provision as a constituent element. An alternative approach, which equally supports the development services within low-income communities, is to encourage funders to make a donation into the credit union's accounts that will be used to build the standard loan loss provision in the credit union.

Effective credit administration

Loan guarantee schemes cannot replace good lending polices and effective credit administration. Loan guarantee schemes should never allow a culture to develop in which the non-repayment or the slow repayment of loans is considered to be acceptable in some circumstances.

In fact, good credit administration eliminates much of the need for loan guarantee schemes. Credit unions that use external funds to on-lend to new members or to make loans unconnected to savings balances are doing so as a result of their own restrictive lending policies, not out of necessity. If an assessment of a person's character and capacity to repay is used as part of the credit assessment, more flexible loan policies can be developed and there is no need for an external fund to guarantee an instant loan to a new member nor to a member without a "requisite" amount of savings.

The importance of mobilising members' savings

All credit unions operating loan guarantee schemes endeavoured to prioritise savings as part of their package of services for low income, over-indebted members. The building of savings results in a range of positive effects for people including planning for the future and increased participation in the community.

Mobilising savings has a long term relevance for credit unions themselves. It affords a credit union the possibility of economic independence from external subsidies and provides the liquidity to enable it to make loans to its members.

Money advice, money advice agencies and credit unions

Multiple debt problems are complex and involve much more than a simple inability to manage money. Instant access to a loan may not always be in the best interests of a person suffering over-indebtedness. A structured approach to managing that debt is much more important. For this reason, this research concludes that it is essential to link all loan guarantee schemes, aimed at serving the over-indebted, closely to money advice services.

Bill paying and budgeting accounts

Both in Ladywood and Huyton, bill paying and budgeting accounts were found to be an essential element of an effective service to low income, over-indebted members. The discipline and the structure of these mechanisms enabled members, all with a history of indebtedness, to make the transition to financial stability and regular credit union membership. As MABS schemes in Ireland illustrate, bill paying and budgeting services are often of more value to the member than an instant loan.

Financial literacy education

Credit unions reaching out to low income, over-indebted people can offer or promote programmes in financial literacy. There is a direct link between financial literacy education and money advice. People with multiple debts can often be ill informed on financial matters and approach the credit union with problems which may not have been as great if they had been able to make informed, educated choices. People on low incomes do make rational choices about access to credit but these choices are often constrained by poor information and knowledge, as well as limitations on access to a range of options.

Acknowledgements

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The research observations and recommendations are made by the author, in consultation with credit union and other research participants. They do not necessarily reflect the opinions of Barclays.

The author would like to thank the staff and volunteers of *East Manchester, Ladywood, Llanelli, Acton and Huyton Credit Unions* without whose good will, interest and enthusiasm this study would not have been possible. In particular, thanks go to Christine Moore and Tim Presswood of East Manchester, Gerardine Giblin and Jackie Parker of Ladywood, Geoff Hopkins and Helena Ashley of Llanelli, Rose McGreal of Acton and Karen Bennett and Marion Hardman of Huyton.

Thanks go too, to the 146 credit unions that replied to the national questionnaire and to the 53 credit union volunteers and activists, money advice and agency workers and other interested contributors who participated in the two research seminars.

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Credit Unions and Loan Guarantee Schemes

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Foreword

Barclays is pleased to be supporting this important piece of research. Loan guarantees are increasingly being discussed as a methodology that could enable credit unions to reach some of the most financially excluded people in our society, whilst minimising risk to their existing members' savings. Yet the experience of credit unions in this field to date has been mixed. The research that Paul Jones has undertaken provides a much needed and invaluable framework for those considering operating or supporting such schemes in the future.

Barclays has a long history of supporting the provision of free independent money advice, having donated over eight million pounds to the sector over the last six years. We believe that, as well as providing access to affordable credit, it is often equally important to provide people with access to free independent money advice. We therefore commend Paul Jones's recommendation of a co-ordinated approach between the money advice sector and credit unions undertaking loan guarantee schemes in the future.

Barclays already has experience of supporting loan guarantees in the UK, recognising that providing instant loans to some of the most excluded people in our society carries greater risks for credit unions. It is clear that, whilst the decision to become involved in such lending activities has its origins in the credit union's social commitment, the decision must also reflect business realities. Barclays will continue to support loan guarantee schemes being operated by credit unions which we believe have the business capacity and credit administration policies to ensure the schemes are viable and sustainable, delivering real benefit to those people who are currently struggling to access mainstream credit.

At Barclays we are committed to promoting financial inclusion. We therefore look forward to working with the credit union and free money advice sectors to develop effective and productive partnerships that deliver real benefits.

Peter Kelly
Head of Financial Inclusion
Barclays plc

Introduction

Credit unions are co-operative financial institutions that are open to all who share their common bond. They aim to offer financial products and services to members from a wide range of social and economic backgrounds. However, as this research report demonstrates, fundamental to credit union philosophy is a commitment to serve people in financial difficulty, particularly those on low incomes and excluded from mainstream financial services.

For many British credit unions, however, putting this commitment into practice is not easy. The vast majority of credit unions, contacted through this research project, expressed a desire to serve over-indebted people and to offer them an opportunity to achieve financial stability. They wanted to offer people instant credit for pressing needs and debt redemption loans to free them from high interest charges paid on debts to extortionate lenders. Yet, implementing this was difficult. Instant loans to new and unknown people, particularly those already deeply in debt, is a risk that any financial institution would find difficult to manage. Many credit unions also found it difficult to find a way round their own traditional but restrictive lending policies. In many credit unions, members have been required to save for a qualifying period ranging from eight weeks to three months as a method of determining their capacity to repay a loan. The loan granted would then be limited to two or three times the amount now saved. Clearly, people with no savings, and little history in the credit union, are difficult to help under such policies.

It is clear from the research that the reason credit unions find it difficult to implement lending programmes for the over-indebted is their concern to keep the source of their funds, their members' savings, safe. In the search for a solution, some credit unions have established loan guarantee schemes to facilitate instant and debt redemption lending to low income and over-indebted people. A loan guarantee scheme involves the accumulation of a fund, usually through grants from external donors, which is then used as a reserve to cover any losses arising from specified categories of high risk loans. With the security of a loan guarantee scheme, a credit union is able to make instant or debt redemption loans without putting its own members' savings at risk; and is therefore able to consider loans that would otherwise be regarded as high risk. The operation of these schemes, both in theory and practice, forms the subject of this research report.

The report is an analysis of the experience of five credit unions operating loan guarantee schemes and of the views and perspectives of 119 other credit unions running, or thinking about running, such schemes. It also reflects the thoughts of money advisers and advice agencies working in partnership with credit unions. It was conducted from September 2002 through to March 2003.

Evidence from the research study suggests that loan guarantee schemes, in isolation, are not the solution to the problem of lending to low income, over-indebted people. As one volunteer put it, in reference to the significant loan losses in one particular scheme, *"you might as well have put the money in a bucket outside the door and let people help themselves"*. However, the report is positive about the value of external support assisting credit unions to serve low-income people in financial difficulty. As several of the case studies illustrate, structured and strategic approaches to lending to people in financial difficulties are not only possible but, given the appropriate framework, support and resources, are undoubtedly effective in assisting people to move from debilitating over-indebtedness to financial stability and long term membership of a credit union. Within this framework, loan guarantee schemes, operated with professionalism, vigour in risk assessment and robust credit control can assist credit unions to achieve their aim of helping low income and over-indebted people either within or outside their current membership.

Research Project and Methodology

...within an emerging credit union movement, as in Britain, loan guarantee schemes may have a role to play in ensuring that credit union services are accessible and open to the most disadvantaged members of the community.

Research Project

The research project aimed to investigate the operation, performance and impact of loan guarantee schemes within British credit unions. Internationally, there is some evidence to suggest that loan guarantee schemes, and the use of external donor funds for on-lending, can, at best, only have a marginal impact on the development of financial services for low income groups and can, at worst, result in a lack of rigour in the management of credit risk. In some countries they have been linked with a failure to mobilise member savings and, thus, an inability to assist people to move out of poverty through the accumulation of their own savings (Richardson 2000a). This experience suggests that loan guarantee schemes cannot be seen as a long term solution to the development of credit union services for the most disadvantaged within society.

However, the project began with the hypothesis that, within an emerging credit union movement, as in Britain, loan guarantee schemes may have a role to play in ensuring that credit union services are accessible and open to the most disadvantaged members of the community. There is evidence from Ireland that loan guarantee schemes, tightly managed and controlled in association with professional money advice services, can be relatively successful. This is supported by some evidence from the United States. The research aimed to investigate the hypothesis that loan guarantee schemes, albeit not a long term solution to credit union product development, can enable credit unions to reach specific groups of low income people who otherwise would find it difficult to access credit union services.

Research Methodology

The research project was designed as a participative and collaborative programme. Its aim was to fully involve credit union staff and volunteers in a process of reflection through which conclusions about the role of loan guarantee schemes would emerge. With the researcher, credit union participants took part in a co-operative enquiry into the strategic development of financial services for low-income, over-indebted members.

The research project had four major elements:-

National questionnaire

- A questionnaire was sent to all British credit unions seeking information regarding the incidence and operation of loan guarantee schemes

Case studies

- An in-depth, collaborative study of five credit union loan guarantee schemes. These were selected to reflect a range of factors and variables (location, size of fund, length of operation, funders, links with money advice agencies etc.). Some of these schemes were more successful than others.
- The case studies involved in-depth semi-structured interviews with credit union staff, funders and borrowers as well as a financial investigation of the operation and impact of the scheme.

Seminars

- Two participative seminars took place in Manchester and Leeds. These brought together credit union staff and volunteers, CAB and money advice workers and other professionals with experience of the operation of loan guarantee schemes. Seminar presentations were given in Manchester by Claire Whyley, Welsh Consumer Council, Marion Hardman and Karen Bennett of Huyton Credit Union Ltd and Christophe Guene of SOFI. In Leeds, presentations were given by Christine Moore and Tim Presswood of East Manchester Credit Union.

Individual interviews

- A series of interviews were conducted with a number of professionals working in this area. These included representatives from NACAB, MABS (Ireland), National Federation of Community Development Credit Unions (NYC), World Council of Credit Unions (Madison), Money Advice Trust and the FSA.

Interest and Involvement

All 682 British credit unions were mailed with a questionnaire seeking information on their interest and involvement in loan guarantee schemes. 146 credit unions replied (a 21.4% return). These included 19 credit unions operating loan guarantee schemes, 105 who were interested in establishing schemes and 22 who were not interested and who had no intention of developing a scheme. The following information was gained from the questionnaires

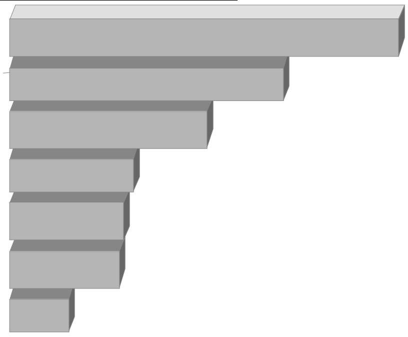
Credit Unions interested in organising a Loan Guarantee Scheme.

An immediate solution to an immediate problem – targeting new members

Table 1 shows that the vast majority of credit unions, replying to the questionnaire, were interested in establishing loan guarantee schemes in order to make loans to people with pre-existing debt problems. The aim was to combat over-indebtedness through settling debts with a credit union loan. It was an immediate solution to an immediate problem faced by the borrower. Overall, credit unions were more interested in offering this service to new rather than to existing members. This indicated, perhaps, that loan guarantee schemes were somewhat regarded as a marketing tool to attract new members rather than as an element of a strategy to serve over-indebted people in a more holistic way.

Table 1. What do you see as the key purpose of a loan guarantee fund?

Debt consolidation loans	81.0%
Instant credit for new members with particular needs	57.1%
Instant credit for current members with particular needs	41.0%
Loans for utility bills	25.7%
Personal business loans	23.8%
Energy conservation loans	22.9%
Other	12.4%

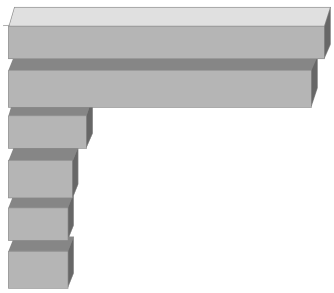


Managing risk – a concern to protect members' assets

Table 2 indicates that loan guarantee schemes are seen as a way of managing riskier loans without jeopardising member savings. Clearly these credit unions have identified the balance required between their justifiable concern to protect the assets of members and ensure the safety of the credit union against their ability to assist people in need, many of whom may be a significant credit risk, and hence present a risk to the long term stability of the credit union. The intention of these credit unions in establishing a loan guarantee scheme is to pass on the risk to an external donor. This indicates a high level of awareness of the difficulty of the endeavour that they are intending to enter into. There is a strong recognition that in attempting to serve those that are considered to be too high a risk for many mainstream providers a significant risk is presented to credit unions. However, for credit unions, this risk results in an actual loss of the savings of credit union members, rather than just a lessening of profits and returns to shareholders. It is this risk – the loss of members savings – that credit unions are aiming to alleviate in establishing loan guarantee schemes. 93% of respondents were clear that *"a loan guarantee scheme will protect our members money at the same time as allowing the credit union to serve people on very low incomes"*. However this meant passing on the whole of the risk to the external donor. 74.3% agreed, and 49.5% strongly agreed, that *"a loan guarantee scheme must protect 100% of the loan made"*. Only 10.5% were open to considering that a loan scheme could cover a proportion of the loan made.

Table 2. What was it that led you to the conclusion that a loan guarantee scheme is a good idea for your credit union?

A solution to making risky loans	65.7%
Current inability to meet the needs of many people requiring loans	62.9%
Availability of funding to set up the scheme	16.2%
The experience of other credit unions	13.3%
Advice from another agency (e.g. money advice service)	12.4%
Others	12.4%



Interest and Involvement

Yet, the belief that loan guarantee schemes were success stories was strong.

Social commitment

Credit unions were not attracted to loan guarantee schemes through knowledge gained from other credit unions. As Table 2 shows, only 13% of respondents stated they considered loan guarantee funds were a good idea because of the practical experience of other credit unions. Yet, the belief that loan guarantee schemes were success stories was strong. 49.5% of respondents strongly agreed and 37.1% agreed (86.6% agreeing in total) that loan guarantee schemes are *"excellent ways to develop credit facilities for people on very low incomes."*. This very positive judgement about loan guarantee schemes was not built on evidence arising from the performance of loan schemes elsewhere but rather seemed to arise out of a hope based on the social commitment and ideology of respondents.

Lending policies

Nearly two thirds of respondents, 62.9%, saw loan guarantee schemes as important because their current lending policies prevented the credit union from meeting the needs of the people they sought to serve. The traditional operating practice of requiring new members to save for a period of time before becoming eligible for a loan, and of linking all loans to a percentage of savings, mitigated against lending to new applicants without savings balances. At this point it is useful to remember that this operating practice which links savings and loans is not required by either credit union legislation or regulation, but is a traditional practice that has evolved in some credit unions and is not in keeping with recommended international best practice. The World Council of Credit Union promotes an assessment of credit risk based upon an assessment of the 5 Cs of credit (Richardson 2000a). The de-coupling of savings and loans is also recommended.

Credit administration

88.6% agreed, and 61.9% of respondents strongly agreed that *"a loan guarantee scheme will only work if the credit union is very rigorous in its lending policies and credit administration"*. This was a strong recognition that loan guarantee schemes must operate to sound, business-like standards. Albeit the enthusiasm for loan guarantee schemes arose from a strong social commitment, there was a recognition that borrowers are not served by poor lending practices and, equally, that the funds of a loan guarantee scheme should be protected. Nevertheless, doubt was expressed as to whether the existing credit administration process could be robust enough to adequately protect members' savings without the safety and protection afforded by a donation of external funds for on-lending to members.

An idea rather than a worked out reality

82.9% of respondents had not *"developed the idea of a loan guarantee scheme with any other agency"*. Discussions with other agencies, particularly money advice agencies who would seem to be the most suited partner, had not prompted the interest in establishing a loan guarantee scheme. It seemed very much a credit union initiative. However, interest in developing a loan guarantee scheme remained, for most, an idea on the drawing board rather than an immediate reality, with a large number awaiting the results of this research and its potential recommendations on best practice. 85% of respondents had not identified any possible source of funding to establish a scheme.

Credit Unions involved in organising a Loan Guarantee Scheme.

Focus on personal lending

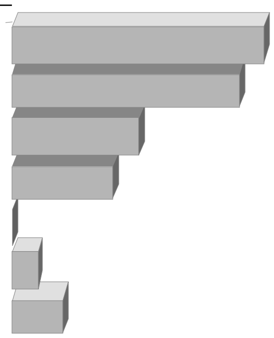
All the credit unions who responded indicated that they were involved in running loan guarantee schemes related solely to personal loans. The results of the survey revealed no examples of credit unions involved in loan funds guaranteeing business or micro-enterprise loans.

Tackling over-indebtedness as well as poverty

The original purpose of establishing the scheme was similar to those given by credit unions interested in loan guarantee schemes. As Table 3 illustrates, the main purpose was to reach out to people in debt and to provide instant credit to new members. The focus was on attracting new members rather than on developing a service that would benefit the existing membership.

Table 3 What is the purpose of the loan guarantee scheme?

Debt consolidation loans	52.6%
Instant credit for new members with particular needs	47.4%
Instant credit for current members with particular needs	26.3%
Loans for utility bills	21.1%
Personal business loans	0%
Energy conservation loans	5.3%
Other	10.5%



Interest and Involvement

For most credit unions, 68.2%, lending from the fund was carried out in isolation from money advice agencies or any other support services.

No more than £20,000 to combat poverty and regenerate a community

Most funds provided to finance loan guarantee schemes were for a modest amount. 42.1% were less than £5,000 and 21.1% between £5,000 and £10,000. 38.8% are over £10,000, the largest being £18,000. They were funded from a variety of sources. 26.3% were funded through public funds, 10.5% by banks and the remainder through charities, trusts, and other agencies. Two credit unions have established funds with their own resources. However these tended to be very small schemes. One fund of £300, for example, was funded by donations from the members to assist those facing financial hardship. The main reasons given for the funders supporting loan guarantee schemes were to combat poverty (36.8% of total) and to promote community regeneration (26.3%)

Partnerships with other agencies

Only 36.8% of funds for loan guarantee schemes were administered in partnership with any other agency: whether a money advice agency or Citizens Advice Bureau. For most credit unions, 68.2%, lending from the fund was carried out in isolation from money advice agencies or any other support services.

Special conditions and targets

63.2% of credit unions have special conditions, or targets, attached to the scheme by the funding body. These were in order of incidence (percentages relate only to this group of credit unions who have special conditions and targets):-

- Loans can only be made to specific categories of individuals. 42.1%
- Loans can only be made up to certain amount. 31.6%
- Loans can only be made if borrowers agree to begin a regular savings relationship with the credit union. 21.0%
- Loans can only be made in partnership with a money advice or other agency. 15.8%

Most loans granted under the guarantee fund were small. Even though data returns in the questionnaire were often incomplete, the majority of loans appeared to be for amounts under £250 which demonstrated the valuable service credit unions were offering people on very low incomes. Some credit unions were flexible, however, and would grant larger loans. Three credit unions used loan guarantee funds for loans over a £1,000 and two for loans over £2,000. 68.4% of credit unions administered and accounted for guaranteed loans separately from standard credit union loans.

Reasons for borrowing from a guaranteed fund

Tables 4 and 5 indicate that, in reality, most people accessing loans underwritten by loan guarantee schemes were already in debt to high cost alternative lenders. The key reasons given for accessing a guaranteed loan were either because people were already heavily in debt or because they did not meet the standard credit union lending criteria established in the credit union's policies.

Table 4 Main groups of borrowers from the fund.

People in debt to high cost alternative lenders	63.2%
People in debt to utility or housing companies	26.3%
People in receipt of welfare or unemployment benefits	26.3%
Single parents	26.3%
Women	26.3%
Other	10.5%

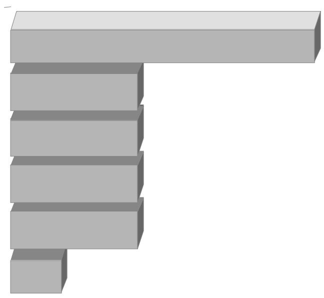
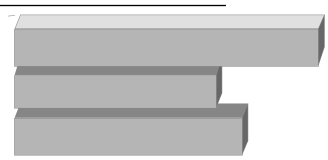


Table 5 Main reasons borrowers access the loan guarantee scheme loans.

Already in debt to other lenders	63.2%
Little or no savings record in the credit union	42.1%
To obtain immediate credit for a specific purpose	47.4%



Delinquency, or loan arrears rates, for loans underwritten by the loan guarantee scheme were revealed to be demonstrably higher than for normal loans,

Less than half, 42.1%, agreed that "the loan guarantee scheme has been a success in our credit union".

Progression to regular membership

73.7% of respondents indicated that there was evidence to suggest that borrowers accessing loans under the scheme had gone on to become regular savers and borrowers in the credit union. However, the number of borrowers progressing to regular membership was not indicated. The case studies indicate that a progression rate of 30% is around the norm.

Arrears and loan loss

Delinquency, or loan arrears rates, for loans underwritten by the loan guarantee scheme were revealed to be demonstrably higher than for normal loans, although this is perhaps not surprising given the recognition of the risk inherent in the economic profile of the people the credit unions aimed to serve. 52.6% of respondents agreed that delinquency rates are higher and only 21% noted that rates are the same as for standard loans. There was one exception. One respondent noted that delinquency rates were less than for standard loans on its small loan guarantee scheme. Write offs of guaranteed loans were also high even though, in most cases, at the time of completion of the questionnaire, credit unions had not written off delinquent loans balances from the fund. At least five credit unions had written off substantial amounts from the fund. Delinquency rates were a key concern in organising loan guarantee schemes. In recognition of the fact that loan default can be prevented through sound credit assessment, administration and granting processes, 57.9% disagreed that *"a loan guarantee scheme enables a credit union to be less rigorous in its credit granting procedures"*

Less than half agree that loan guarantee schemes were a success

Only 17.6% of respondents recorded that the original funder was willing to replenish the fund. Most funds were one-off initiatives, 78.9% of which were not maintained as going concerns. They were either discontinued or left to run their course. Only 26.3% of respondents who had operated a loan guarantee scheme agreed with the statement that "*a loan guarantee scheme is an effective solution to assisting people on low incomes to access affordable credit*". In addition, only 15.8% agreed that "*the loan guarantee scheme has assisted our credit union to reach significant numbers of people who would not normally have used the credit union.*" Less than half, 42.1%, agreed that *"the loan guarantee scheme has been a success in our credit union".*

A positive learning experience

The experience of organising a loan guarantee scheme was, however, positive for many credit unions. 52.7% agreed that *"the loan guarantee scheme has helped us to develop more rigorous credit administration and delinquency policies"*. 63.2% of respondents were clear that the operation of a loan guarantee scheme influenced or changed the general policies and procedures of the credit union for the better. Of this group, 52.6% were influenced in the development of their loan policies, 47.4% improved their credit control procedures, 36.8% revised their credit administration practices, 21.1% enhanced their record keeping practices and 21.1% their provisions for bad debts. However, only 10.5% were prompted to further develop financial products for low income groups and only 10.5% were influenced to further explore working in partnership with other agencies.

East Manchester Credit Union Ltd

Background

In easy reach of the new stadium created for Manchester's Commonwealth Games, East Manchester Credit Union is situated within one of the most exciting and innovative regeneration areas in the country. The credit union serves low income communities in the areas of Beswick, Openshaw, Bradford, Newton Heath and Clayton to the east of the city of Manchester, an area designated as one of seventeen national pathfinders under the New Deal for Communities initiative . Through this initiative, and the local regeneration partnership, New East Manchester, the credit union has received organisational and financial support to develop accessible and affordable services for low income members. The credit union has strong links with money advice workers and with the financial inclusion officer within the regeneration partnership. The credit union is part of the financial inclusion group established by the regeneration agency. The credit union has developed two loan guarantee schemes in partnership, first with the CAB and, secondly, with the Wired up Communities regeneration initiative.

1. ***Community Loan Guarantee Scheme***

   This scheme was established by the credit union in order to enable the credit union to grant loans to people in crisis and emergency situations who would not normally meet the credit union's usual criteria for personal loans.

2. ***Eastserve.com Loan Guarantee Scheme***

   All local residents in the regeneration area are eligible, through the Government's Wired up Communities initiative, to purchase a new computer with internet access for only £200. In partnership with Eastserve.com, a community based internet project, the credit union has established a loan guarantee scheme in order to enable residents to obtain a loan to cover the cost of the computer. All residents who are eligible for a computer are also eligible to apply for a credit union loan. Smaller loans are available for people wishing to purchase reconditioned computers at reduced cost.

Community Loan Guarantee Scheme

Loan criteria and source of funding

The loan guarantee scheme was established with initial grants totalling £10,000. £5,000 was granted by the Greater Manchester Community Foundation, which accessed the funds through a Health Action Zone Initiative. £5,000 was also granted by the regeneration agency, Beacons for a Brighter Future, using funds identified through New Deal for Communities and the Single Regeneration Budget. The credit union has used this fund to make loans up to a total amount of £10,000. £5,000 has been recovered in loan repayments and, as loans are repaid, the credit union aims to use the fund to make further guaranteed loans. Loans are strictly monitored against the amount of the fund as the credit union uses the fund to cover 100% of loans made. It is regarded as a safety net and no member savings are risked in the administration of the scheme.

The funders of the scheme, and the credit union, set specific criteria for its administration. The scheme was established primarily for people facing immediate crisis situations with regard to their inability to purchase general emergency items (only in two cases were loans from high cost lenders paid off). A key feature of the scheme was that it enabled people who were not members of the credit union to obtain an instant loan for an emergency purpose. One of the funders did ask for a general report on the progress of the scheme but neither requested specific or intensive monitoring or evaluation. However, the credit union does have to report annually on the funding to the financial inclusion group and board of the Beacon's for a Brighter Future.

Credit administration

Loans granted with support of the loan guarantee scheme were administered, and recorded, quite separately from standard loans within the credit union. Applications were only considered, both from members and non-members alike, following an in-depth and rigorous interview with a CAB money adviser. All relevant documentation, including benefit books and payslips, had to be produced and a detailed income and expenditure analysis was carried out. The money adviser only recommended the applicant for a loan after other avenues of income maximisation had been explored. In fact, the three applications that failed to be supported by the money adviser were on the grounds of eligibility for a Social Fund loan.

Officially, the money adviser did not make the decision about granting the loan. This was retained by the credit union credit committee and loan officers. However, in practice, CAB referrals recommending loans were in all cases accepted by the credit union. The policy of the credit union was to grant loans primarily on character and on the applicants' capacity to repay. Capacity to repay was adjudged on the outcome of the income and expenditure analysis and character on the money

The scheme did enable the credit union to reach out into the community and make a difference in an identified number of cases.

advisor's view of applicants' future willingness to repay.

"*The decision whether to give a loan or not was based very much on whether people seemed genuine or not*", stated one of the loan officers. There were no credit checks and loan granting did become somewhat a matter of good faith in the character and ability of the applicant. In fact, very few applicants failed to have their loan application supported. A very positive attitude to the possibility of future repayment of the loan prevailed. As one credit union worker commented, "*next time, we intend to involve the CAB more fully in the evaluation of the project*". A significant factor here was that the money adviser was not involved in any follow up work after the loan was granted. The advisor's role terminated on the granting of the loan.

Even though the credit union administered and recorded loans granted under the scheme separately, staff and volunteers endeavoured to promote the scheme within the general context of the credit union. Attention was particularly given to ensuring that the grant-assisted loan guarantee fund did not become general knowledge within the membership and community at large. The fear was that if this did become known, borrowers motivation to repay may be diminished. In fact, despite best efforts, knowledge about the existence of the fund did tend to become known within parts of the larger community.

Loans granted

38 loans were made with the support of the loan guarantee fund. Loans varied between £100 and £600, with the average being £200. In principle, the scheme aimed to prioritise the granting of small loans for immediate needs and emergency purposes. 13 of these loans have now been fully repaid. However loan delinquency has been high on the overall portfolio of loans. 26 of the 38 loans were in arrears. The total write off amounts to £4,600 or 46% of the total amount of loans granted.

Status of borrowers

The majority of borrowers were in receipt of welfare benefits. Only two were in employment. Most were women, the majority of whom were single parents and all of whom were in need of immediate credit. All had no other source of credit open to them (including the Social Fund) apart from recourse to high cost alternative lenders.

Managing repayments

The credit union did not organise or implement any specific system of credit control related to the loans guaranteed by the fund. However, it was clear that these loans had a much higher delinquency rate than standard credit union loans. All borrowers fell into arrears with their loans and a very high proportion had to be written off out of the fund. It was clear to credit union staff and volunteers that lending to very high risk borrowers requires additional effort to support and help an individual to maintain a regular pattern of repayments. The credit union were unable to provide this support and, despite income and expenditure analysis with the money adviser, many of the borrowers did not have the capacity or the willingness to repay.

Organisational learning

Credit union officers identified the learning points arising from the operation of the scheme over a twelve month period:-

- ***Real, yet limited, positive outcomes***
  - The scheme did enable the credit union to reach out into the community and make a difference in an identified number of cases.
  - Around 30% of borrowers in the scheme went on to become regular members. This was represented by the 12 people who went on to save and borrow regularly in the credit union. The scheme did therefore enable some people to make the first steps out of over indebtedness and into financial inclusion.
- ***Delinquency and loan recovery***
  - The scheme was subject to a much higher delinquency rate compared to the standard loan portfolio within the credit union. The reasons identified for this were – that the credit union was lending to people already in severe crisis situations; that the credit union was the last port of call for borrowers (most of whom had been refused by other lenders and could not access the social fund); that borrowers had little loyalty to the credit union as they had not previously been members; that many borrowers already had multiple debts; that borrowers often had poor financial literacy and unstable backgrounds (moving house, location etc) and that it was not easy to identify potential defaulters through credit assessment procedures.
  - The scheme demanded more rigorous credit control and loan recovery procedures which, due to a lack of resources, were not easy to put and keep in place. They were high cost and time consuming and often involved a high level of ongoing personal contact with

Through the operation of the scheme, credit union workers did realise that there were some people who it was difficult if not impossible to help.

borrower. However, without more rigorous borrower-focused systems, it was difficult to make the scheme operate successfully

- ***Organisational capacity to operate the scheme***

  - Overall the scheme was time and labour intensive. Managing a portfolio of high risk small loans was demanding. Without adequate personnel and staffing time it was not easy to reach large numbers of the people the credit union intended to reach. "*The scheme cannot really be judged a great success*", said one credit union officer, "*We only recruited 12 new members through the scheme and there was a high rate of delinquency. We did not have the time or staffing to run it successfully*"

- ***A high cost scheme***

  - The scheme was high cost in terms of staff and volunteer time as well as in direct administrative costs. There were added costs of reminder letters, often sent by registered post, and County Court fees. "*It is very expensive to chase the debt*", noted one credit union worker to make the scheme operate successfully

- ***The necessity of rigorous credit administration procedures***

  - It was clear to all at the credit union that a scheme aimed at serving people in financial crisis required not less but more rigorous credit administration procedures. This perhaps was the most difficult learning curve for credit union workers, the majority of whom were socially and ethically motivated to reach out to and assist those facing financial hardship. "*It made everyone a lot more stringent about loan administration*", noted one credit union officer, "*it was important to have clear procedures, such as having documentary proof of income, recording evidence of how long a person was at an address and at a previous address, making sure people had a referee which was followed up by a phone call, insisting borrowers came in person to the credit union, seeing payslips and checking how long the borrower had been employed*". It was increasingly appreciated in the credit union that the greater the stress on the ability to repay, the more important a detailed assessment of the borrower's circumstances and financial situation became. The necessity of learning how to sometimes say no to a loan was particularly difficult for the credit union officers.

  - The usefulness of credit checks was discussed and debated but they were not implemented during the period of the scheme.

  - Loan granting was restricted to small loans of less than £600. This was felt to be more productive and, through spreading the risk, avoided a concentrated loss on larger loans.

- ***Importance of partnerships***

  - The link with the money advice worker was a key feature of the scheme and seen as essential to its operation. In future operations of the scheme, applications for loans will only be accepted through referrals from money advice workers, health workers, children centre workers and other professionals. A supportive professional link with the borrower enables a more ongoing and productive relationship with the credit union itself.

  - It was noted, however, that it is very important for CAB and money advice workers, as well as other professionals, to receive greater training in the economic operation of the credit union. Loans need to be made that both support the borrower and protect the credit union as a financial institution.

- ***The inability to help all comers***

  - Through the operation of the scheme, credit union workers did realise that there were some people who it was difficult if not impossible to help. The social and economic circumstances of certain individuals entail that regular and consistent repayments of a credit union loan are very difficult if not impossible.

- ***Relationship with the funder***

  - In this scheme, the funders did not participate actively in the evaluation and monitoring of the scheme. They provided the initial grant rather than participated in a longer term strategic partnership with the credit union. It was felt that a more productive partnership with the funding agency would have helped in the development of the scheme.

Eastserve.com Loan Guarantee Scheme

Loan criteria and source of funding

Eastserve.com is a community internet initiative, funded through the Wired up communities programme. It aims to deliver government and community services online to the residents of East

Manchester. To this end, it offers new internet-ready computers to all residents at an all inclusive price of just £200 and reconditioned models for a reduced sum. However, for the majority of residents in East Manchester, £200 is not easy to find. So Eastserve.com has entered into a partnership arrangement with the credit union in order to enable all purchasers of computers to access an instant £200 loan to buy a computer. This loan offer is open to members and non-members alike and is available at the time of purchase. Non-members must become members at the time of applying for the loan and pay a £2 membership fee.

The credit union administers both the loans and the sale of the computers on behalf of Eastserve.com. Eastserve.com provides financial support to employ a full time project administrator and, also, to protect the credit union from potential loan losses, offers the credit union loan protection to an amount of 15% of the total sum of loans made. This loan guarantee scheme is funded, not with an amount of money donated to the credit union in advance, but through loan losses being deductible from money owed to Eastserve.com for the computers.

The computer project was developed in two phases. In phase one, the credit union itself made computer loans without formal loan guarantee support. Offering instant computer loans was seen by the credit union as a way of offering its members an important service and of reaching out to the wider community, targeting the general public and increasing membership. In phase one, £18,000 of loans were made without a loan guarantee scheme. This initial phase resulted in 15% of the loans having to be written off. Although not part of a formal agreement, Eastserve.com covered this loss with a grant of £2,800. It was this reality of a 15% bad debt that provided the ratio for the loan guarantee scheme established, by agreement on the basis of shared risk, to further the extension of computer loans in phase two of the scheme.

In phase two of the scheme, designed on the basis of what happened in phase one, a loan fund established to cover 15% of loans made – in this case the risk was shared by the credit union and the funder.

Status of Borrowers

The scheme offers computer loans to all members of the community, on condition that non-members become members of the credit union on applying for a loan. All borrowers have to agree to save a minimum of £1 per week in addition to loan repayments. Members with poor credit records, or bad debts, within the credit union are unable to access computer loans. Over 80% of people purchasing a computer do so with a computer loan from the credit union. This figure alone indicates the extent of low income and poverty within the community of East Manchester. Without a loan, the majority of people just could not afford the £200 for the computer.

Credit administration

The credit union could not administer the scheme without full-time paid administrative staff. As one worker noted, "*the scheme was a bit of a nightmare*", in the sense that processing large numbers of loans, computer sales and new membership applications was demanding and time consuming. The financial support to employ the administrator was key to the success of the scheme. It was recognised that volunteers alone could not have managed the project. Everything depended on having organisational capacity to make the project work efficiently and effectively.

To ensure that loans were processed speedily, the credit union introduced simplified loan forms and application procedures. It adopted a flexible approach to lending in response to this particular market opportunity. Loan interest was charged at the standard rate and all loans were required to be repaid over a one year period.

Loans granted

In phase one, 180 loans were made to a total amount of £18,000. In phase two, 1,600 loans have been made totalling £300,000

Managing delinquency

Arrears on the scheme currently stand at around 15% . There are no current write offs. It is expected that the final overall delinquency ratio will be no more than 10%, which is the baseline target for the project. The credit union implements all standard loan delinquency procedures in relation to the scheme and considers taking court action where appropriate. The scheme is managed no less rigorously than standard lending within the credit union.

Organisational learning

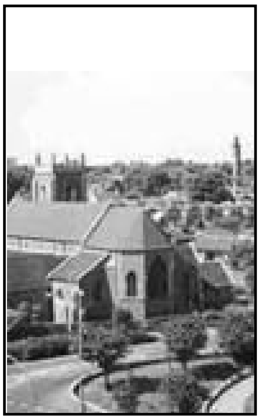
Credit union officers identified the learning points arising from the operation of the scheme:-

- ***A productive partnership***
  - the shared responsibility and shared risk approach to the scheme has been important to its success. Both the credit union and Eastserve.com receive tangible benefits from the scheme. The credit union is able to reach

- The scheme could not have been operated without employing a worker. It depended on the making of large numbers of small loans and this does add a considerable cost to the management of the project.

large numbers of people within the community and extend its membership (around 35% of borrowers stay on as regular credit union members. This figure is likely to increase with the extension of the scheme to offer broadband access in the near future). Eastserve.com is able to supply computers to large numbers of people who would be unable to purchase a computer without a credit union loan.

- ***Identifying a market niche***
  - The scheme has focused on a particular niche in the market and thus has been very popular. A large number of loans have been made demonstrating that the loans were made in direct response to consumer need. In many ways, the credit union was selling a product rather than a loan.
- ***Delinquency rate***
  - The delinquency rate has been lower than the community loan scheme and about the same as the standard loan portfolio within the credit union. It is estimated that the loan scheme will eventually run at about a 10% delinquency rate. Currently it is running at around 15% which is due to the fact that people do not start to repay their loan until the computer is delivered. Many people commence payments therefore already in arrears.
  - The reasons for the lower loan delinquency as noted by the credit union include:- lending to a more diverse group of people, the link to specific item (perhaps some people think computer might be re-possessed), the fact that borrowers have to have an address for computer and a land-line telephone and the fact that borrowers have to have contact with a range of people (administrator, delivery people etc).
- ***Membership growth***
  - 650 new regular members have been already gained through computer scheme. Out of phase one 60 out of the 180 people stayed members. The current membership retention rate is running about 35% of borrowers. It is envisaged that this will increase when access to broadband is offered to credit union members at a new discounted loan rate.
- ***High credit administration costs***
  - The scheme could not have been operated without employing a worker. It depended on the making of large numbers of small loans and this does add a considerable cost to the management of the project. It is clear that the project could not run without specific external financial support to cover staff costs. Perhaps a larger more established credit union would have the organisational capacity to manage the scheme within current staffing. However, this would not have been possible at East Manchester.
- ***Rigorous credit administration***
  - The scheme depended upon rigorous credit administration procedures just as much as the community loan guarantee scheme. Loans are not given to credit union bad debtors.



Ladywood Community Credit Union Ltd

Background

Ladywood has been long regarded as one of the most deprived areas of Birmingham. The majority of residents in this multi-ethnic community are on low incomes and many are over-indebted to alternative and predatory lenders. It was out of a strong social commitment to this community that Ladywood Community Credit Union was created in 1987. It is based within a neighbourhood community centre and,as a partner of the Ladywood Community Project, has strong links with local community groups and organisations. The credit union serves a membership of nearly 400 people drawn from a small common bond of some 4,500 households. It is managed by one full time member of staff and a team of about 20 volunteers.

In 1997, in partnership with the Ladywood Money Advice Unit, the credit union established a "*contingency loan scheme*" to enable people facing financial difficulty, but who did not meet the usual lending criteria, to obtain small loans without unnecessary delay. Contingency loans were designed primarily to assist people with urgent financial needs, either to purchase emergency items or to settle pressing non-negotiable debts. A key feature of this scheme is that contingency loans can only be accessed through the intervention of a money adviser. In some cases, the granting of the loan is also linked to a budget and bill payment scheme operated through the credit union. All contingency loans are fully guaranteed by a loan guarantee fund or contingency loan provision in the credit union. Members' savings are thus not put at risk through the operation of the scheme.

Loan Guarantee Scheme

Source and conditions of funding

The loan guarantee fund, which supports the scheme, was established with the financial support of Oxfam. Oxfam had undertaken research into the incidence and nature of debt within the Ladywood community and wanted to explore a model through which a credit union could meet the needs of the indebted. Oxfam was also keen to ensure that lending was undertaken within the context of money advice and a budget account and bill payment facility. The credit union, given its links with the Money Advice Unit, was seen as the best vehicle to reach those in greatest need in the community. The only condition made by Oxfam for supporting the scheme was a requirement that the credit union could demonstrate its impact in improving the quality of life for local people. The fund was established with an initial grant of £3,000 from Oxfam, a sum augmented by further donations from other organisations, the largest of which was £2,000 from a local housing association. The total guarantee fund amounted to £11,500.

The funding for the Ladywood Money Advice Unit was a totally separate affair. The Unit was funded initially through the Tudor Trust and then subsequently by Ladywood Sure Start, which also agreed to fund the full-time credit union manager post. Sure Start funding, by its nature, aims to support services for parents and carers of children under four years of age. In fact, a substantial number of people accessing contingency loans do have young children of Sure Start age. However Sure Start is prepared to be flexible and allow the Unit to serve all people in financial difficulty.

Credit administration

The loan guarantee fund, in the words of a staff member, "*encourages more adventurous lending*". In general, the credit union maintains a careful and somewhat fixed approach to its normal lending business. Eligibility depends on a fixed period of preliminary saving, and loans are limited to a multiple of 3 times shares. "*We are naturally risk averse*", explained one volunteer in justifying the reasons behind this traditional model of lending. The loan guarantee fund enabled the credit union to be more flexible and to do things differently. Knowing that members' savings were not put at risk, the credit union felt able to lend to people who were in financial distress and who were either new to the credit union or did not have sufficient savings to merit a standard loan.

The credit union set particular set criteria and conditions for obtaining a contingency loan, guaranteed by the fund. These are:

1. *A borrower must be, or be eligible to become, a member of Ladywood Credit Union.*
2. *The need for the loan must be urgent and/or non-negotiable; i.e. a debt or part of a debt, or other sort of payment, that could not be resolved by an adviser taking up the issue to win delay or better terms. The payment must be such as to pre-empt a greater harm, like the loss of liberty, loss of an essential resource or the deepening of existing problems*
3. *The contingency fund will secure a sum not exceeding £500" (Credit Union policy manual)*

There is a standard procedure for accessing contingency loans. All applicants must be recommended for a loan by a money adviser who offers individual financial advice and assessment. The adviser explores, with the applicant, the reasons behind the financial problem and, if possible, tries to resolve the problem by means other than a referral for a contingency loan. Debts are renegotiated with creditors and welfare benefit entitlement is investigated. In all cases, a rigorous

In the loan granting process, emphasis is placed on the relationship between the money adviser and the person in financial difficulty.

income and expenditure analysis is carried out. The money adviser only recommends a person for a contingency loan if the lending criteria are fully met and if the applicant has demonstrated, through the personal financial assessment, the capacity to repay.

Contingency loans are given only in cases of emergency. Applicants do not have to be deeply in debt even though most do have other loans outstanding, including social fund loans. What counts most is the applicant's immediate financial need and whether, in the words of a money adviser, *"the loan would really alleviate the pressures the person is under*". There is a recognition that just granting a loan may not be always in the best interests of the applicant. Most loans are granted for immediate and pressing needs, the greatest number of which have been given for basic living costs and essential household items (34% of the total). Loans are only given when no other appropriate sources of finance is available.

According to credit union policy, it is the credit union itself that makes the decision about granting the loan. Decisions are not taken by the money adviser. However, in practice, no loan, recommended by an adviser, has been refused. The money adviser acts, in a certain sense, both as a financial adviser to the applicant and as an agent of the credit union. This dual role is not one without difficulties and a possible conflict of interest here has been recognised by the credit union.

In the loan granting process, emphasis is placed on the relationship between the money adviser and the person in financial difficulty. Many applicants are already known to the money adviser and personal knowledge of the applicant is an influential factor in making a decision whether or not to recommend a loan. It is through the openness and trust developed between adviser and applicant that a person's willingness and capacity to repay is assessed. Money advisers at Ladywood were, for example, against the introduction of credit checks as part of the credit administrative process. *"If we did credit checks, we would not grant a loan"*, remarked one staff member, *"it would undermine the relationship between advisory and borrower. If we said we were doing a credit check, people would not want to proceed. They would feel we did not trust them"*. Advisers were conscious that much depended here on the personal honesty of the applicant. Yet, given the need of applicant, recommending loans on personal assessment was seen as the preferred way of managing risk.

In the scheme, all borrowers must agree to save along with their loan repayment. This agreement to save is regarded as essential both by the Money Advice Unit and the credit union. By saving, the member not only amasses personal wealth but, over time, becomes eligible to obtain standard credit union loans in their own right as a member. The scheme aims not just at the resolution of an immediate problem but at fostering the long term financial stability of the member. To the same end, some loans are granted on condition that the borrower opens a budget account and bill paying facility. In this case, the money adviser consolidates a member's debts and arranges for the credit union to make regular payments to the creditors. The member benefits by paying just one amount to the credit union to cover all debts. Typical debts repaid through the budget scheme include arrears to the water authority, council tax and bank and home credit loans. In fact, the credit union has a policy of never settling a home credit loan for a member. Through the money adviser, an acceptable monthly payment is agreed with the company which is then re-paid by the member through the bill paying facility.

Loans granted

Since 1997, 80 contingency loans have been granted to 54 people. Apart from in the initial years, the average number of loans made is just over 20 per annum. The volume of loans under the scheme represents about 25% of the total loans made in the credit union in any one year (in the year 99-00, 20 of the 80 loans made in the year were contingency loans). Overall, since 1997, £17,144 has been lent in contingency loans and the current outstanding balance (as of 11/12/2002) of £7,735 represents about 10% of current total loan balance in the credit union.

Contingency loans are all small loans, which explains why they amount to 20% of the number of loans made but only to 10% of the total loan amount outstanding. *"The average debt to be recovered through a court order"*, explained the credit union manager, *" is just £180. This made us think that, for many people, the amount of money needed to settle a debt is relatively low, whether that's for fuel debt, rent arrears, mail order debt and so on, and a lot of that is negotiable. And there is not much point giving someone a loan that she has to pay back at £25 a week. So we decided to concentrate on small loans. We wanted to award loans that assisted in minimising outgoings*" . Contingency loans are usually up to a maximum of £250. The current lending policy allows loans up to £500 but, in practice, this has been found to be too high. Small loans also minimise the risk of loss to the fund. A loss of a £500 to a *"professional borrower, whose prior debts were hidden successfully from the money adviser*" was a significant factor in ensuring loan amounts were kept small.

Borrower profile

81% of all contingency loans have been granted to women, 90% of whom were under forty-five. Typically, young single women, 18 – 35 years of age, with children

The operation of the scheme has raised a number of issues in regard to the strategic development of financial services for those facing financial exclusion or particular financial hardship.

of school age, make most use of the scheme. Prior to obtaining a loan, borrowers were either non-members (who became members) or non-active members with insufficient savings to access a standard credit union loan.

Contingency loans are loans of last resort. In all cases, for example, applicants were unable to obtain a social fund or crisis loan, the eligibility for which was always explored by the adviser. Of the 80 loans made, 63 were made to members who were ineligible for a social fund loan. 30 were ineligible on the grounds of not being in receipt of the correct benefit, 28 as they were working or had a working partner, and 5 because they failed to meet residency or claiming conditions. In the 17 other cases, applications were made to the Social Fund but refused on grounds of insufficient means to repay (6 people) or inappropriate needs or purposes (11 people).

For a contingency loan, what matters is the immediate need of the borrower, not individual status. Borrowers were drawn from a variety of income backgrounds. 22 were working, starting work or on working family tax credit, 9 had another working adult in the household, 21 were unemployed (IS or JSA), 18 on incapacity or disability benefit, 7 other benefits and 3 ineligible to claim. In many cases, the need was relatively short term (e.g. a deposit for a tenancy or immediate living costs) but, in the others, financial need was more persistent over time. 27% of borrowers went on to borrow a second or third contingency loan. Even though the aim of the scheme is to encourage members to become regular savers and borrowers in the credit union, applications for subsequent contingency loans are judged, like the first, on need and conformity to lending criteria. Borrowers with a second contingency loan, albeit with the first repaid, were unable to access standard loans, for the most part, because they had not been able to save sufficiently in the credit union. Standard loans were always no more than three times a person's savings which presented difficulties for those with minimal savings balances.

17 people, or 31% or all borrowers, went on to become regular saving and borrowing members of the credit union. 10 of these had been existing, but non-active, credit union members and none had ever fallen into serious arrears on their contingency loan accounts. 7 members of this group went on to become volunteers in the credit union; 2 as Board members, 2 as credit committee members, 1 on the supervisory committee and 2 as tellers. Reflecting borrower profile in general, six of the seven volunteers are women.

Managing repayments

Contingency loans are monitored and accounted for separately in the credit union. Credit control procedures are standard and those in arrears are contacted by letter, by telephone and informally within the community. "*It is a credit control headache*", asserted one staff member in explaining the amount of time and energy put into following up slow and bad payers. The credit union will pursue debtors through the County Court but, before that happens, all defaulters are encouraged to meet with a money adviser who can offer ongoing support.

There is a much higher rate of arrears on contingency loans and it would be much worse without the additional effort put into their recovery. Over the period, 8 loans (10% of total) were written off but it is estimated that a number of others, amounting to over £1,000, are also irrecoverable. As of December 2002, 23% of contingency loans were over three months in arrears. This compares with an overall delinquency rate for standard loans of 16%. Slow payments are, according to staff members, a constant problem. To encourage repayment, the credit union sometimes suspends interest on loans altogether which results in the contingency loan scheme becoming a completely non-earning activity.

It is not a condition of the contingency loan scheme that borrowers must participate in the budget scheme. In fact, only 12 out of the group of 54 were in the budget scheme. However, 6 of these are within the group of 17 who went on to become regular savers. "*If people are in the budget scheme*", noted one staff member "*they tend to be repaying their loans. This is something we have been talking about recently. A large number are not in the budget payment scheme and we are thinking of ways of encouraging more people to use it*".

Organisational learning

The loan guarantee scheme has enabled the credit union to make a number of loans to people in need who, in normal circumstances, would not have been able to access a standard credit union loan. The operation of the scheme has raised a number of issues in regard to the strategic development of financial services for those facing financial exclusion or particular financial hardship.

- ***Flexibility in lending***
  - The loan scheme has allowed the credit union to develop flexibility in lending in order to reach people in greatest financial need. It has been able to waive its usual requirements for a period of prior saving and for linking the amount loaned to the amount saved. The credit union has learnt that more flexible lending demands a more rigorous approach to credit administration systems. In developing this loan product for those in severe financial hardship, these systems have involved much greater one-to-one work

A recognition developed in the credit union that making loans to people in severe financial difficulty may not always be a solution to their longer-term problems nor in their best interests.

with the borrower, expert money advice, education and support and a greater assessment of the capacity to repay.

- As yet, the experience of developing a more flexible, but rigorous, approach to lending has not impacted on the general credit administration systems within the credit union. For ordinary loans, members must still demonstrate a three months savings history in order to access loans no more than three times their savings. "*For a long time loans could only be double the amount saved. We are risk averse, we are operating in a high risk area with lots of slow payers"*, explained a loan officer in justifying the reluctance to offer the general membership instant loans and loans not linked to a multiplier of savings balances.

• ***Quick fixes don't work***

- A recognition developed in the credit union that making loans to people in severe financial difficulty may not always be a solution to their longer-term problems nor in their best interests. Often their financial problems went beyond anything that could be solved with a small loan. The hard realisation dawned that there were people that the credit union just cannot help. As a staff member explained, "*There are people who don't fit the criteria and who just don't have the capacity to repay. Credit unions cannot be a universal physician"*.

• ***Money advice and financial education***

- Recognising that people in financial difficulty may have multiple underlying problems, the credit union understood the link with the money advice service as a central element within the scheme. The money adviser was not only able to offer the applicant the advice they needed but was able to conduct a professional income and expenditure analysis on which a loan decision could be based. "*Nobody feels confident as to making the initial assessment*", explained a credit union officer, "*so the role of money adviser is key*". She continued," *We never circumvent insisting the person goes to the money adviser. We never throw a loan at a person, perhaps there are other ways of helping the person"*.

- The money adviser also offers informal education in financial literacy. The credit union recognised that this is a key area for development. There was some concern that the loan fund did promote dependency among some borrowers who, with greater education and support, could possibly more on to become regular credit union members.

• ***The issue of independent advice***

- The money adviser recommends a person for a loan after making an assessment of the application and the person's suitability for a loan. On occasion, the money adviser will not recommend a loan as she considers the person will not or cannot repay. This always presents the money advisers with a dilemma. The person needs the loan, but, at the same time, the adviser is keeping an eye on the needs of the credit union. "*In these cases*", explained an adviser, "*we tend to weed people out informally suggesting other solutions"*. This conflict of interest is particularly evident as, in practice, loans officers never turn any applicant down who has been recommended by an adviser.

- At Ladywood, the credit union and Money Advice Unit are independent entities. However, there is close inter-relationship between the two organisations. Some advisers are, for example, credit union officers. This close link between the two organisations works well both because of the good personal relationships between staff members and the relatively small number of contingency loans being processed. In cases where a borrower goes back to a money adviser because problems repaying the credit union loan, the adviser, if a credit union officer, declares a conflict of interest and passes the person on to other money adviser. Clearly, a money adviser in an external agency must act in the interests of the client which may directly conflict with those of the credit union. A credit union loan may be regarded as a non-priority debt and the money adviser may advise prioritising repayments on other more pressing debts. This raises questions for the credit union. It may be that a credit union would be better advised to employ its own money advisers, who could offer advice albeit not independently. In working with outside advice agencies, clear definitions of roles, responsibilities and procedures are essential.

• ***Budget and payment service***

- There is evidence, arising from the operation of the scheme, that the contingency loan scheme operates more successfully when linked to a budget and bill payment service. The support the service offers the member enables, in many cases, progression to financial stability and to becoming a regular saving and borrowing member of the credit union. The policy of not settling home credit loans for borrowers but rather setting up repayment programmes through the bill payment service has been particularly successful protecting both the credit union and member alike.

The loan fund cannot be the central thrust of a strategy to serve people in this area. We need to keep the fund in perspective, it isn't the solution"

- ***Debt recovery and credit control***

  - "*We are changing our view on slow payment*", explained one staff member. The scheme was subject to high delinquency rates and greater losses were only prevented through the development of rigorous credit control procedures. Traditionally, Ladywood, in common with many small community credit unions, would accept slow payment as part of the reality of serving low income members. The necessity of following up even one missed payment is now seen as essential in all credit control procedures within the credit union.

- ***A local accessible service***

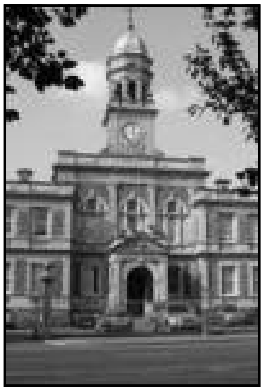
  - Referrals for contingency loans is usually on behalf of people already known to the Money Advice Unit either directly or through the network of organisations in the community centre. The advantage of this is that delinquency can be controlled through social relationships and bonds. The drawback is that the number of people able to access the scheme is relatively low. There are undoubtedly many people in need within the community that the credit union does not reach through the scheme. One reason for this is that the scheme is kept within manageable limits but also because loans, being 100% covered by the guarantee fund, are limited to the amount of money in the fund.

- ***Organisational capacity and administration costs***

  – Operating the scheme within manageable limits is both an organisational and economic issue. The experience of Ladywood is that the scheme absorbs a disproportionate amount of staff time and resources. There is a need for greater one-to-one member service support and the reality of processing and recovering small loans from financially vulnerable members is expensive. Ladywood does not recover its costs on the scheme. Some costs, particularly debt recovery costs, are recoverable from the loan guarantee fund itself. Overall, the scheme is subsided by normal lending and external subsidy for staff costs. Twenty loans a year is probably, given the current organisational capacity of the credit union, the maximum number of loans the credit union could handle. This represents perhaps the steady stream of applicants coming through the Money Advice Unit. The challenge remains of offering a similar service of instant and readily available loans to those in the community who do not necessarily have the capacity to save to access a standard credit union loan.

- ***The loan guarantee fund in context***

  - "*The loan guarantee fund has always been seen as a tool*", asserted a member of staff, "t*he priority is money advice and money management. The loan fund cannot be the central thrust of a strategy to serve people in this area. We need to keep the fund in perspective, it isn't the solution*". The important point here is the notion of strategy. Developing appropriate savings and loans products to serve those in financial distress depends on much more than a guarantee fund. Much more important are the accessibility of products themselves, the robustness of the credit administration and loan recovery procedures, and the links with money advice and financial literacy programmes. The fund at Ladywood, however, did give staff and volunteers the confidence to develop new ways of working within this particular segment of the market. Yet this confidence depended on the 100% guaranteed cover on contingency loans. It is doubtful if Ladywood would have proceeded with the scheme if this cover was reduced to say 50% of cover on any one loan.



LLanelli and District Credit Union Ltd

Background

Registered in 1998, Llanelli Credit Union serves both the town and rural district of Llanelli which is situated about twelve miles to the west of Swansea in South West Wales. The credit union was established with a strong local identity and with the aim of offering financial services to a community that had experienced economic difficulties over many years. At the end of 1999, the credit union had 422 members, £90k in savings and £67k out on loan. Two years later, in September 2001, it had grown to 1067 members, amassed £349k in savings and had £342k out on loan. With the support of external funding, the credit union employs a general manager, office manager and a small staff team.

In 1999, a year after registration, a high-street bank offered the credit union an interest free loan to use as "*working capital*" to develop the business. At the time, Llanelli Credit Union was very new and had less than 20k in savings. It used the bank loan, augmented with a further loan from a credit union, to create a "*Rescue Loan Scheme*" with the particular purpose of assisting people who had become over-indebted to home credit companies. The new credit union was motivated by a strong social mission and, when offered the bank loan, decided that it could use it to both combat high interest lenders and to recruit new members. "*In principle*", noted a credit union staff member, " *the rescue scheme was good. It offered people a new start. It allowed people to pay off their high interest home credit loans and go on to become credit union members*". The assumption was that, once rescued from home credit, new members would go on to repay their credit union loans and to become good credit union members. This assumption was not fully borne out in practice.

Loan Guarantee Scheme

Source and conditions of funding

The Llanelli Rescue Loan Scheme was a loan guarantee scheme in retrospect. It started very experimentally and in response to the offer of an interest-free loan from the bank The bank wanted to support the newly emerging credit union and the credit union wanted, as part of its social mission, to be able to reach out to some of the most needy members of the community as well as to gain new members. The bank granted the credit union a £10,000 interest-free loan which the credit union repaid at a rate of £288 per month. However, from time to time, the bank topped up the loan back up the original £10,000 in order to support the lending capacity of the credit union. To build up the pool of funds for on-lending within the Rescue Loan Scheme, the credit union also borrowed £20,000 from a credit union, this time at 6% APR.

At the outset of the scheme, the credit union was liable to repay both the credit union and bank loans. Rescue loans made from the total fund of £30,000 were, in principle, therefore, made at risk to the credit union. However, the bank was a keen supporter of the credit union. It had recently closed its branch in Llanelli and, according to credit union staff, regarded the loan as a contribution to the regeneration of the community. "*It was like we were replacing the bank in the community*", explained Llanelli's manager, "*we were seen as a financial service for small savers and borrowers, reaching the people the bank could not itself serve"*. Credit union staff felt that, if the credit union had got into major difficulties with the rescue scheme, the bank would be there to support them and that members' savings would be protected. "*I don't think we would have proceeded in the way we did if we did not feel that the bank would not let us down. But we did take a chance, we had nothing in writing. But we were confident the bank would support us if anything went wrong"*, explained another staff member. In fact, eventually, the loan was converted into a grant and it covered 100% of all losses connected with the scheme.

The scheme was very experimental. Both the bank and the credit union were feeling their way in a partnership which was very flexible and informal. There were no written agreements and the funding was given without any prior conditions or criteria for lending. In fact, the only conditions were that the credit union held its account with the bank and agreed to publicity about the project. It was the credit union that decided that the loan would be used for the particular purpose of enabling people to escape from their high interest home credit loans.

It is clear that at the beginning it appeared that the credit union was taking on all of the risk associated with the scheme. Certainly it was taking on all of the risk's connected to the on-lending of the other credit union' funds. But, as it was repaying the loan to the bank, it did appear that it was taking on all of the risk here too. However, it has to be stressed that credit union staff did feel that the credit union was protected to a certain extent by the bank. The extent of that protection was neither determined nor worked out prior to the scheme but it did materialise in practice.

Credit administration

Based on a firm assumption that the bank would continue to offer its support, the credit union felt able to relax its usual borrowing conditions and lend to people who were not already members nor savers in the credit union but who were in immediate need of financial assistance. Being able to offer loans immediately to people in need was, of course, the basic rationale of the scheme. The support of the bank

As one staff member noted, "it was very disheartening. Quite a few people were very easily tempted to go back to the home credit company and take another loan after we had rescued them. But that was down to education and a tradition of using home credit".

allowed the credit union to undertake what it considered to be higher risk lending and make loans it would not normally approve if on-lending members' savings alone.

The scheme was not advertised but, as people in financial difficulty regularly approached the credit union, applicants for loans were not difficult to find. And word soon got around the town too prompting further enquiries. Although the credit union waived its usual lending requirements, it did implement particular criteria for borrowing under the scheme. In general, within the "*high interest lending rescue policy*", the applicant had to:-

- be already, or agree to become, a member of the credit union. This involved agreeing to saving alongside the regular repayment of the loan.
- be able to produce evidence of a regular payment record to the high interest lender for a minimum period of 13 weeks. This was a particular feature of the scheme. Applicants had to show that they had been paying the home credit company regularly and those in default to the alternative lender were refused a loan. It was important to the credit union that applicants demonstrated a regular commitment to repay the debt.
- give notice of seven days and request a loan of no more than £1,000.
- agree to an interview with a solicitor, appointed by the credit union to manage the redemption of the applicant's account with the other lender.

The role of the solicitor was seen as important within the credit administration process. The solicitor conducted an in-depth income and expenditure analysis with the applicant and gave independent financial advice on the best way forward. It was the solicitor who assessed the applicant's loan repayment record with the lender, who negotiated directly with the home credit company (as authorised to do so by the applicant) and who recommended the applicant for a loan. Not every applicant was recommended for a loan and the solicitor particularly declined to recommend those with poor repayment records. Financial advice, through the solicitor, was paid for through legal aid which was obtainable at the time. The credit union did not use any other money advice agency apart from the solicitor.

Loans officers were delegated to grant loans up to £500. Loans for higher amounts were referred to the credit committee and decisions were based on the applicant's capacity to repay as judged from the income and expenditure statement. However, the recommendation of the solicitor was regarded as very important as, in all cases, applicants recommended for a loan by the solicitor were accepted by the credit union. Loan agreements were carried out by a credit union loans officer in the applicant's own home. This afforded the credit union the opportunity to get to know borrowers within their own context and build a relationship with them..

The amount agreed in settlement of the debt to the home credit company was paid directly through the solicitor. The solicitor sent the cheque and the credit union reimbursed the solicitor through a banker's order arranged for the day of payment. The home credit company was, therefore, unaware of the role of the credit union in the transaction.

Loans granted under the Rescue Scheme were monitored and evaluated separately from the standard credit union loan book. Particular attention was given to credit control procedures in relation to these loans.

Loans granted

36 unsecured loans were granted under the scheme. There were all granted from January to November 1999 at which point the scheme terminated. In its year of operation, 11 loans were for £1,000 or more (the largest loan was £1,150), 14 were between £500 and £1000, and 11 were less than £500. The total amount of loans made under the Scheme was £23,923. The maximum repayment period was 24 months even though most of the loans were made for a period of a year.

Status of borrowers

Most of the borrowers in the Rescue Loan Scheme were new to the credit union. In fact, the ability to give instant loans to new members was one of the key motivators behind establishing the scheme. Some borrowers were existing members who often had little or minimal savings record in the credit union. All borrowers were in difficulty with loans they had taken out with home credit companies but, nevertheless, were able to demonstrate a regular repayment history with the alternative lender.

Managing repayments

The delinquency rate on rescue loans was much higher than that for standard credit union loans. That so many loans became delinquent so quickly had an impact on credit union staff. This was not something that they originally expected. As one staff member noted, "*it was very disheartening. Quite a few people were very easily tempted to go back to the home credit company and take another loan after we had rescued them. But that was down to education and a tradition of using home credit*". Nearly all rescue loans fell into arrears some considerably so. 14.5% of the total rescue loan balance was finally written off from the credit union's books.

The fact that loan write offs were not even higher was

Llanelli's strategy to tackle bad debt included the introduction of a home collection service.

due to the debt recovery action undertaken by the credit union. However, this was costly both financially and in terms of staff time and energy. Rescue loans were monitored closely and borrowers were contacted after just one missed payment. All means of debt recovery at the credit union's disposal were used including letters, home visits, tracing agencies, the County Court and bailiffs. "*Sometimes the problem is in finding people*", explained a staff member, "*quite a few people walk away from the debt but we are getting some results*". 16.6% of all rescue loans ended up in the hands of solicitors.

Llanelli's strategy to tackle bad debt included the introduction of a home collection service. This arose originally out of the need to visit a member's home after a missed payment but, given its popularity with members, it grew into a regular service offered by the credit union. The attraction of home collections to home credit customers is already well documented (Jones 2001) and the attraction of regular doorstep collections to credit union members was no less strong. However, there was no real evidence to conclude that delinquency rates were any lower among rescue loan customers using home collections than those paying directly to the credit union. The credit union did not assess the transactions costs associated with the home credit service. Although one home collector was employed with external funding, most of the collections were made by volunteers 19% of rescue loans were recovered through home collections.

The difficulties associated with delinquent repayments eventually led to the termination of the scheme after a year of operation. However, the rescue scheme did lead the credit union to revise both its credit administration and credit control procedures.

Organisational learning

Staff and volunteers identified a number of key learning points that arose from the operation of the scheme over a twelve month period. A number of these led to some changes in credit administration and control within the credit union. Key learning points identified were:-

- ***Real, yet limited, positive outcomes***
  - The Rescue Loan Scheme undoubtedly benefited a number of participants some of whom were able to free themselves completely from dependence on home credit loans. Staff were able to quote individual cases where rescue loans had made a profound difference to people's lives. One case quoted involved a 34 year old unemployed married woman, with children and a disabled husband, who was thousands of pounds in debt to home credit companies. The rescue loan freed her from her debt and she went on to become a good saver in the credit union. Another case concerned an employed woman who looked after her invalid mother. A rescue loan freed her from the debt and she went on to borrow £5,000 from the credit union to purchase the car she needed for work.

    However, such success stories were very limited. Only 27% of rescue loan members went on to be regular savers and borrowers in the credit union.
- ***A difficult and expensive option***
  - Overall, the results of the scheme were disappointing. It was very demanding on staff and volunteer resources. A great deal of time had to be put in both to administer the scheme and recover the loans. "*We would probably never do it again*", explained a member of staff", "*it wore us out. It was hard work and high risk. You really have to ask yourself do you want to live with it again. It was a lot of hassle*".

    The disappointment faced by staff members did call into question a number of assumptions about credit union lending. Comments were made such as "*there were a lot of dishonest people about*", "*it was like money being given away to them*", "*people missed the point about managing their money*" and "*we got very few new members out of it, people came to us because there was free money. They knew it was a scheme because they did not have to go through procedure of saving with credit union*".

    Another assumption that was called into question was the belief that credit unions can make large numbers of small loans to high risk groups at the standard 12.68% APR. "*Making large numbers of high risk loans is expensive. We are not covering our costs. We should be able to charge higher amounts*"
- ***Delinquency and loan recovery***
  - The experience of operating the scheme led to a re-evaluation of credit control systems within the credit union. "*We got a lot tighter in our credit control because of the scheme, You just have to be tougher and be ready to take immediate action. We now employ a full time credit control officer*" The credit union learnt the importance of implementing a full loan recovery procedure. As well an internal credit control officer, the credit union employs a debt recovery officer who is able to make home visits. "*People were walking away from their debts. But now we are getting results. We are ready to use the Courts and bailiffs if necessary*".
- ***Home Collection Service***
  - A credit union home collection service grew out of the Rescue Loan Scheme. The service is offered to all credit union members there who

" We have become much more careful in allocating loans",

find it difficult to get to the credit union office. However, it operates mainly in one particular area of the town. It is operated by a paid member of staff and by volunteers and about 120 members take advantage of it. Overall, it is regard very positively by staff and members alike. " *We gain a lot of personal knowledge about members and are able to develop personal relationships and trust. We are taking on home credit at its own game*".

The credit union has not made an analysis of transaction costs associated with the home collection service. Clearly it is expensive in terms of staff and volunteer resources. The staff member was paid for with external financial support and volunteers gave their time freely. It was recognised that this service would be difficult to maintain into the future unless the credit union is able to charge higher interest or a collection fee on home collected loans. There is a danger that if the home credit service terminates some loans may be harder to collect.

However, there was no evidence that home collections made a significant difference to delinquency rates on rescue loans. 19% of all rescue loans were recovered through home collections.

- ***Improved credit administration***

  - The greatest learning outcome gained through the operation of the scheme was in the area of credit administration. " *We have become much more careful in allocating loans*", explained a staff member, " *we have developed new loan application forms and ask for much more information, where they live, their employer and so on. We interview people and ask for much more documentation. We are different now, more detached, we ask to see wage slips bank statements and benefit books even ask the name of the doctor. We have to look at the risk very seriously".*

  Granting loans to people unknown to credit union staff and volunteers was a key feature of the scheme. People came to the office requesting a rescue loan and, if they fitted the criteria, were allocated a loan without a savings record and without any unnecessary delay. Difficulties in recovering loans encouraged the credit union staff to radically review loan granting procedures. New policies and procedures were developed that involved a new training programme for loan officers and the credit committee. These procedures entailed a greater assessment of the financial situation of the member and the capacity to repay (through a detailed income and expenditure analysis, including an analysis of level of current debts) and increased requirements for background information and documentation. "*We ask for much more evidence now". "We would do credit checks if could afford them but they are expensive – but it will be a necessity in the future when scrap the multiplier"*. As one volunteer put it, "*this is a high risk business, not a charity"*

- ***Partnerships with money advice agencies***

  - Llanelli did not operate the Rescue Loan Scheme in partnership with any money advice agency. There was no official link with money advisers (apart from the solicitor) or with the CAB. In some respects, the lack of an effective partnership was due to the past experience of the credit union working with money advice agencies. The dilemma for the credit union arose from the fact that money advice agencies, in cases of default, must act the interests of the client rather than in the interests of the credit union. In speaking of one money advice agency, one staff member explained *"They were totally against us, they teach people how to be irresponsible, the credit union is bottom of the list and often people threaten the credit union with the money advice agency"*. Llanelli found it difficult to develop a genuine partnership arrangement with money advice agencies as roles and responsibilities were perceived as being too diverse.

- ***Developing financial products for low income indebted members***

  - Llanelli Credit Union discontinued the Rescue Loan Scheme after one year of operation. But this does not mean that the credit union has moved away from serving low income, indebted members. Small loans, with regular weekly repayments, are still available to people who wish to join the credit union as too are savings products tailor made to the small saver. The credit union is, however, much more conscious of the fact that making loans to people which they cannot repay is doing very little either for them or for the credit union. Since its experience in making immediate loans to new members, Llanelli Credit Union has reasserted its policy that members must save in the credit union for a period of time before being eligible for a loan. Loans are also now only given up to a maximum of three times the amount saved.

Acton Residents' Credit Union Ltd

Background

Registered in 1997, Acton Credit Union Ltd serves one of west London's most disadvantaged low income communities. High unemployment and benefit dependency characterise this multi-ethnic neighbourhood and, by any indicator, Acton exhibits many of the effects of long term and sustained poverty. Overcrowding is twice the London average and poor health is 70% higher than the average for the borough of Ealing within which Acton is situated .

Acton Credit Union was established with a strong social mission and aims particularly to serve people on low incomes and those marginalised from mainstream financial services. However, quite early in its development, the credit union found that it was unable to serve all the people coming to it for help. People presented themselves in financial crisis requesting immediate loans to settle debts that were causing distress in their lives. But the credit union was prevented, by its own policies, from making loans to people who had not been a member for three months and whose savings balance was less than 50% of the loan amount requested. New members with no savings just could not obtain a loan in the credit union.

"*There was a lot of angst about giving loans*", explained one staff member, "*we seemed to be very risk averse. There has always been a very close common bond and loans were given only to people known to credit union members*". Acton's solution to this dilemma of wanting to help people in financial crisis whilst, at the same time, avoiding all financial risk was to establish a new and much more flexible loan fund.

The Money Action Fund was established in February 2001 with the key aim of assisting applicants in financial distress to obtain emergency loans. Its objects, as noted in the original proposal, were "*a) to grant loans at no interest to alleviate financial hardship; b) to prevent wherever possible the instigation of actions through the court and c) to encourage membership of the credit union and, in this way, promote self-help for those in financial hardship*". MAF was to be used exclusively in cases of pressing need and particularly to enable borrowers to settle outstanding high-interest debts. It was designed exclusively for new members who were ineligible to obtain a standard credit union loan. Current members could not apply to MAF. Each borrower was allowed one MAF loan only. Any future loans were granted according to standard lending criteria.

Credit unions are not legally permitted to establish subsidiaries, however, the Money Action Fund was seen as the "*charitable arm*" of the credit union as loans were made free of interest and borrowers were offered money advice on handling personal finances. MAF was not seen as part of the income generating activity of the credit union. It was designed solely in the interest of those in need. Albeit under the auspices of the credit union, MAF operated as an independent fund, accountable to an independent sub-committee and accounted for separately from the main credit union accounts. It was regarded as a "*charitable financial trust*" which, if it grew substantially, was seen as having to register one day with the Charity Commissioners.

Loan Guarantee Scheme

Source and conditions of funding

The credit union had been supported with a Single Regeneration Budget grant to employ staff and develop the organisation. The West London Training and Enterprise Council was approached to establish the Money Action Fund and £6,000 was granted. No particular criteria or targets were set by the TEC in regard to how the fund would be disbursed. This was left to the Acton Board of Directors. It was, in the words of a staff member, "*unattached money*" which could be used to support lending to people in financial crisis according to the MAF's own policies and procedures. £1,000 of the total amount granted was allocated to cover administration costs.

With SRB financial support, a money adviser had been employed by the credit union whose role was to include personal financial advice for those accessing MAF loans. Unfortunately, this did not quite work out as intended due to a number of personnel difficulties. The money adviser post was subsequently discontinued. Nevertheless, money advice did continue to form part of the MAF project.

Credit administration

Acton Credit Union was often being approached by people in financial difficulty but who were not eligible for a standard loan according to the credit union's own policy requirements. People in similar situations were also referred to the credit union by local churches and advice and welfare agencies. Once the fund was established, some of these people became eligible for a MAF loan. Applicants met with a MAF loans officer who conducted an investigatory interview in the person's own home. Applications forms were simplified to maximise the speed and flexibility of the credit administration system. In deciding upon the loan, what mattered the most was the level and immediacy of need. This

The overall aim was to encourage MAF borrowers to become regular saving and borrowing members of the credit union and thus gain financial independence, self-reliance and security.

did not mean that the capacity of the applicant to repay the loan was not taken into account. The loans officer carried out a basic income and expenditure analysis and agreed, with the applicant, an affordable repayment plan. Informal financial advice was offered at the same time. The loans officer, working to criteria established by the committee, made the decision about granting the loan. There was no need to submit the loan for committee approval.

Borrowers had to join the credit union and agree to a savings plan whilst replaying the loan. The overall aim was to encourage MAF borrowers to become regular saving and borrowing members of the credit union and thus gain financial independence, self-reliance and security. However, to achieve this, flexibility was seen to be essential. Above all, monthly repayments were set at levels affordable to the borrower without particular reference to a set repayment period.

MAF was a revolving loan fund and loans were only granted that were 100% covered by money available within the fund. As Acton's literature explained, "*money loaned out for use from the fund is to be returned to the fund so as to be available for others who may need to make use of it*". This meant that loans were only made up to the amount available within the fund. The fund was not seen as a reserve to cover future losses estimated as a proportion of the total amount loaned. The fund had to cover the entire amount loaned in each case. This clearly limited the availability of MAF loans.

Loans granted

Only six MAF loans were made during the period of operation of the fund. The majority of these were substantial loans, granted out of a desire to make a real difference in the lives of people suffering a financial crisis. In general, MAF was created to enable people facing damaging financial crises to overcome these and move on into a more secure and stable financial future. In fact, it was the experience of people facing eviction coming to the credit union for help that first moved Acton volunteers to consider establishing the scheme.

The first loan of £2,394 was made to a female Somali refugee who was threatened by pawnbrokers that she would lose the gold jewellery she had deposited as pawn against a loan. Subsequent loans were £1,000 to a professional man with large credit card debts, £1,161 loaned to a 19 year old woman also to clear credit card debts, £1182 loaned to assist a newly married couple with housing costs, £347 loaned to another 19 year old woman who was being aggressively pursued by a debt collection agency and, lastly, £400 loaned to a young woman on a low income to enable her to get beyond just being able to afford the interest payment on a large credit card debt.

Status of borrowers

The criteria for eligibility for a MAF did not depend on the social or economic status of the borrower. The fund was open to all living in Acton. The essential criteria were being in need of an urgent loan to pay off a debt and a willingness to join and commence saving in the credit union. Within the small group of borrowers, there were people of all backgrounds, some were working, others were on welfare benefits. This diverse group included a professional man who had found himself in difficulty with credit cards and a Somali refugee who had limited understanding of and no access to financial services in the country.

Managing repayments

There was a high delinquency and loss rate on MAF loans. The first loan fell into delinquency within the first few weeks of repayment and over £2,000 of the loan is now judged irrecoverable. The rest, according to staff members, *"are coming in fits and starts and in small amounts"*. Estimating actual delinquency is difficult as no repayment period was set as part of the loan agreement. However, two thirds of borrowers are seriously behind in payments and it is calculated that at least 40 % of the total amount lent will be irrecoverable. This could be even higher as the level of some monthly payments is so low that, if repayments are not increased, some borrowers could take many years to repay the loan.

Given the low number of MAF borrowers, loan recovery procedures were informal and depended very much on ongoing personal contact with the member. There was no system of formal credit control and given the nature of the scheme, recovery through the Courts would be particularly difficult. In fact, in many ways, formal credit control was not part of the social methodology of this programme. MAF was based on trust between the borrower and the credit union. It was a borrower rather than a credit union oriented programme.

Organisational learning

- ***A socially motivated programme***
  - The Money Action Fund arose out of a desire to respond to the needs of over-indebted people in financial crisis. It was a solution to a problem posed by the inability of the credit union itself, through its own standard policies to assist people in particular need. According

It was clear to volunteers that responding to the needs of over-indebted people is a much bigger problem than can be solved through a small revolving loan guarantee fund.

to volunteers, the programme did "*immediately relieve desperate situations and certainly prevented ill health through worry and debt*". There were some benefits. 50% of participants went on to become credit union members even though loan repayments on the MAF loans were slow. One of these fully repaid the loan and went on to become a regular borrower. The two others continue to pay the loan albeit over an extended period. Knowledge of the scheme did bring the credit union to the attention of the local community.

- However, the operation of the scheme sat uncomfortably with volunteers understanding of credit union philosophy and methodology. MAF was much more a charitable activity than as aspect of the business of the credit union. "*I felt like a do-gooder*", explained one staff member, "*the credit union should not be into that sort of charitable activity* ". In many ways, despite the focus on the borrower, MAF did not generate the sorts of results the volunteers were looking for. "*How naive I was*", the worker went on to elucidate. "*we didn't expect such losses and to make loans with no interest and no stated repayment period was a mistake. The fund did not reach its full potential and one person we lent money to returned to high interest lenders. We are just not able to solve everyone's problems*". It was clear to volunteers that responding to the needs of over-indebted people is a much bigger problem than can be solved through a small revolving loan guarantee fund.
- There were also concerns that the scheme itself, as constituted, did not fully comply with good credit union operating standards as acceptable to the FSA.

• ***A demanding and time consuming programme***

- MAF was discontinued after two years of operation even though two thirds of borrowers still have loans outstanding. It ended because volunteers, or rather the one staff member who administered the scheme was "*worn out and fed up and wished I'd never started it*". As she explained "*I'd say to any credit union thinking about doing something similar, don't do it. It's time consuming and stressful and, when people get to know money is available, you are harassed, followed around and stopped in the street*". It is clear that operating a project aimed a serving people in severe financial difficulty is both expensive in time and resources. It is not something that can be undertaken without having an adequate support structure in place.

• ***Improving credit administration***

- MAF was created because the credit union's standard lending criteria were not flexible enough to respond to the needs of the people new to the credit union and who had not saved for 13 weeks. To this was added a general hesitancy in the credit union about lending. *"The credit committee were too frightened to give money out"*, remarked a member of staff, "*and people could only borrow twice their savings*". MAF was not established because the credit union lacked money to loan, at the time liquidity ratio was 33%. Acton was a cash rich credit union. The fund arose because the credit unions' own policies and culture would not allow it to lend to the people that MAF aimed to serve.
- The fact that MAF ran alongside the credit union as a kind of quasi-charitable activity did disturb the volunteers. " *We would not do it again because I would realise that the credit union should be doing what we were doing. It needs to be within the credit union even if the credit union puts money aside as a hardship fund*", expressed the manager. She continued, "*The credit union needs to reduce its waiting period and, if its got the right documentation, it should give a loan immediately. But the credit union would not do that at the time. The fund was really about 'do-gooding', you shouldn't need it in a properly run credit union. But the Board were not willing to take the risk*". It seems clear that the loan guarantee scheme arose, at least in part, from of a lack of experience in credit administration and in lending to people facing financial difficulties,

• ***Money advice and financial education***

- "*It is no good just giving the money, you have got to have a money advice service that runs alongside it*", asserted the manager speaking about her experience of working closely with MAF borrowers. In fact, just giving money to people without financial advice and ongoing support often had a negative effect. It can be that a borrower is just moving a debt from one creditor to another without any realistic plan of improving their financial situation. Acton did endeavour to employ a money advice worker as part of the scheme but, for a

...it became clear that ad hoc responses to deep seated financial problems are not usually successful.

number of reasons, this did not fully materialise. Informal financial advice was given, however, in all cases and was built into the programme. Unfortunately, there was also no CAB or other advice agency active in Ealing at the time with which to develop a partnership arrangement. The manager at Acton did see the importance of having a budget or bill payment service as part of a programme aimed at supporting people in financial difficulty. However, due to a lack of organisational capacity, this was not viable at the time.

- ***Developing a strategy to respond to the needs of over-indebted members***

  - MAF was a project set up to answer an immediate and pressing situation. It did not, in the words of the manager, *"fulfil its potential"*. It endeavoured to respond to a highly complex area of financial need with little resources and organisational capacity. It tried to respond to some intractable problems without always evident success. Responding to the needs of the Somali community was particularly demanding. In fact, MAF was a very demanding endeavour to take on. It put pressure on volunteers and staff as knowledge of the scheme permeated the community and it became clear that ad hoc responses to deep seated financial problems are not usually successful. It was clear to Acton that what really was needed was a much more strategic approach to the issue which involved improved credit administration systems within the credit union itself, money advice and financial literacy programmes as well as budget and bill payment services. *"The loan guarantee fund was not the only solution"*, explained the manager, *"it needs to be part of something more"*.

Huyton Credit Union Ltd

Background

Huyton Credit Union Ltd serves a low income community to the east of Liverpool. Over recent years, the credit union has developed its local presence, mainly through employing staff and opening new premises, with the result that membership has begun to increase significantly. At the same time, there has been a rise in the number of people in financial difficulty approaching the credit union for immediate help with their problems. The majority are people who are over-indebted to alternative financial providers or moneylenders. Very early on, staff members realised that making instant loans to settle pressing debts was not necessarily the most appropriate answer. People's financial problems were often multi-faceted and multi-layered and demanded a more imaginative and holistic response.

Huyton's solution was to create Britain's first Money Advice & Budgeting Service (MABS). Modelled on the MABS to be found throughout the Republic of Ireland , Huyton MABS is a structured and co-ordinated money advice service which aims, *"to provide people with support, skills, and information which will directly help them to cope with debt and allow them to take control of their finances"*(project constitution). It is managed directly by Huyton Credit Union which employs a professional money adviser who is directly accountable to the credit union manager and, ultimately, to the Board of Directors. In order to offer financial advice, the credit union obtained a consumer credit licence. Huyton MABS opened in June 2002

Huyton Money Advice & Budgeting Service

Outline of the service

Huyton MABS is based on three key inter-related elements; a money advice service, a budgeting and bill paying account and access to credit union loans unrestricted by standard loans policies. In addition, MABS encourages clients to save in the credit union both in order to build personal assets and to qualify for loans as regular members in the future. Clients are also offered financial literacy information and education. The service is open to anyone in the community and people can approach MABS directly or be referred by a relevant agency. People have, of course, to become credit union members in order to open accounts and access loans.

Huyton MABS focuses on the total social and financial situation of client. It does not just make instant loans to settle pressing debts. It endeavours to work with clients to uncover the root causes of indebtedness and to offer a structured approach to dealing with each person's individual situation. Access to loans for people facing financial difficulties is possible but is always set within the wider context of money advice and the use of budgeting and bill payment facilities. This holistic approach is seen to be the defining characteristic and strength of the MABS programme.

Loans granted through MABS are covered by an externally donated loan guarantee fund in order to protect the savings of the Huyton membership. The fund enables the credit union to be more flexible in its lending policies. It allows the credit union, through MABS, to make instant loans to people who have not saved the amount normally required to access a loan. It permits the credit union to simplify its credit administration procedures and make an application for a loan relatively easy and straightforward.

Source and conditions of funding

Huyton MABS is funded through New Deal for Communities and the Esmee Fairburn Foundation in order to *"improve the lifestyles of the socially excluded"* (project constitution). Total funding allocated to MABS is £69,125 per annum, over an initial period of one year, which covers the costs of employing staff and the day-to-day operations of the service. The loan guarantee fund was established with £10,000 allocated out of the mainstream budget in order to assist in the making of loans to MABS clients where and if necessary.

An open, free and confidential service

Free and confidential money advice, and the support of a professional money advice worker, are the central aspects of MABS. The service aims to respond to individual needs and no pre-conditions about the use of the service are set. People may attend for one or a series of sessions with the adviser. All clients are offered a detailed, household income and expenditure analysis aimed at reducing outgoings and maximising disposal income. This entails advice on welfare benefit and income tax entitlement as well as on managing debt repayments. Advice is given on legal processes and people are referred for professional legal advice where appropriate. As the money adviser stressed, *"Practical support is available for as long as clients require it or until they are confident to take full control themselves"*.

Special credit union budgeting accounts

The role of the money adviser is to assist clients

The special account assists by bringing consistency, discipline and order into members' financial affairs.

with their household finances and with budgeting. Debt repayment to often multiple creditors is the key issue affecting most people approaching MABS for help. It is over-indebtedness that often prevents clients from meeting even basic living expenses. With the agreement of clients, the money adviser approaches creditors on their behalf and, if possible, negotiates reduced and affordable debt repayments. In order to make these repayments, and to assist in budgeting generally, clients are offered a special credit union budget and bill paying account. This account is not used for savings nor does it accrue any dividend. It is used solely for the payment of debt arrears and current bills. The member pays a single weekly amount into the account and then the credit union forwards agreed monthly payments to creditors and, usually, to utility companies for current bills. All debt repayments and bills are managed by MABS and the credit union on their behalf.

The special account assists by bringing consistency, discipline and order into members' financial affairs. However, it does not remove from the client the responsibility for making weekly payment into the account. Unlike loan guarantee schemes that pay off a member's debt by transferring that debt to credit union itself, in MABS clients retain their personal debts to creditors. MABS assists by negotiating affordable repayments to reduce those debts and by offering a disciplined structure to aid repayment. The credit union only makes payments to creditors, and for bills, if sufficient funds are in the member's special account.

Focus on promoting saving

MABS overall aim is the longer term financial stability of the person seeking help. To assist in this, the aim of MABS is to introduce clients into standard membership of the credit union. For this reason, those accessing special accounts and loans must also save as any regular member. Not only does this build personal wealth, it enables the member to obtain credit union loans in the future. Regular saving also has another purpose. If in emergency a MABS loan is required, the amount saved per week may be reduced so that loan repayment is facilitated without an overall increase in the weekly amount lodged in the credit union.

Credit administration

Access to loans through MABS is limited and related to two specific purposes. First, loans are granted to settle non-negotiable debts, the repayment of which, in the view of the adviser, would make a significant improvement in the life of the client. In the experience of Huyton's money adviser, most creditors will negotiate affordable repayments, particularly when they know that these repayments are being managed through a special account. However, some debts are non-negotiable (e.g. council tax, TV license debt) and a small loan to pay the debt is often the best way forward. MABS does not, except in these circumstances, settle existing debts.

Small loans can also be arranged to cover any new financial difficulty that may arise for the client once the budgeting scheme has been put in place. The availability of this loan encourages members not to resort to moneylenders and alternative credit providers when a problem arises but seek the support of the MABS adviser. The adviser can arrange a small loan, speedily and without unnecessary formality, if it is judged appropriate. Loans are granted irrespective of the current savings balance or any obligatory period of saving.

MABS loans are usually limited to a maximum of £300. They are not granted as a *"quick fix"* but rather are made within the overall context of the member's use of savings and special accounts. They are granted to prevent further difficulties for the member which would disrupt the financial stability afforded through the budgeting and bill payment facilities.

Loans are granted by the credit union through the credit committee. Nevertheless, the role of the money adviser is critical within the loan granting process. Loans can only be made through the money adviser and it is her knowledge of the client, alongside the client's history of using the saving and special accounts, that is the key factor in making the loan. In some ways, the money adviser does adopt the role of loans officer in these cases.

MABS loans are underwritten by the MABS loan guarantee fund to ensure the safety of members' savings in the credit union. At the start of MABS, Huyton Credit Union was of the firm opinion that it was the existence of this fund that enabled the credit union to serve those people who would not have normally used the credit union. Over time, it has become clearer that it is not so much the fund that is central to serving those in financial difficulties but, rather, effective credit administration, the special accounts and the ongoing supports of the money advice service. MABS loans are monitored and accounted for separately to the standard loan portfolio.

Loans granted

Huyton MABS has only been operating since June 2002. It has offered advice to about 100 people but, as yet, has only made three guaranteed loans.

MABS loans are subject to the same credit control procedures as all credit union loans and arrears are pursued normally.

These loans, amounting to just £700, have prevented members returning to high cost alternative lenders in situations of need. Money advice, financial education, the saving and special accounts are current priorities. Although it is envisaged that, as the project develops, loans will increase, initial demand for loans has been modest. In many cases, clients have come to MABS with a financial difficulty which project workers have considered is better solved with a small grant rather than a loan. £3,000 of the loan fund has thus been vired into a *"Helping Hand Grant Fund"* to enable clients overcome financial hurdles and begin a savings and budgeting programme.

Status of borrowers and users of

People have come to MABS with a range of financial difficulties. Most are in debt to alternative financial providers, utility companies or for housing related costs. 60% of clients are people on low incomes in receipt of the Working Families Tax Credit. Having a modest income, they are people who are ineligible to use the legal aid debt advice services offered through such agencies as the Citizens' Advice Bureau. Most are single parents, aged 20 – 40 years, who have returned to work and are not used to budgeting and to managing additional work-related costs. Ironically, MABS finds that people return to low paid work and then find themselves in debt. A significant number are low-income self-employed people who find it difficult to manage their finances. 95% of clients have health problems, the majority suffering from debt related stress.

Managing repayments

MABS loans are subject to the same credit control procedures as all credit union loans and arrears are pursued normally. MAB borrowers are unaware that their loans are covered by a loan guarantee fund and are clear that they are personally responsible to repay the loan. Clearly, if members knew of the existence of the fund, there would be a possible impact on delinquency levels.

- MABS loans in arrears are referred, at a very early stage, to the money adviser who makes personal contact with the borrower by telephone or by letter. Effectiveness in debt control depends on the relationship between the borrower and the money adviser. The ongoing support and encouragement offered by the adviser can result in the reduction of loan delinquency. It may be claimed that, in this role, the adviser is acting more in the interests of the credit union, even as a credit control officer, rather than in the interests of the client. However, MABS is based on an understanding that access to affordable credit is an ongoing need even of people already in debt. The adviser acts to ensure that this access to credit is not lost.

Organisational learning

Huyton MABS has been in operation for less than a year. However, the following points have already emerged in regard to the operation of initiatives based on loan guarantee funds:-

- ***A co-ordinated and structured approach.*** Huyton MABS is not an instant solution to people's financial problems. Rather than granting instant loans to transfer debts to the credit union, it offers an exploration of the deeper issues underlying over-indebtedness as well as practical help through a structured programme tailored to the needs of the member. Huyton MABS has found that people benefit most from the personal support of the an adviser together with the external discipline of special accounts. Undoubtedly, MABS demands much from a member in terms of behavioural change and not everyone proceeds to use the services provided. However, it is found that making additional loans is only effective within this structured context. The discipline of the system has enabled a number of people to go on to become regular credit union members.
- ***Access to credit.*** MABS does recognise that people in debt still need credit. This availability of loans, unrestricted by standard credit union policies, has assisted clients to continue with the credit union without amassing additional debts with money lenders.
- ***Loan guarantee fund in context***. Initially, Huyton considered that the loan guarantee fund was essential to enable the credit union to make riskier loans to people who do not meet standard lending criteria. In fact, it is true that the existence of the fund has encouraged more adventurous lending and has enabled the credit union to reach people who would not normally use the credit union. However, very few MABS loans have had to written off from the fund. It is clear that, given the appropriate systems of ongoing support and credit assessment, lending to people in financial difficulty does not necessarily depend on an external fund. Risk has been minimised to the credit union more through effective procedures than externally donated funds.
- ***Financial education and financial literacy.*** Many of the people coming to MABS have

It is clear that many people seeking loans are doing so for essential items for which state welfare or charitable grants are more appropriate

become over-indebted through poor understanding of financial products and services. MABS has found that money advice must be linked to the wider issues of financial education and financial literacy if long term improvements in the lives of clients are to be achieved.

- ***Grants rather than loans.***
  It is clear that many people seeking loans are doing so for essential items for which state welfare or charitable grants are more appropriate. People living on a very low income are often forced into indebtedness through having to purchase basic living items. Huyton has recently taken £3,000 from loan guarantee fund, with the agreement of the funders, to set up a "Helping Hand Grant Fund" to meet this need. Grants are offered to clients to fully meet, or partly meet, the costs of an immediate household need.

- ***Management and costs.***
  MABS is costly in terms of staffing and resources. Unlike credit unions that have initiated loan guarantee funds without the resources to offer professional money advice and ongoing support, Huyton ensured it identified an appropriate funding package over time. The operation of special accounts is particularly expensive in terms of staff time and it is unlikely that the credit union, out of its own resources alone, would be able to continue a MABS service into the future. MABS depends on external subsidy and support.

- ***Conflict of interest.***
  Huyton has identified a certain conflict of interest arising from the fact that the money adviser has to act primarily in the interests of the client. In the case of loan default, for example, the adviser does encourage the member to repay. In a market where access to credit on a low income is often very expensive, it is clearly in the interests of the member to retain access to credit union loans. However, in cases of severe financial difficulty, the adviser recognises that the credit union loan is, in legal terms, a non-priority debt. Thus, a certain residual conflict may, in certain cases, remain. This has led Huyton to consider establishing, as in Ireland, MABS as a distinct organisational entity separated from the credit union.

Money Advice and Budgeting Service – Ireland

Various forms of local loan guarantee schemes have been associated with Irish credit unions for many years. Mostly these have taken the form of informal arrangements between credit unions and charities, or government welfare agencies, in which external funds were made available to guarantee loans to people who were in debt to moneylenders. Credit union experience of these informal schemes was not always positive. Delinquency rates could be relatively high and people who received a one-off loan to pay off a debt to a moneylender were often tempted to return to the moneylender once a new credit need arose.

It was clear to credit unions and other agencies that ad-hoc systems of making loans to settle pressing debts did not always result in long term improvements in the financial situation of the borrower. Many people had multiple social and financial problems and a loan, by itself, was not always the solution nor the most appropriate response to their needs. The setting up of the Money Advice and Budgeting Service (MABS), in 1992, heralded a new strategic approach to tackling the problem of over indebtedness within low income communities.

MABS is an independent money advice agency, funded by the Department of Social and Family Affairs, which operates in close partnership with participating credit unions. As its name suggests, it combines confidential money advice, budgeting and bill payment facilities and access to credit, normally in form of a credit union loan. There are currently 62 MABS centres operating throughout the Republic of Ireland.

A strategic and co-ordinated approach

"The basic aim of the service", explains Liam Edwards, MABS co-ordinator at the Department of Social and Family Affairs, *"is to help people who are in the clutches of moneylenders, and others who have budgeting problems, to manage their money and to gain access to affordable credit which is available in their local credit union"*. Although MABS is not designed exclusively for people on low incomes, over 70% of the people using the service are in receipt of welfare benefit.

MABS is a co-ordinated service which is based on four key elements:-

- money advice and the ongoing support of a money advice worker,
- a special credit union account
- a savings account
- credit union loans (underwritten by a MABS loan guarantee fund)

MABS is a government-funded initiative which depends on the support of credit unions that have the capacity to offer appropriate services to low income members. MABS provides professional money advice and manages the support programme, whilst the credit unions provide savings and budgeting accounts and credit facilities. It is this inter-relationship between MABS and credit unions that enables the development of structured and co-ordinated response to the needs of over-indebted people.

Money Advice, Special and Savings Accounts

The MABS response to over-indebtedness is not one that is based on the notion of a *"quick fix"*. There is no attempt to solve a person's financial problem or outstanding debt with an immediate loan. MABS takes a longer-term and more holistic view. The support process begins with an interview with a money adviser at a MABS office. A detailed analysis of the client's income and expenditure is undertaken with the aim of maximising income *(through the take up of benefits and tax adjustments)* and working out an affordable weekly budget. In particular, this financial assessment identifies the amount the client has available, after deduction of living expenses, for outstanding debt repayment. Debts are then prioritised and creditors contacted by MABS on behalf of the client. The adviser endeavours to renegotiate repayments that are both acceptable to the creditors and affordable to the client.

The client is then introduced by MABS to a local credit union where, if accepted into membership, the person opens two accounts, a special account and a savings account. This special account is the important element within the MABS process. It is a budgeting and bill payments account which assists the member to develop a certain financial discipline and achieve stability. The member pays a fixed sum into the account each week which is then redirected through MABS to the creditors, as per the negotiated agreements. One weekly payment by the member services all outstanding debts and, often pays current rent and energy bills as well.

In order to operate the special account, the member must authorise the credit union to pass on financial information to MABS. MABS handles the payments to creditors on a monthly basis only when notified by the credit union that funds are available in the member's account. If the member has not made the required payments, MABS only pays the creditors the amount available in the member's account. Fundamental to the programme is the importance of the member accepting personal responsibility to repay regularly. Over time debts are repaid and, based on the payment record, the client has access to future credit union loans as a regular credit union member.

The savings account is equally a central element of the programme. Members, along with their payment into the special account, save an amount they can afford each week. Through building personal wealth, evidence suggests that members grow in confidence and self-esteem and begin to use a credit union's financial services in a way that brings control into their lives (cf Kober and Paxton 2002). MABS brings discipline into people's lives through integrating saving, budgeting and, if necessary, affordable credit within the one programme.

Loan Guarantee Fund

Loans are not made through the MABS programme to clear outstanding debts. These are always managed through the money advice and budgeting process. However, it is recognised that people who are repaying debts, and saving, do have new and additional borrowing needs. If a new credit need does arise, MABS clients they are strongly advised to contact their money adviser for support. In a case of real need, and in order to prevent the person reverting to a money lender, the adviser will help to negotiate a small loan in the credit union. However MABS loans are not granted easily. As with all credit union loans, they are subject to credit risk assessment and depend on the member's record and ability to repay. As Liam Edward stresses, *"the money adviser should be satisfied that the loan is needed and that the client is in a position to repay"*.

Irish credit unions do have established, standard lending criteria and MABS borrowers do not meet these. They may be new members without a savings record or existing members with a poor one. MABS clients are regarded as high-risk borrowers. So that credit union funds are not put at risk, MABS guarantees all the loans it supports with a loan guarantee fund. This is either lodged as a MABS deposit in the credit union or retained in MABS itself. In the latter case, MABS furnishes the credit union with a letter of credit to cover the loan. In the case of a lodged fund, this is usually a relatively small amount, around £10,000, which is held by the credit union in a MABS account. It is only accessed, under authorisation by MABS, in cases of default.

MABS borrowers are, of course, unaware of the existence of the loan guarantee fund. From their point of view, a MABS loan is granted in the same way as any credit union loan. Applicants have to apply and to meet credit administration criteria. The only difference is that, with the pre-existing support of the adviser, the need for a prior savings period and a particular savings balance is waived and there is somewhat less formality in the process. There is obviously also a focus on keeping repayments affordable in the light of existing commitments.

It is recognised both by MABS, and by participating credit unions, that lending to already over-indebted people is a high risk business. The success of the MABS programme, both in lending and in debt resolution, depends very much on the quality of the support offered through the adviser to the client. As the Irish League's guidelines stress, *"the role of the money adviser is the vital ingredient to the success of the scheme"* (ILCU 1996). The relationship with the adviser is ongoing and not restricted to an initial interview. In some ways and on a social level, the relationship with the adviser replaces that with the moneylender in the life of the client.

The assessment of a loan request is a particularly critical for the adviser. This is made on the past payment record, on the character of the borrower and on the capacity to repay. Much depends on the advisor's knowledge of the client. In order to support regular payment, the adviser will ensure that loan repayments are set at an affordable level. Sometimes, this can be done without increasing the client's overall weekly payment as some of the weekly saving element can be vired to loan repayment. Liam Edwards is clear that ongoing support is critical to the programme, but the kind of support that is important is that which leads the client to build a good credit history, to learn how to budget and manage finances and to become increasingly independent. The ultimate goal of the programme, according to Liam is *"that people will be able to approach the credit union and borrow in their own right"*

Loans granted

The context for granting loans within MABS is clear. As Liam Edwards stresses, *"the loan guarantee fund should not be used for new clients, who have not gone through the money advice process, or to pay off debts"*. Loans are only granted for financial needs that arise once the money advice and budgeting programme is operational.

The loans made through MABS are usually small and for immediate pressing needs. They are usually no more than £300, even though there is always the possibility of larger loans in consultation with the MABS management committee. The fact that initial assessment of the loan is through the money adviser does not entail the credit union being in any way lax in its credit administration. Apart from the standard requirement to save a certain amount before being eligible to borrow, lending standards are as rigorous for a MABS loan as for any credit union loan. All borrowers must show clear evidence of a capacity and a willingness to repay the loan. Credit control procedures are the same as for any credit union loan. In fact, all MABS loans are closely monitored and controlled.

Loans granted through the MABS programme are covered individually 100% by the loan guarantee fund. However, this does not mean that the total of MABS loans can only amount to the total of the fund lodged in the credit union. Credit unions can make loans greater than the lodged amount. There is a expectation that the fund itself will hardly ever be called upon as loans made are normally repaid.

Loan default

Pat Coughlan, manager of Lough Credit Union in Cork, estimated that very few of the many MABS loans made through the credit union had been written off against the loan guarantee fund in the last two years. Denis Corbett, MABS co-ordinator in Cork, agreed that very little is written off against MABS loans. *"I would not expect loan referrals from money advisers"* explained Denis, *"if the advisers were not convinced that the client would repay"*. The reality is that, given the appropriate support systems, very few MABS clients, albeit often on very low incomes and with outstanding debts, fail to repay their credit union loans.

In cases of default, the money adviser contacts the borrower immediately and follows up each case individually. Immediate support is offered and everything is done to resolve the problem. However, for its part, the credit union follows its own standard debt recovery procedures. If the member cannot or will not replay, and the MABS adviser has done everything possible to rectify the situation, MABS contacts the credit union and arranges to pay the outstanding loan either from the lodged or external fund. Even though the credit union does retain the right to proceed with legal action, loans are often written off before this to avoid, in the words of one MABS adviser, *"real tragedy in the life of the borrower"*.

According to Denis Corbett, from the MABS perspective, three key factors can be identified that are key to preventing loan loss:-

- *the ongoing personal relationship with the adviser and the resultant knowledge of the member.*
- *access to external grants –in some cases, a loan is inappropriate and clients need a grant to settle a pressing need. In Ireland, there is support through charities and the Community Welfare Service.*
- *the stress on self help – MABS is not a quick fix solution to a problem but a programme that helps people to help themselves.*

Credit union administration

The programme, for the most part is administered by MABS. However, the management of special accounts and the MABS loans can be administratively very demanding and financially costly for credit unions. This is recognised by Liam Edwards, who stresses that *"credit unions need to consider with great care the implications of the scheme on their workloads"*. The Irish League's guidelines are clear too, *"It should be accepted from the outset that the operation of the MABS scheme by credit unions will place an additional burden of work on voluntary and paid personnel"* (ILCU 1996). In fact, the Irish League advises that credit unions do not proceed in participating in a MABS programme unless they are satisfied that they have the capacity to handle the additional administration. To assist, MABS does sometimes subsidise the administration costs of the credit union.

Predatory Relief Investment and Deposits™ - USA

American Community Development Credit Unions (CDCUs) have a stated mission to serve people on low incomes. The National Federation of Community Development Credit Unions (NFCDCU), based in New York City, has a range of financial products aimed at economically strengthening CDCUs so that they can expand their impact within low income communities. In April 2002, NFCDCU launched a new loan guarantee product, the Predatory Relief and Intervention Deposit (PRIDES), which assists CDCUs to make high-risk loans to people who would otherwise be vulnerable to high cost and "predatory" lenders. In the US, there is not the equivalent of home credit companies. Rather, the lenders that concern US credit unions are "payday" lenders, tax-refund anticipation lenders, automobile title lenders and unscrupulous mortgage-finance companies.

PRIDE has been created initially with a loan to NFCDCU from the Ford Foundation. NFCDCU acts as an intermediary and uses this loan to make PRIDE deposits to credit unions to assist their lending to vulnerable members. Typical PRIDE deposits in credit unions are $100,000 or more.

A risk-shared approach

Unlike loan guarantee schemes in Britain, PRIDE is not based on a grant given to a credit union to cover 100% of the risk of lending to over-indebted people. It is based on a different set of assumptions. It is a interest-bearing deposit made in the credit union, for a fixed term, which can be used as partial security against anti-predatory loans. NFCDCU shares the risk by covering 25% to 40% of the loan balance, the rate of cover being set on a case by case basis. As Patrick Blake, director of the NFCDCU Capitalization Program, explained, *"the concept of shared risk is fundamental to the product. In setting up this programme, people very much opposed at setting the level at 50%. We had to set it lower. Nobody would have listened to us if we had said it had to be 100%. In fact, the Ford Foundation would not have gone with it"*.

To clarify exactly how PRIDE works, consider the following example. NFCDCU makes a PRIDE deposit of $100,000 in the credit union. The credit union then makes an anti-predatory loan of $20,000 loan, which is covered by a 25% or $5,000 loan guarantee. If this loan is irrecoverable, say after $8,000 has been repaid, loss of $12,000 is shared proportionately. The credit union would lose $9,000 and NFCDCU $3,000. When a PRIDE deposit matures, the credit union repays NFCDCU the original amount minus NFCDCU's share of the losses on anti-predatory loans. All losses are shared on a pro-rata, loan by loan basis.

It is important to stress that interest is paid to NFCDCU by the credit union on the deposit. It is not free money and must be repaid. Interest rates vary from 3.5% to 5% depending on the purpose and term of the deposit. For "*pay-day*", tax-refund anticipation or similar lending, with a maximum term of 2 years, a 3.5% APR is charged. For longer term mortgage relief, with terms up to a maximum of 9 years, the interest rate is 5%. Of course, the credit union on-lends the funds to members at a much higher rate of interest, as high as 17% APR.

Economic strength and organisational capacity

NFCDCU will only make deposits into credit unions that can demonstrate that they have the financial strength, the administrative capacity and lending experience to ensure the maximum impact of the programme and the minimum loss on loans. Only credit unions with an overall capital reserve ratio of 8% are considered for PRIDE. All applicants must submit a comprehensive business and financial plan and a detailed strategic and market analysis of the proposed anti-predatory lending programme. Of particular concern to NFCDCU is a the credit union's previous track record in credit administration. Loan and delinquency information is required for analysis plus the CVs of key management personnel and lending officers. Credit unions must demonstrate also how the PRIDE programme would relate to their existing financial education programme

If accessing PRIDE is subject to detailed analysis, continuation in the programme is equally rigorous. Bi-annual statistical reports must be submitted, plus information *"about the performance of the overall portfolio and the anti-predatory lending programme, including rates, terms, collateral, co-makers, credit scores, debt ratios, and credit histories and other information that may be needed by NFCDCU"* (PRIDE documentation). Guaranteed loans, in fact, may cease to be guaranteed if it is judged by NFCDCU that there were not made prudently or not in accordance with lending policies, Annual loan losses in excess of 10%, failure to pay interest on the PRIDE deposit or an overall deterioration of the capital ratio to less than 4.5%, are all seen as defaults on the PRIDE agreement and result in expulsion from the programme.

Observations

A strategy for serving the over-indebted

Over-indebtedness is a growing problem, particularly within low income communities (CAB 2001b). As credit unions raise their profile and become more widely known, the demand for assistance from already over-indebted people will undoubtedly increase. 81% of questionnaire respondents regarded the primary purpose of loan guarantee schemes to be the consolidation of the pre-existing debts of people approaching the credit union for the first time.

Loan guarantee schemes can help credit unions manage some of the risk involved in lending to people, already over-indebted to other lenders. Credit unions have rightly recognised the high risk nature of lending to over-indebted people and have sought to protect their members' savings with external donor funds. However, loan guarantee schemes alone cannot be seen as the solution to the problem of high risk lending. This research indicates that ad hoc responses to debt problems, based solely on making externally guaranteed debt-redemption or *"rescue"* loans, achieve limited success. As the majority of the case studies illustrate, not only does this approach often result in high loan loss rates, it does not enable the majority of borrowers to achieve long-term financial stability, control of their finances and an enduring relationship with a credit union. From the survey, 86.6% of credit unions, with an interest in loan guarantee schemes, have the general perception that they *"are an excellent way to develop credit facilities for people on very low incomes"*. The reality is, however, somewhat different in practice. Less than half of the credit unions that had operated loan guarantee schemes felt that they had been a success. East Manchester, Acton and Llanelli credit unions all discontinued existing loan schemes after only about one year of operation. One reason given was that the scheme, as operated at the time in the credit union was not the most appropriate way to serve over-indebted people.

Serious, multiple debts are seldom the result of poor money management alone and cannot be solved with an instant loan. Credit unions that wish to serve over-indebted people need to develop strategies aimed at responding appropriately to their multi-layered and multi-faceted needs. An effective and strategic response is likely to include one to one personal support involving money advice, help with budgeting and an element of financial education, in addition to access to affordable credit. It is this approach that has been explored in Ladywood and, particularly and more recently, in Huyton. It is this approach that underpins the relationship between credit unions and the Money Advice and Budgeting Service in Ireland.

In fact, given the organisational capacity, credit unions are well placed to serve low-income people with debt problems, particularly those indebted to high interest and alternative lenders. Credit unions are often local, accessible and able to offer the simple and straightforward, affordable credit products people need (Jones 2001). Externally donated funds, that strengthen existing loan loss provisions and afford a measure of protection for credit unions operating in low income areas, are undoubtedly of benefit and do assist credit unions develop appropriate services. However, these services must be firmly based on a holistic understanding of the needs of the over-indebted member. A *"quick fix"* loan is not the only and most relevant answer.

The economics of serving low-income consumers

Experience in the US indicates that credit unions can generate a profit and earn income from providing financial services to under-served low income groups (Caskey 2001), if these services are attractive and responsive to people's needs. US low-income credit unions offer simple transaction services such as cheque cashing, money transmission and bill payments, in addition to access to affordable credit and savings accounts. However, it is important to note that US credit unions are free to charge interest rates on loans related to the market. This enables them to price higher risk loans at a higher interest rate in recognition of the increased risk. Nevertheless, the rate charged remains lower than that charged by the limited range of providers willing to provide credit to low income consumers (Jones 2002). In addition, US low-income credit unions are often large enough to achieve cross subsidy within the credit union itself. By attracting an economically diverse membership, requiring more profitable financial products such as mortgages, car loans and credit cards, multiple high volume, low value transaction services to low income members can be subsidised (Jones 2003).

It is much harder for British credit unions to develop appropriate services for over-indebted, low-income groups out of their own resources. Many lack the size and economic strength to effectively cross-subsidise services internally and all are restricted by current legislation. The cap on the maximum interest-rate that can be charged on small, high-risk loans makes it harder for credit unions to lend profitably and build loan loss reserves. In fact, the inability to charge more than 12.68% APR on small loans is regarded by the US Community Development Credit Union movement as a key limiting factor in the development of services in low income communities (Jones 2003). In addition, until early 2003, credit unions have also been prevented from charging for ancillary services such as bill-payment accounts.

In the US there are government programmes providing financial assistance to low-income designated credit unions to enable them to serve low-income members. In Ireland, there is the national support of the government-funded MABS programme. Without the ability to charge market rates on loans and to achieve cross subsidy within the credit union's own range of financial services, British credit unions are even more dependent on external financial subsidy in order to serve over-indebted and low-income groups. It is this economic reality that has led many credit unions to seek external financial support to develop loan guarantee schemes within low income communities.

A business decision that reflects social commitment

Credit unions become involved in serving over-indebted people for philosophical reasons. Whether community or employee-based, credit unions prioritise responding to the needs of people in financial difficulty as an important social goal. However, credit unions need to approach the development of services for over-indebted and low-income groups as a business rather than as a charity (Burger and Zellmer 1995).

In the case studies, there were examples of lending practices that seemed more related to charitable activity than to business or enterprise. The result was not always in the best interests of the borrower, and was rarely in the best interest of the credit union as a whole. Borrowers lost by failing to develop a long term relationship with a credit union, current members hardly gained as they were excluded from the more favourable lending criteria offered to new members. There was always the danger that the loan guarantee scheme would undermine the overall business development and strength of the credit union by diverting resources away from the operational needs of the credit union and of its existing members.

It was significant that loan guarantee schemes were aimed more at attracting and serving new members than offering favourable credit options to all members. From the survey, 47.4% of credit unions operated schemes for new members in comparison to just 26.3% offering the benefits of the scheme to the existing membership. As was noted in Llanelli, loan guarantee schemes were often more a marketing tool to attract new members than an element of a business strategy to serve over-indebted, low income members.

Effective and strategic loan guarantee schemes, which include money advice and other services, demand organisational capacity and are expensive and time consuming. They require skilled, professional staff experienced in credit assessment and administration, adequate resources in addition to the externally donated funds used to protect against the credit risk inherent in such a scheme. Most case study credit unions lacked this organisational capacity and found the operation of the loan guarantee scheme to be very demanding, stressful and labour intensive. The result was that very few individuals were assisted through the schemes. Ladywood reached the most people with 53 people assisted over three years. Lack of organisational capacity was the key reason given for discontinuing a number of the schemes.

In order to serve over-indebted members, adequately protect the credit union and preserve the supply of external funds, loan guarantee schemes need to operate to standard commercial and business standards. They need to be adequately resourced and funded in a way that integrates them into the overall business strategy of the credit union. They should not operate to the detriment of the credit union or its current membership. Excessive loan losses in loan guarantee schemes undermine the reputation of the credit union and jeopardise the existence of the scheme itself. It is for this reason that the National Federation of Community Development Credit Unions imposes rigorous operating conditions on its funded loan guarantee schemes in the US. Its schemes can only proceed if they can demonstrate the organisational and economic capacity to ensure their success for the benefit of the credit union as a whole.

Developing strategic partnerships

Credit unions developing loan guarantee schemes in the interests of low income, over-indebted members are attempting to take on a major social responsibility within society. They are endeavouring to respond to one of the largest social problems of the age, the problem of over-indebtedness.

Rather than taking on this task alone, credit unions need to be working in partnership with other agencies and funders and to be establishing co-operative and collaborative solutions to tackling indebtedness within society. In Ireland, credit unions and government, through the MABS programme, work together to strategically tackle over-indebtedness. US credit unions work with the large private sector organisations such as the Ford Foundation. In Britain, there are beginnings of co-operation too. In Leeds City Credit Union, for example, a loan guarantee schemes operates in active partnership with Sure Start.

There are also forms of loan guarantee schemes that are not linked to services for the over-indebted but which have direct benefits for people on low incomes. These include East Manchester's Computer Loan Scheme and Leeds City's Energy Loan Scheme. These forms of loan guarantee schemes, being directly linked to certain products, appear to be particularly successful. They are examples of good partnership working in practice which benefits borrowers and the credit union alike.

Funding loan guarantee schemes

63.2% of loan guarantee schemes are established with one-off grants of less than £10,000 which are mainly used to establish a loan loss provision. There was little forward planning and little involvement of external donors after the initial grant was made.

In many ways, the loan loss provision is not the most significant, nor the most expensive, element of a loan guarantee fund. In fact, effective loan guarantee schemes write off little against the loan loss provision as effective credit control programmes are in place to minimise loss. The greater costs are more related to the effective management of the scheme. In fact, case study credit unions were covering most of the costs of credit administration and control, member relations and support and referral to money advice agencies from within their general expenditure. It was for this reason that the majority of case study credit unions regarded the scheme as too operationally expensive and demanding.

In order to successfully manage a loan guarantee scheme, funding is required not just for on-lending and loan loss reserves, but also for staff and resources to administer the programme. Skilled professional staff are required both to implement effective credit assessment and credit control and to offer appropriate money advice, albeit this latter could be organised through a partner money advice agency. Huyton Credit Union, which has endeavoured to have in place many of the elements of an integrated scheme, has estimated its annual budget at £70,000 per annum. If schemes are to reach significant numbers of people within the community, and achieve maximum impact, they need funding partners who are interested in establishing longer term, strategic initiatives. Single one-off grants of a few thousand pounds are able to achieve very little.

Loan guarantee schemes do normally require a dedicated loan loss provision as a constituent element. An alternative approach, which equally supports the development services within low-income communities, is to encourage funders to make a donation into the credit union's accounts that will be used to build the standard loan loss provision in the credit union. This approach will enable the credit union to help existing members in need, as well as those new to the credit union. Adopting this approach will also help to ensure the financial strength of the credit union when managing credit risk.

Effective credit administration

Loan guarantee schemes cannot replace good lending polices and effective credit administration. It is worrying that many credit unions operating loan guarantee schemes suffered large losses. Irrespective of external guarantees, poor lending only leads to the greater social distress of borrowers. If a person cannot afford to repay, or there is a risk he or she will not repay, the credit union should not make the loan. Credit unions that make loans in the knowledge of likely default are not only undermining their own financial stability but creating greater long-term difficulties for the borrower. Loan guarantee schemes should never allow a culture to develop in which the non-repayment or the slow repayment of loans is considered to be acceptable in some circumstances. Such a culture is likely to include a range of subjective, perhaps biased, opinions and views. Adherence to a loan policy, applied equally to all members, enables a credit union to avoid subjectivity and bias in lending decisions.

In fact, good credit administration eliminates much of the need for loan guarantee schemes. Credit unions that use external funds to on-lend to new members or to make loans unconnected to savings balances are doing so as a result of their own restrictive lending policies, not out of necessity. It is neither a legal nor a regulatory requirement to require a member to undertake a period of savings prior to being granted a loan or to restrict loan granting to a multiple of shares held by the member. If an assessment of a person's character and capacity to repay is used as part of the credit assessment, more flexible loan policies can be developed and there is no need for an external fund to guarantee an instant loan to a new member nor to a member without a "requisite" amount of savings.

It is significant that in Ireland, credit unions involved in the MABS programme very rarely write off loans against the loan guarantee fund. In the US, loan loss rates in excess of 10% of the value of loans made are regarded as a breach of contract with the funder and result in the termination of the loan guarantee scheme. In both cases, the funds provided for the loan guarantee scheme are considered to be an accounting provision that provides for any default on loans underwritten by the scheme. The existence of the loan guarantee scheme is not publicised and a borrower is not aware that their loan has been underwritten by the scheme and loans made against the fund are not expected to have higher delinquency rates than standard credit union loans. In fact, in the US, the fund only guarantees 25 – 40% of the loan, the credit union always carrying the larger share of the risk. In Ireland, even though the fund does guarantee 100% of any one loan, total loans made against the fund are expected to be greater than the fund lodged in the credit union. In itself, this is an indication of the low level of expected default on loans.

The importance of mobilising members' saving

"Savings are a key part of the package of services that must be offered. The service package should include the savings account. Without savings it is difficult to bring individuals into an established financial network. Putting lending before savings is somewhat like putting the cart before the horse. Members who establish a record of managing their own finances are better borrowers. The savings side of the relationship ensures understanding of lending standards and the obligation to repay. Therefore, educating low-and-moderate income members on the benefits of savings is a key element in building a successful financial relationship" (Burger and Zellmer 1995)

Burger and Zellmer's findings in their 1995 research into serving low and moderate income members in the US coincide with the findings of this research into the operation of loan guarantee schemes. All credit unions operating loan guarantee schemes endeavoured to prioritise savings as part of their package of services for low income, over-indebted members. Sherraden has argued that the building of personal assets, or savings, results in a range of positive effects for people including planning for the future and increased participation in the community (NCB 2002). Having savings changes the way people feel about themselves and enables them to be more open about the way they use financial services in the future. Internationally there is evidence that it is savings, not borrowing, that raises people's expectations and increases their participation in credit union membership generally. As Richardson points out, *"I remember some sage advice given to me many years ago: 'It's not what you earn that is important, it is what you save'. It is both heretical and hypocritical to talk of poverty eradication without incorporating savings accumulation into the poverty alleviation strategy. The doctrine of micro-savings is the only cornerstone upon which poverty can truly be eradicated"* (Richardson 2000a).

Mobilising savings has, of course, a long term relevance for credit unions themselves. It affords a credit union the possibility of economic independence from external subsidies and provides the liquidity to enable it to make loans to its members. Greater savings mobilisation together with effective credit administration and control systems enables credit unions to increase income and, thereby, loan loss reserves in the credit union.

Money advice, money advice agencies and credit unions

Multiple debt problems are complex and involve much more than a simple inability to manage money. Instant access to a loan may not always be in the best interests of a person suffering over-indebtedness. A structured approach to managing that debt is much more important. For this reason, this research concludes that it is essential to link all loan guarantee schemes, aimed at serving the over-indebted, closely to money advice services.

Credit union staff and volunteers do not usually have the expertise to offer money advice. Advisers need to be trained professionals who are skilled in identifying clients' problems and exploring solutions to those problems. Credit unions, therefore, need to *"work constructively with money advice agencies who are helping people deal with multiple debt problems"* (CAB 2001b). This research has revealed that difficulties can arise between credit unions and money advice agencies. Credit unions must act in the interests of the credit union and its membership and money advisers have to act in the interests of their client. In cases of default on loans, arranged in partnership with the money adviser, there are undoubtedly possible conflict of interests. Credit unions must do everything to pursue the debt and money advisers have no choice but to regard credit union loans as non-priority debts. The relationship between credit unions and money advice agencies is, therefore, complex but is essential to success in serving low income, over-indebted people.

Some credit unions, such as Huyton, may employ their own professional money adviser. To do this, credit unions need to obtain a consumer credit license which is required whenever a business helps people with their debt problems by taking over their debts, by negotiating on their behalf or by advising them how to discharge specific debts (cf. Office of Fair Trading). Employing a credit union money adviser does not, in fact, eliminate the conflict of interest between the credit union and the advice service. In cases of default, unsecured credit union loans are always regarded as non-priority debts and it is the responsibility of the adviser to inform the member accordingly. For this reason, Huyton is endeavouring to establish its Money Advice and Budgeting Service as an independent advice service, organisationally separated from the credit union. The credit union and MABS then have the possibility of working in partnership, each agency respecting its own roles and responsibilities.

Bill paying and budgeting accounts

Both in Ladywood and Huyton, bill paying and budgeting accounts were found to be an essential element of an effective service to low income, over-indebted members. The discipline and the structure of these mechanisms enabled members, all with a history of indebtedness, to make the transition to financial stability and regular credit union membership. As MABS schemes in Ireland illustrate, bill paying and budgeting services are often of more value to the member than an instant loan.

This finding corresponds with research conducted by Caskey in the US. He found that credit unions that were able to offer instant small loans combined with convenient cheque cashing and reliable bill paying mechanisms could serve low-income groups effectively and profitably (Caskey 1997). In later research, he went on to discover that adding cheque cashing and bill paying services to traditional credit union services often increases the profitability of credit unions operating in low income areas rather than reducing it (Caskey 2001). Of course, Caskey assumed that cheque cashing, and some bill payment accounts, would be income generating albeit at rates less than the market norm. He also noted the importance, and profitability, of offering money transfer services particularly within certain communities. All of these services not only are of immediate use to the member but they encourage longer-term take-up of a credit union's services. *"Importantly, payment services to the underserved builds relationships with these individuals and uses these relationships to build savings and address their credit problems. Credit unions can't help the underserved if they do not open the door to them."* (Caskey 2001)

Financial literacy education

Credit unions reaching out to low income, over-indebted people can offer or promote programmes in financial literacy. Huyton Credit Union, for example, has included financial literacy education as a constituent part of its loan guarantee scheme. There is a direct link between financial literacy education and money advice. People with multiple debts can often be ill informed on financial matters and approach the credit union with problems which may not have been as great if they had been able to make informed, educated choices. People on low incomes do make rational choices about access to credit but these choices are often constrained by poor information and knowledge, as well as limitations on access to a range of options. (Jones 2002).

The Citizens Advice Bureau emphases that financial literacy is a key skill *"if individuals are to be informed and confident participants in the 21st century"*(CAB 2001a). Credit unions are in a key position to provide consumer information and advice in order to enable members make choices about financial products. However, given the Consumer Credit Act and, more particularly, the implementation in Britain of the European Union's Distance Marketing Directive, credit unions need to ensure that they give proper advice and information about their services and their financial products to members and that they abide by any requirements developed in respect of statutory disclosure information. Members must be able to make informed choices about credit union products too. Traditional credit union promotion of loans as the best possible option may not always be in the interests of everyone. Credit unions, in promoting financial literacy, must ensure that they could not be considered guilty of mis-selling their own products.

Recommendations

1 A strategy for serving the over-indebted

- It is recommended that loan guarantee schemes, if they are to be successful, must be integrated within a credit union as part of its wider strategic development of services for low income, over-indebted people.

2 The economics of serving low-income consumers

- It is recommended that Government support the ability of credit unions to adequately serve low-income, over-indebted consumers through further de-regulation of credit union legislation to remove the maximum interest rate charged on loans and allow credit unions the ability to charge market rates.
- A substantial Government funding programme is required to enable credit unions to more effectively serve low income and over-indebted groups if this legislative change is not forthcoming. External funding should always be monitored to ensure appropriate financial disciplines are maintained within credit unions (LGA 2001).

3 A business decision that reflects social commitment

- It is recommended that credit unions regard loan guarantee schemes as businesses and not a charitable undertakings. As such, credit unions need to realistically identify costs and sources of income incurred, either from achieving cross-subsidies within the credit union itself or from external donations.
- All credit unions need to ensure effective credit administration and credit control systems as well as the building of loan loss provisions. This applies equally to loan guarantee schemes as it does to all lending within the credit union.
- It is recommended that credit unions only establish loan guarantee schemes if they have ensured the organisational capacity, staffing and financial strength to manage the scheme and offer a quality service to members.

4 Developing strategic partnerships

- It is recommended that credit unions do not establish a loan guarantee scheme in isolation. Rather they should develop strategic partnership arrangements with Government, the private sector and voluntary agencies, such as money advice services and Citizens Advice Bureaux, who are equipped to assist low income consumers with their financial problems. These organisations may take the lead in establishing a range of initiatives aimed at serving low-income, over-indebted communities.
- Partnership initiatives aimed at serving over-indebted people could effectively include an externally funded loan guarantee scheme operated by a credit union. This enables the credit union to work in partnership with other agencies without risking their own members' savings.

5 Funding loan guarantee schemes

- It is recommended that credit unions establishing loan guarantee schemes ensure they have the financial resources to implement a holistic strategy aimed at developing services for low income, over-indebted members. Internal financial resources, or external subsidies, need to be identified to cover effective credit administration and credit control, bill payment and budget accounts, money advice and financial literacy education as well as to build an adequate provision for loan loss that reflects the level of credit risk accepted by the credit union.
- Credit unions should resist establishing loan guarantee schemes that are in effect just a small donation made available for on-lending to those in need. This approach is unsustainable in the long-term. As a result of the likely loan loss rates that may be anticipated as a direct result of lending to high risk groups, this pool of funds will always require replenishment by the donor and therefore the continuation of the service is dependent upon the continued generosity and charity of an external donor.
- It is recommended that, instead of creating a separate loan guarantee scheme aimed at providing a source of funds for on-lending to members, a funder, wishing to help a credit union provide credit to low-income communities, could be encouraged to make a donation into the credit union's accounts that will be used to build the standard loan loss provision in the credit union. This approach will enable the credit union to help existing members in need, as well as those new to the credit union. Adopting this approach will also help to ensure the financial strength of the credit union when managing credit risk.

6 Effective credit administration

- Credit unions must maintain credit standards and develop a rigorous and responsible approach to credit assessment and lending for guaranteed loans. "Free and easy credit is not the goal, nor is that fair to the entire membership" (Burger and Zellmer 1995)

Recommendations

- Credit unions should develop credit assessment systems that focus on the character and capacity of the borrower to repay the loan. (Richardson 2000a). Capacity to repay needs to be assessed by non-subjective credit checks and credit scoring techniques adapted for credit union use. (Overstreet and Rubin 1996)
- It is recommended that credit unions develop more flexible lending policies so that, given effective credit assessment and administration systems, loans can be made to members irrespective of length of membership and of savings balances. A loan guarantee scheme should not be used as an alternative to a restrictive lending policy freely adopted by a credit union. Prior to considering using a loan guarantee scheme as an option to make loans to those that the loan policy prevents a credit union lending, the loan policy should first be reviewed, and if necessary revised to remove any unnecessary restrictions. *"Credit unions need to focus on making loans, not denying them"* (Burger and Zellmer 1995)
- Credit unions may need to realise that not all comers can be served with credit union loans, irrespective of the existence of an external guarantee fund. Some people unfortunately will not have either the willingness or the capacity to repay a loan.
- It is advisable that loan guarantee schemes are strictly monitored and evaluated. Loans made need to be identified and repayments carefully monitored.
- It is recommended that delinquency rates on underwritten loans are assessed in the same way as for standard credit union loans. All loans need to be subject to the same rigorous credit control procedures.
- It is recommended that a scheme should be fundamentally revised or discontinued if annual loan loss rates reach 10% of the underwritten loan portfolio per annum
- Credit unions could consider sharing the risk of lending to high risk groups rather than passing the entire risk over to external donor funds. This may both encourage responsible lending and develop the confidence of the funder in the scheme.
- Members granted loans under a loan guarantee scheme should not be aware that their loan has been underwritten by the scheme. Loan guarantee schemes cannot be advertised or promoted as different to standard credit union administration. This signals to the borrower that default is expected and accepted; such an approach does not help to ensure repayment of a loan.

7 The importance of mobilising savings

- All credit union strategies aimed at serving low-income, over-indebted members should prioritise savings programmes as part of the package of services they offer. Encouraging members to save, helps people begin to help themselves and regain financial control and independence. Simply providing loans alone, keeps a person in debt.
- It is recommended that credit unions promote savings products that permit easily withdrawable access for members to their savings. Savings need not be necessarily linked or "attached" to loans, and ideally should be decoupled. Analysis by the *World Council of Credit Unions* has revealed that members tend to increase their savings when they know that their savings are liquid and easily withdrawable, rather than "attached" to a loan. In credit unions which require their members to save in order to access credit, and then refuse access to these shares while the loan is outstanding, the member has a tendency to save only the amount they are required to, as a condition of accessing a loan.
- Credit union strategies need to be based on the understanding that the use of members savings to fund members' credit needs is a more long-term, sustainable and permanent option than using external credit to on-lend to members.

8 Money advice, money advice agencies and credit unions

- Credit unions should work constructively in partnership with money advice agencies particularly when operating loan guarantee schemes
- Credit unions and money advice agencies need to develop ways of improving mutual understanding in the area of lending to over-indebted members. Joint training and written partnership accords or agreements are important in assisting mutual recognition and understanding.
- Credit unions must recognise that money advice agencies cannot always recommend just one financial product or provider and must always act in the interests of the client.
- Credit unions employing their own money advisers or offering a form of occasional "money advice"

should review the extent to which they are able to provide such a service; taking care to ensure that they are operating in compliance with the requirements of Consumer Credit legislation and forthcoming legislation and regulatory requirements in respect of distance marketing and statutory status and product disclosure.

9 Bill paying and budgeting accounts/services

- Credit unions should recognise the need of low income and over-indebted people for bill payment and budgeting accounts and endeavour to prioritise access to these independently or within loan guarantee schemes.

- Credit unions could develop income-generating cheque cashing services and money transfer services for members as part of an overall strategy of serving low income members.

- It is recommended that ABCUL investigates the introduction in Britain of the *International Remittance Network* (IRnet) developed by the *World Council of Credit Unions* to enable affordable international money transfers by credit unions on behalf of their membership.

10 Financial literacy education

- Credit unions should include within their development of loan guarantee schemes promotion and participation in financial literacy education programmes as part of their strategy for serving low income members.

- It is recommended that credit unions ensure that in offering financial information that they comply with any subsequent legislative or regulatory requirements established as a result of the implementation in the UK of the European Union's *Distance Marketing Directive*. Care should also be taken to ensure that within the provision of financial education and information, the credit union does not inadvertently mis-sell its own products.

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