Fear and Loaning

Impact of Covid-19 on affordable credit providers serving financially vulnerable customers

Carnegie UK Trust and Community Finance Solutions, University of Salford

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1 Foreword

This report gives a great snapshot of how the Covid-19 pandemic is impacting affordable credit providers and for many will give the grim reassurance that no, it's not just their business feeling the pain. It highlights that those affordable credit providers whose focus is on very small sum, short term loans are feeling a greater pressure on their business models.

What is certain is that many more people in the UK will find themselves in vulnerable circumstances and the need for fair and affordable credit is likely to grow significantly over the coming months, not least as some high cost providers fail or withdraw from the UK market place.

So how should affordable credit providers use the insights here to consider what next?

The great ice hockey player, Wayne Gretzky reportedly said, when asked how he was so good, 'skate to where the puck is going, not to where it is'. It is a well-used quote and yet a valuable call to action for providers today.

Context: great businesses are led by customer needs, understanding their behaviours and paying attention to competitor behaviour. Many people have realised just how fragile their financial position is and we are seeing an appetite to save – how can that inform wrap around services lenders provide? Many are navigating the benefits system for the first time whilst in a place of cognitive overload. What partnerships can lenders create to support this challenge?

Change: how will lenders adapt their business model to be sustainable in meeting the changing customer needs and market conditions? Many providers have found an acceleration to digital possible over the last few months – how has this changed business models and risk profiles? Continuing to look at how lenders decrease their costs per £ lent is critical: reducing costs to acquire new customers, costs to serve, costs of finance and costs of default. Scale, process efficiencies and clear customer personas / journeys all play their part. We know relationships are key in ensuring that customers' financial well-being is improved – lean processes focus lenders to consider where the human interaction adds most value, designed with real insights into customer behaviour and choices. All of these present opportunities for change. Most significantly of all, the fragmentation of the affordable credit market comes with a cost. Consolidation and collaboration must be on the agenda now more than ever.

Catalyst: Fair4AllFinance have a role as a catalyst – to work with providers and other stakeholders including Carnegie UK Trust and Community Finance Solutions at the University of Salford to prove the model of how one can sustainably serve a customer group too often ignored, and drive a 10x increase in affordable credit provision. We can provide tools, insights and, to those whose beneficiaries are predominantly in England, patient capital and grant funding. To create a thriving and sustainable affordable credit sector we also need leaders to think radically about how they play their part. When we approach challenges with a 10%mindset we can get stuck in incremental change. What happens when you adopt a 10x thinking transformational change mindset is that the unthinkable becomes possible. We have seen that in some bold public policy moves in responding to the economic crisis caused by the health crisis.

Out of crisis comes opportunity, lenders must be ready to play their part and follow Gretsky's puck.

Sacha Romanovich
CEO, Fair4All Finance

2 Introduction

The affordable credit sector will have an important role to play in helping low-income communities and households cope with and rebuild following the Covid-19 crisis.

This not-for-profit sector of credit unions and Community Development Finance Institutions (CDFIs) provides ethical, affordable credit and serves as a gateway to broader financial inclusion by offering small loans and ancillary support. However, these providers are themselves vulnerable to the pandemic. Providing small loans to financially vulnerable households is an economically marginal activity.

Ours and other evidence highlights low income customers are likely to be more vulnerable to the crisis because they are in more precarious forms of employment, have fewer resources (such as savings or safety networks) to cope and are more reliant on forms of support linked to their children attending school (e.g. free school meals).

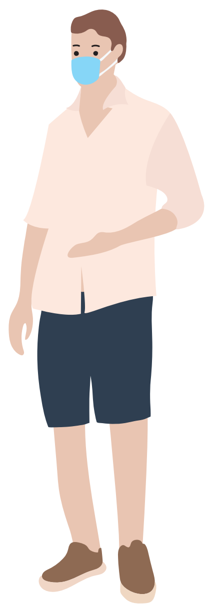
It is important to monitor the impact of Covid-19 on affordable credit providers so that they can continue supporting financially vulnerable consumers in the medium to long term. To develop a deeper understanding of the issues facing the sector and help inform new policy and practice interventions, Community Finance Solutions at the University of Salford and Carnegie UK Trust recently conducted a survey of the impact of Covid-19 on affordable credit providers (credit unions and CDFIs) in England, Scotland and Wales.

The survey was carried out in May 2020, with initial analysis presented in a webinar on 9th June 2020.

In this report, we have explored the survey data on more granular detail, splitting the lenders by the amounts they lend, on average, to borrowers which we split by:

- £1,000 and below;
- between £1,001 and £1,999; and
- above £2,000.

We see distinctions in how Covid-19 has affected the credit unions and CDFIs targeting low-income households. We also highlight developments and areas that need monitoring as the crisis unfolds.



3. Context

The current Covid-19 health crisis has metamorphized into the worst economic crisis since the Great Frost of 1709[1], with severe impacts and hardship being consistently forecast for households across the UK.

To avert the immediate damage to the UK economy, where output dropped by over 25% between February and April 2020[2], an extensive support package has been put in place that includes:

- 8.7 million workers supported in the period 1st March 2020 to 31st May 2020 with total claims of £17.5bn[3] through the UK Government Job Retention Scheme;
- 1.86 million mortgage payment breaks have been issued as of 28 May 2020 – equivalent to 1 in 6 mortgages, the average deferral £755 per month;[4]
- 27 million customer accounts benefitted from £500 overdrafts each with nil interest:[5,6]
- 877,800 customer accounts had been given a payment freeze on their credit card as of 21st May 2020, with 608,000 payment holidays on personal loans.[7]

Despite these support measures the number of workers on UK payrolls fell by 649,000 between March and June 2020.[8] Furthermore, the number of new individual claims of Universal Credit has exceeded 2.825m since lockdown began on 23rd March 2020.[9]

There are real concerns that once furloughing tapers off and ends unemployment figures will rise far higher still, with the Chairman of Reid Recruitment being quoted in the Financial Times saying "*A tsunami of job losses is a real possibility*"[10] and predicting the numbers could reach 5 million people, about 15% of the workforce. For context the impact of the financial crash in 2008 saw unemployment rise to 8.5% in 2011. You must go back to 1983 to see unemployment figures of 11.9%.

These significant and dramatic changes in the economy have immediate consequences for personal lending.

The Centre for Economic and Policy Research (CEPR) concluded from their analysis of over 8 million transactions from 34,000 individuals between January and April 2020 that consumption was down between 40% to 50%. They reported:

1 Financial Times (2020) *BoE warns UK set to enter worst recession for 300 years* 7 May 2020 FT (online) https://www.ft.com/content/734e604b-93d9-43a6-a6ec-19e8b22dad3c [accessed June 2020]

2 The UK reported its worst ever hit to its economic output. By the end of April, the economy was about 25 per cent smaller than in February, with two consecutive monthly falls in GDP of 20.4% (April 2020) and 5.8% (March 2020) Financial Times (2020) *UK economy shrinks by record 20% in April* 20 June 2020 FT (online) https://www.ft.com/content/f25dc58b-32c9-499d-af66-f677f20c53a2 [accessed June 2020]

3 HMRC *Coronavirus Job Retention Scheme Official Statistics* HMRC; online 11 June 2020 https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/891249/Coronavirus_Job_Retention_Scheme_Statistics_June_2020.pdf [accessed June 2020]

4 UK Finance *Lenders commit to ongoing support for mortgage borrowers impacted by Covid-19* UK Finance; online June 2 2020 https://www.ukfinance.org.uk/press/press-releases/lenders-commit-to-ongoing-support-for-mortgage-borrowers [accessed June 2020]

5 FCA *Coronavirus: information for consumers on personal loans, credit cards, overdrafts, motor finance and other forms of credit* FCA; online July 2020 https://www.fca.org.uk/consumers/coronavirus-information-personal-loans-credit-cards-overdrafts [accessed June 2020]

6 Financial Times (2020) *Banks in talks over credit card holiday extension for borrowers* June 8 2020 FT (online) https://www.ft.com/content/dc430a79-69ae-41fd-b00d-7a5996484da9 [accessed June 2020]

7 UK Finance *Lenders approve almost 1.5 million payment holidays on credit cards and personal loans* UK Finance; online May 29 2020 https://www.ukfinance.org.uk/press/press-releases/lenders-approve-almost-1.5%20million-payment-holidays [accessed June 2020]

8 BBC News Coronavirus: *UK payrolls shrink by 649,000 jobs in lockdown* BBC News; online July 16 2020 https://www.bbc.co.uk/news/business-53427304 [accessed July 2020]

9 DWP report 2.825m individual UC claims between 23th March and 9th June 2020. Department of Work and Pensions *Universal Credit declarations (claims) and advances: management information* Gov.uk; online June 30 2020 https://www.gov.uk/government/publications/universal-credit-declarations-claims-and-advances-management-information [accessed June 2020]

10 Financial Times (2020) *Big drop in UK vacancies stokes fears of mass unemployment* June 8 2020 FT (online) https://www.ft.com/content/5483d718-8edf-4a25-94d5-4379c822c704 [accessed June 2020]

"Income reductions have become far more frequent, with a median decline around 30%. The share of borrowers facing financing issues has increased significantly for both secured and unsecured lending. Consumption and income inequality have surged, with the most economically vulnerable groups experiencing the largest percentage decline"[11]

The lack of consumption alongside uncertainty of employment and reduced income for many has resulted in impacts across all lenders. Volume is down within home collected credit. Provident Financial Group (PFG) reported in June:

"Lending to new customers was paused following the Government lockdown. New customer lending in Home Credit UK restarted in mid-May with a cautious approach including tighter credit decisioning and an adapted model for Covid-19."[12]

On 30 March 2020, Caversham Finance Limited trading as BrightHouse, was placed into administration. The High Cost Short Term Credit (HCSTC) market appears to be facing a steady decline with the removal of its three main players[13] from the market within the past two years via administration or voluntary liquidation. The remaining payday lenders are reportedly not seeing the same conversions of applications to loans.

The reasons why people are not needing to, or are not able to borrow money in the short-term are obvious – lack of opportunity to consume; support for income through unprecedented Government intervention; and concern for the future which discourages spending. Generally, it should be regarded as a positive development for households that have less need to borrow money. But these are exceptional circumstances and given that Government support schemes will be withdrawn in the coming months and there is severe economic downturn coming, it is reasonable to assume that in the near future, the demand for credit is likely to rise very significantly.

In this context, the welcome declines in high cost commercial credit markets should be seen as an opportunity for affordable credit providers to be visible, ready and able to offer fair, affordable credit to many of the people who are likely to require this type of support in the coming years.

However, if affordable credit providers are to offer this support then they themselves need to be resilient through the current stage of the crisis. Measures to support affordable credit providers facing the contractions in their loan books and the imminent loss of income have been put in place by UK and devolved governments. Fair4All Finance received additional funds (restricted to England only) and launched a Covid-19 Resilience (grant) Fund which, within two weeks, had issued over £3million in grants to social lenders. The Scottish Government and Welsh Assembly announced similar resilience grants for third sector organisations. In Scotland a specific Credit Union Loan Fund of subordinated debt at 0% interest with no administration fees, and a 61-month repayment term was announced and almost immediately, oversubscribed.

The need for credit is unlikely to subside in the longer term, people will need and want to borrow for holidays, special events, white goods and to meet their consumption needs. To prepare the affordable credit sector for this, so that it is ready and able to meet the needs of low and lower-income households requires honest appraisal and strategic thought now on the changes that might be required.

11 Centre for Economic Policy Research DP14733 *Consumption in the time of Covid-19: Evidence from UK transaction data* CEPR; online May 2020 https://cepr.org/active/publications/discussion_papers/dp.php?dpno=14733 [accessed June 2020]

12 Provident Financial Group *Trading Statement* Provident Financial Group; online May 27 2020 https://www.providentfinancial.com/media/newsroom/2020/trading-statement/ [accessed June 2020]

13 Wonga (August 2018), Quick Quid (October 2019) and Money Shop (October 2019)

4. Data, method and survey characteristics

Carnegie UK Trust and Community Finance Solutions at the University of Salford conducted an online survey of 63 credit unions and CDFIs in England, Scotland and Wales about the impact of Covid-19 on demand, lending volume, income, liquidity, viability and confidence. Data was gathered in a two-week period to 27th May 2020. Follow up interviews were held with 25 affordable credit providers. The table below details some characteristics of the sample, and compares the credit union sample with characteristics for all credit unions using the most recent Bank of England data.

Table 1: Characteristics of survey sample

	CDFI	Credit Union	Bank of England data on credit unions	% coverage (Credit Unions only)
FTE staff (Number)	169	535	1,732	30.9%
Outstanding loan portfolio (£)	£19.9m	£474m	£1,011m	46.9%
Active borrowers (Number)	34,304	173,515	394,769	44.0%
Savings balance (£)	£0.350m	£733m	£1,482m	49.5%
Branches (Number)	28	102	-	-
Number providers	5	58	282	20.6%

The credit union sample makes up just over 20% of the sector but accounts for between 45-50% of the lending activity. In terms of the CDFI sector, there is no equivalent sector data but based on previous research[14] we estimate that the research covers over 90% of the personal lenders within the sector.

We use average loan size as a proxy for the level of financial exclusion of the customer base and assume that those with average loans of £1,000 or below predominantly serve low-income consumers. Loan size is a commonly used proxy for understanding the customer profile in the microfinance literature, and sums of less than £1,000 are not issued by banks for personal loans. A sum of less than £1,000 over a short term, typically 52 weeks or less, is most often used by those with median net incomes in the bottom third of incomes. It is a proxy used in Fair4All Finance decision-making to identify those lenders that are more concentrated on lending to low income households.

We present and analyse the data for credit unions (credit unions only) and the full sample (all lenders). Credit unions differ from CDFIs in that they take deposits and serve a more diverse customer base, including more affluent households. (All the CDFIs are in the smallest average loan size bracket.)

We also conducted follow-up telephone interviews with 25 providers – 4 CDFIs and 21 credit unions. Compared to the overall sample, there is an overrepresentation of CDFIs and English providers among the interviewees. None of the 14 smallest credit unions with less than £1m in loan portfolio were interviewed. The interviews focused on the impact of Covid-19 on the viability and liquidity of the provider.

14 Dayson, K., Vik, P. and Curtis, J. *Scaling up of the UK personal lending CDFI sector: From £20m to £200m in lending by 2027.* Community Finance Solutions, University of Salford, produced for Carnegie UK Trust; online 2020 https://www.carnegieuktrust.org.uk/publications/scaling-up-the-uk-personal-lending-cdfi-sector-from-20m-to-200m-in-lending-by-2027/ [accessed June 2020]

4.1 Cohort characteristics

We grouped the sample into three cohorts based on the average loan amount. In absence of detailed data on borrower characteristics, we assume that those providing smaller loans target more disadvantaged customers than those making larger loans.

The Office for National Statistics (ONS) tables were used to ascertain the equivalised gross income and equivalised disposable incomes of the bottom four income deciles in 2018/2019 to relate the sums to income levels. These were:

Table 2: ONS Household Disposable Income and Inequality UK – Reference tables 2018/19

	Bottom decile	2nd bottom	3rd bottom	4th bottom
Equivalised Gross Income	£11,317	£18,227	£22,783	£27,308
Equivalise Disposable Income	£9,888	£16,342	£20,100	£23,375

The groups differ in some important respects (see table below).

Table 3: Cohort characteristics

		≤ £1,000	£1,001-1,999	≥ £2,000
Sample size	All Lenders	20		
	Credit Unions only	15	22	19
Size (Mean average)				
Age of provider (Number, years)	All Lenders	23		
	Credit Unions only	22	26	27
FTE staff (Number)	All Lenders	14		
	Credit Unions only	8	10	11
Outstanding Loan Portfolio (OLP) (£)	All Lenders	£2,528,122		
	Credit Unions only	£2,043,125	£4,354,633	£19,273,190
Borrowers (Number)	All Lenders	3,830		
	Credit Unions only	2,820	3,294	4,937
Savings book (£)	All Lenders	£2,998,620		
	Credit Unions only	£3,175,195	£6,866,810	£28,043,099
Branches (Number)	All Lenders	3		
	Credit Unions only	2	2	1
Loan size (£)	All Lenders	£682		
	Credit Unions only	£706	£1,393	£3,645
Term (Number, months)	All Lenders	16		
	Credit Unions only	18	22	35

The providers of loans of £1,000 and less and up to £2,000 are not surprisingly significantly smaller in terms of outstanding portfolio compared with those providing loans of £2,000 and above. The providers of the smallest amounts on average have more branches and staff reflecting the resource intensive nature of working with and preferences of low-income consumers as well as the legacy structure of many of these providers.

This does not apply if we only look at the credit unions in this subsample. Credit unions providing the smallest loans have the same number of branches but fewer employees than those providing larger amounts. The credit unions in the smallest loan bracket are on average smaller than the average for the subsample with £500,000 less in loan portfolio and 1,000 fewer borrowers.

4.2 Cohort Loan demand, value and volume

We first turn to the demand for loans. Table 4 shows the number of applications and year-on-year growth in loan applications for February-April 2019 and 2020.

Table 4: Cohort applications and growth rates

		≤ £1,000	£1,001-£1,999	≥ £2,000
# applications				
Feb ’19	**All Lenders**	15,411		
	Credit Unions only	4,458	4,143	6,288
Mar ’19	**All Lenders**	17,801		
	Credit Unions only	5,211	4,673	6,516
Apr ’19	**All Lenders**	17,339		
	Credit Unions only	5,116	5,366	7,007
Feb ’20	**All Lenders**	18,128		
	Credit Unions only	5,230	4,352	5,841
Mar ’20	**All Lenders**	18,701		
	Credit Unions only	6,085	4,086	5,332
Apr ’20	**All Lenders**	13,296		
	Credit Unions only	4,256	3,003	2,375
				YOY growth (%)
Feb ’20	**All Lenders**	18%		
	Credit Unions only	17%	5%	-7%
Mar ’20	**All Lenders**	5%		
	Credit Unions only	17%	-13%	-18%
Apr ’20	**All Lenders**	-23%		
	Credit Unions only	-17%	-44%	-66%

There are three salient observations we can make about the loan applications:

- **Those providing the smallest loans have a much greater number of applications compared with those lending larger amounts**. This is largely caused by the five CDFIs in the sample which all lend small amounts and receive a greater number of applications.
- **Providers in all three loan amount categories experience a significant year-on-year decline in applications in April 2020**. This is most likely a direct result of the lockdown and social distancing measures introduced from the 23rd March 2020. These led to a drop in consumption as flights were grounded, shops, pubs and restaurants were closed, universal credit claims rose, furlough and associated uncertainty began, and earnings (for many) dropped.
- **The fall in applications is higher among those making larger loans reflecting that better-off customers have more options** including greater access to zero interest overdraft facilities and a greater ability to draw on existing savings, reducing the need to borrow from a credit union. Conversely, low-income consumers have fewer alternatives as they often have basic bank accounts, without an overdraft facility, and a greater proportion of low income households lack a savings buffer to draw on.

Table 5 shows the number and value of loans disbursed and year-on-year growth rates for February-April 2019 and 2020.

Table 5: Cohort loan volume and values and growth rates

		≤ £1,000	£1,001-£1,999	≥ £2,000
# loans				
Feb '19	**All Lenders**	5,897		
	Credit Unions only	3,961	3,874	4,401
Mar '19	**All Lenders**	7,046		
	Credit Unions only	4,682	4,414	4,669
Apr '19	**All Lenders**	6,971		
	Credit Unions only	4,642	6,038	4,995
Feb '20	**All Lenders**	5,854		
	Credit Unions only	4,424	4,075	3,866
Mar '20	**All Lenders**	6,524		
	Credit Unions only	5,233	4,440	3,763
Apr '20	**All Lenders**	3,950		
	Credit Unions only	3,371	2,865	1,662
YOY growth (%)				
Feb '20	**All Lenders**	-1%		
	Credit Unions only	12%	5%	-12%
Mar '20	**All Lenders**	-7%		
	Credit Unions only	12%	1%	-19%
Apr '20	**All Lenders**	-43%		
	Credit Unions only	-27%	-53%	-67%
Value loans (£)				
Feb '19	**All Lenders**	£3,113,554		
	Credit Unions only	£1,962,992	£4,453,901	£12,187,961
Mar '19	**All Lenders**	£3,764,178		
	Credit Unions only	£2,250,375	£5,130,866	£12,868,607
Apr '19	**All Lenders**	£3,766,423		
	Credit Unions only	£2,339,785	£6,146,633	£13,283,923
Feb '20	**All Lenders**	£2,665,362		
	Credit Unions only	£1,792,452	£4,374,501	£11,582,995
Mar '20	**All Lenders**	£3,066,325		
	Credit Unions only	£2,172,716	£4,060,582	£9,800,811
Apr '20	**All Lenders**	£1,505,574		
	Credit Unions only	£1,123,780	£2,073,568	£3,456,728
YOY growth (%)				
Feb '20	**All Lenders**	-14%		
	Credit Unions only	-9%	-2%	-5%
March '20	**All Lenders**	-19%		
	Credit Unions only	-3%	-21%	-24%
Apr '20	**All Lenders**	-60%		
	Credit Unions only	-52%	-66%	-74%

The data suggest that providers of larger loans experience greater declines in lending:

- **The providers with average loans of £1,000 or less make a greater number of loans but of a smaller value** compared with those with average loans of £2,000 or more.

- **Providers across all categories reported significant declines in the number and, especially, the value, of loans disbursed**. The decline in lending is steeper for providers offering larger loans. As suggested above, better off consumers may use cheaper forms of finance (i.e. interest free overdraft facilities reportedly available at the time of writing to c.27m current account holders) and draw on their savings rather than resort to credit union loans.

- Disproportionately, for many higher income employees, working from home (and the majority of home working is within higher than average income households) and for a proportion of employees on furlough, there has been a net gain as costs such as those associated with commuting have been reduced, and spending has reduced on a range of items leading to many households paying down debt. The Resolution Foundation reported that "*38% of adults in top income quintile have experienced no income hit alongside a reduction in spending – strengthening household budgets – compared to 12% in bottom quintile*".[15]

- As we will discuss below, the fact that the value of loans declines more than the number of loans issued suggests that providers are making smaller loans – possibly to support some of their lower income customers bridge temporary falls in income caused by Covid-19.

The table below compares the average loan sizes for February-April 2019 and 2020 (calculated by dividing the value of loans by the number of loans).

Table 6: Cohort average loan value and growth rates

		≤ £1,000	£1,001-£1,999	≥ £2,000
Average loan size (£)				
Feb '19	**All Lenders** **Credit Unions only**	£528 £496	£1,150	£2,769
Mar '19	**All Lenders** **Credit Unions only**	£534 £481	£1,162	£2,756
Apr '19	**All Lenders** **Credit Unions only**	£540 £504	£1,018	£2,659
Feb '20	**All Lenders** **Credit Unions only**	£455 £405	£1,073	£2,996
Mar '20	**All Lenders** **Credit Unions only**	£470 £415	£915	£2,605
Apr '20	**All Lenders** **Credit Unions only**	£381 £333	£724	£2,080
YOY growth (%)				
Feb '20	**All Lenders** **Credit Unions only**	-14% -18%	-7%	8%
Mar '20	**All Lenders** **Credit Unions only**	-12% -14%	-21%	-6%
Apr '20	**All Lenders** **Credit Unions only**	-34% -30%	-29%	-22%

15 M Brewer & L Gardiner, *Return to spender: Findings on family incomes and spending from the Resolution Foundation's coronavirus survey*, Resolution Foundation; online June 2020 https://www.resolutionfoundation.org/publications/return-to-spender/ [accessed June 2020]

Average loan amounts fell considerably following the introduction of lockdown, especially for providers of smaller loans:

- **There are year-on-year declines in loan amounts for providers in all three amount brackets** with one exception: the average loan size for providers of loans at or above £2,000 increased from February 2019 to February 2020.

- **The steepest decline in loan amounts was from April 2019 to April 2020 when lenders experienced declines between 22% and 34%**. This may suggest that providers were making smaller loans to their customers to help them bridge temporary gaps between income and expenses. We find support for this among the interviews.

We have used the data reported on number of applications and loans to calculate conversion rates – the percentage of applications that lead to a loan (see table below).

Table 7: Cohort application to loan conversion rates

Conversion rate (%)	≤ £1,000	£1,001-£1,999	≥ £2,000
Feb ‘19	34%	59%	70%
Mar ‘19	36%	62%	72%
Apr ‘19	36%	60%	71%
Feb ‘20	29%	57%	66%
Mar ‘20	31%	60%	71%
Apr ‘20	27%	52%	70%
N	**17**	**16**	16

Providers of smaller loans have much lower conversion rates than organisations providing larger loans:

- **The conversion rate is significantly lower for providers of loans of £1,000 and below**, especially compared to providers of loans of £2,000 or greater.

- **This lower conversion is exclusively driven by the five CDFIs in this group** as these have a conversion rate of less than 20% on average. If we exclude CDFIs from this group, the conversion rate increases to above 70% for the period. (See below for discussion of this difference)

- **The conversion rates do not fall for the higher value (>£2,000) loan bracket**. From April 2019 to April 2020, the conversion rate fell by 9-10 percentage points for providers in the two lower loan brackets.

CDFIs

Five of the sixty three respondents were leading personal lending Community Development Finance Institutions (CDFIs). They share some characteristics with Credit Unions. They are asset locked social enterprises regulated by the FCA. They differ in that they cannot hold customer deposits, relying on social investment for loan capital, and they are unrestricted on loan price and not limited to a common bond. In practice, the sector is small, with around £25m lent annually, and has been focussed in geographical locations: Central Scotland, North East, and North West England, the West Midlands, South Wales and London.

The CDFI client group are predominantly low-income consumers, unable to access mainstream credit, invariably young women with dependent children, living in rented accommodation, wholly or partly reliant on benefits. Typically loan values are small. In our survey responses their average loan sizes were around £600 ranking three of the five CDFIs in the lowest six average loan sizes. They invariably offer only short term (sub 52 week) loans, again, our survey had CDFIs in the first 4 places (again, of 63) for the lender with the shortest average loan term.

As CDFIs have extended their range nationally, increasingly online, they receive proportionately more applications, often more speculative ones. CDFIs ranked three of the top five slots for applications received in April 2019, and still had three of the top five in April 2020. Their conversion rates are, however, significantly lower.

In April 2019 Credit Unions in the cohort of "*average loans under £1,000*" (where all five CDFIs were located), were converting 77% of applications to loans, (3,941 of 5,116 applications). A year later this conversation rate had dropped to 71% (3,037 of 4,256 applications). CDFIs loan conversions in comparison had been 19% in April 2019 (2,329 of 12,231), and only 6% in April 2020 (579 of 9,040 applications). Just as the overall drop in loans across the board that we reported is alarming, this conversion rate (before arrears) is a cause for concern.

4.3 Cohort Loan Income

The table below shows the amount the providers usually obtain through the Eligible Loan Deduction Scheme[16] operated by the DWP, which was paused in April 2020, and the amount of year-on-year growth in loan interest and fee income for February-April 2019 and 2020.

Table 8: Cohort ELDS and overall loan income and growth rates

		≤ £1,000	£1,001-1,999	≥ £2,000
ELDS (£)				
Average per month	**All Lenders**	£1,293		
	Credit Unions only	£590	£827	£63
Total per month	**All Lenders**	£25,850		
	Credit Unions only	£8,850	£10,150	£1,192
Loan income (£)				
Feb '19	**All Lenders**	£1,260,738		
	Credit Unions only	£523,830	£1,075,958	£2,692,124
Mar '19	**All Lenders**	£1,335,163		
	Credit Unions only	£522,003	£1,109,656	£2,842,512
Apr '19	**All Lenders**	£1,325,227		
	Credit Unions only	£574,135	£1,258,979	£2,545,356
Feb '20	**All Lenders**	£1,389,670		
	Credit Unions only	£576,510	£1,188,227	£2,772,051
Mar '20	**All Lenders**	£1,357,514		
	Credit Unions only	£639,773	£1,336,575	£2,945,443
Apr '20	**All Lenders**	£1,179,126		
	Credit Unions only	£558,854	£1,266,709	£2,500,136
YOY growth (%)				
Feb '20	**All Lenders**	10%		
	Credit Unions only	10%	10%	3%
Mar '20	**All Lenders**	2%		
	Credit Unions only	23%	20%	4%
Apr '20	**All Lenders**	-11%		
	Credit Unions only	-3%	1%	-2%

16 The ELDS is a route by which lenders that are affiliated to the scheme can seek to recoup loans that have defaulted from borrowers via a small repayment from benefits. The restrictions on the scheme means that ELDS considers priority debts (Rent, council tax, utility etc) ahead of non-priority debts and a maximum of 3 creditors and a maximum percentage of the benefit is allowable as deduction. In reality, defaulters' non-priority debts often move on and off ELDS as either the number of priority creditors or thresholds are reached. It still represents a significant recovery route for certain lenders and the continued loss of ELDS will have impacts on provisioning, default and loan decisions.

The data suggests that the income of CDFIs has been more adversely affected by the Covid-19 crisis compared with credit unions:

- **Providers offering smaller amounts claim a larger share of ELDS payments** on average and in gross terms compared with those lending larger amounts. On average, providers of loans of below £2,000 lose between £600-£800 on the temporary stop to ELDS compared with just £60 for providers of loans of £2,000 or greater. When we include CDFIs, those lending the smallest amounts lose £1,200 on average per month, indicating that CDFIs to a greater degree lend to benefit-dependent customers.

- **The interest income of the credit union sector is, so far, holding up regardless of average loan amount** with growth rates ranging from -3 to +1%. It will take time for the fall in loan volume to translate into lower interest income. However, when including CDFIs, those lending the smallest amounts experience a significantly greater drop in income (-11% compared with -3%). This is partly because the CDFIs lost more on the pausing of ELDS. Because they offer shorter-term loans, falls in volume of loans will more quickly translate into income losses. It is also possible that these providers have experienced greater arrears because they serve a financially more vulnerable customer group.

- **A prolonged ELDS pause will impact loan decisions.** If affordable credit providers believe a backstop (reclaiming loans via benefit) is likely to be an unavailable option for some time, they may further tighten loan criteria.

4.4 Cohort Short-term effects of Covid-19

We asked providers about short-term effects on customer savings, loan payment holiday requests, the actions they had taken in response to the virus and support they had received (see table below). Trends in savings and payment holiday requests are important because they are indicative of the financial health of customers and affect the financial viability of providers.

Table 9: Cohort customer savings, payment holidays and other actions

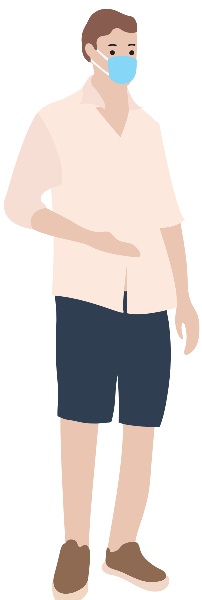
		≤ £1,000	£1,001-1,999	≥ £2,000
Customer savings				
Decreased		0%	0%	0%
No change		33%	18%	11%
Increased		67%	82%	79%
NA		0%	0%	11%
Concerned (yes)		29%	36%	32%
Payment holiday requests				
Decreased	**All Lenders**	5%		
	Credit Unions only	0%	0%	0%
No change	**All Lenders**	5%		
	Credit Unions only	7%	5%	5%
Increased	**All Lenders**	85%		
	Credit Unions only	87%	95%	84%
NA	**All Lenders**	5%		
	Credit Unions only	7%	0%	11%
Concerned (yes)	**All Lenders**	58%		
	Credit Unions only	43%	67%	71%
Actions				
Furlough	**All Lenders**	60%		
	Credit Unions only	47%	73%	37%
Temporary closure of branches	**All Lenders**	80%		
	Credit Unions only	73%	55%	32%
New product	**All Lenders**	40%		
	Credit Unions only	40%	41%	5%
Tighten lending criteria	**All Lenders**	20%		
	Credit Unions only	7%	50%	16%
Received support	**All Lenders**	80%		
	Credit Unions only	73%	82%	26%

Providers of smaller average loans appear to have been more affected by Covid-19 than those providing larger loans:

- **More than two-thirds of credit unions report that customer savings are increasing** across all categories. A greater percentage of providers of loans of £1,001-£1,999 and £2,000 or more report a greater increase in savings (82% and 79%) compared with providers of the smallest average loans (67%). This may be because these customers have lower incomes and are less able to save.

- **More than 80% of providers across all categories report an increase in payment holidays**. In the follow-up interviews and in comments in the survey, many providers reported that they previously received few, if any, requests prior to Covid-19. Providers in the smallest average loan bracket were less concerned, possibly because they have greater experience of managing such requests.

- **A considerably smaller proportion of providers of loans of £2,000 or above have taken action by furloughing staff, temporary closing branches or introducing new products.** Organisations lending larger amounts have fewer branches to close and associated staff to furlough, and potentially greater reserves to see them through the crisis. The interviews and data on confidence, discussed below, suggest that these providers have stronger financial positions to weather the crisis. Only a quarter of providers of the largest average loans have received support compared with 73-80% of the providers of smaller average loans. This may suggest that providers of larger loans have been less likely to apply for and receive support because of their stronger financial position and greater perceived ability to weather the immediate crisis.



4.5 Cohort Viability and sustainability

Our data evidences increases in payment holiday requests, falls in loan volume and demand, and increases in customer savings. If this continues, it could affect the viability and sustainability of providers. The table below displays the proportion of providers that reported they will be unable to meet short-term costs without additional support, that are forecasting breaching regulatory ratios or loan covenants as well as their level of confidence that they will still be trading this time next year.

Table 10: Cohort potential breaches and confidence

		≤ £1,000	£1,001-£1,999	≥ £2,000
Breach				
Yes	**All Lenders**	20%		
	Credit Unions only	30%	14%	10%
No	**All Lenders**	80%		
	Credit Unions only	65%	86%	90%
NA	**All Lenders**	0%		
	Credit Unions only	5%	0%	0%
Short-term costs				
Yes	**All Lenders**	47%		
	Credit Unions only	55%	62%	74%
No	**All Lenders**	27%		
	Credit Unions only	25%	29%	0%
Don't know	**All Lenders**	27%		
	Credit Unions only	20%	10%	26%
Confidence				
Very confident	**All Lenders**	45%		
	Credit Unions only	60%	59%	53%
Fairly confident	**All Lenders**	35%		
	Credit Unions only	20%	36%	37%
Not very confident	**All Lenders**	5%		
	Credit Unions only	0%	5%	5%
Not at all confident	**All Lenders**	5%		
	Credit Unions only	7%	0%	2%
Don't know	**All Lenders**	10%		
	Credit Unions only	13%	0%	5%

The survey data suggest the providers of the smallest amounts are worse affected by the crisis judging by compliance with regulatory ratios, liquidity and confidence:

- **Lenders making the smallest loans are more likely to report problems with liquidity**. 45%-54% of the providers of loans of £1,000 or less say they will be unable to or do not know if they will be able to meet short-term costs. This compares with 39% for providers of loans of £1,001-£1,999 and a quarter of the providers of loans of £2,000 and above.

- **Providers in the smallest average loan bracket are more likely to forecast a breach of regulatory ratios or covenants in loan agreements**. 30% of these providers forecast breaching such ratios or covenants in the next 6 months compared with 14% for the £1,001-£1,999 brackets and 10% of those offering loans of £2,000 or more. This is less pronounced for the credit unions in the smallest loan bracket, 20% of which forecast breaching ratios or covenants.

- **Confidence levels are high, but credit unions and CDFIs offering the smallest loans are less confident about their long-term sustainability**. 80% are very or fairly confident compared with 95% (£1,001-£1,999) and 90% (≥ £2,000).

5 Conclusion and next steps

The results of the joint survey of Carnegie UK Trust and the Community Finance Solutions at the University of Salford show that there were already significant effects of Covid-19 on the credit union and CDFI sector barely two months into lockdown measures. Across all lenders we reported:

- A dramatic fall in lending of 70% year-on-year, across all types of providers which represents a considerable loss of future income;
- 56% of all lenders interviewed have furloughed staff and temporarily closed branches;
- More than 8 in 10 providers report increases in payment holiday requests and a 14% rise in customer deposits (putting downward pressure on capital asset ratios);
- 65% of all lenders interviewed reported they could meet short term costs, just over half reported they were very confident that they would be trading this time next year.

Drilling deeper in this report, we see that those providing the smaller average loan amounts seem to have been most adversely affected by Covid-19, including higher likelihood of furloughing staff, closing branches and of using government support schemes. They are also less confident and more likely to forecast breaches of regulatory ratios or covenants and inability to meet short-term costs. CDFIs have been particularly badly affected, as they also report greater drops in income.

It is too early to tell if providers serving low-income consumers will be worse affected by Covid-19 than other providers for a number of reasons.

Firstly, we have yet to see the full and lasting effects of Covid-19 on the economy. These have been cushioned by the various Government support mechanisms, notably the furlough scheme. It will also depend on the duration and nature of social distancing measures and future outbreaks as well as government policies to deal with the economic fallout.

Secondly, given the uncertainty concerning the economic impact and recovery, we do not know which market segments will be worst affected and which will recover. The evidence to date point to a slow recovery. Despite the easing of restrictions, the UK economy only grew by 1.8% in May, well short of the 5% recovery expected by many economists.[17]

Thirdly, we do not yet know the effects of the support schemes recently put in place by UK and devolved governments.

However, there are indications that providers of smaller loans may be worse affected. The FCA interventions which include loan and mortgage payment breaks alongside the £500 interest free overdraft arrangements are potentially (unintentionally) having an impact on those lenders that issue smaller average sized loans. The banks are able to extend, in some circumstances, their offer of interest free overdrafts for a further three-month period. Borrowers can request this, or an extension to their existing arrangement if they already have it, up to 31st October 2020. This means interest free overdrafts will potentially be available to borrowers in the period up to Christmas 2020, traditionally an important revenue driver for CDFIs and those credit unions that lend to lower income households.

In reality, the combination of interest free overdrafts, growing numbers of UC claimants and ongoing uncertainty around income and individual financial resilience will mean loans issued by lenders will be highly unlikely to reach 2019 levels, with a corresponding erosion of loan income which, in turn, will challenge operational sustainability.

To be clear, it is a positive development that some people are now able to access interest free credit should they need it through routes that had previously not been available to them. The concern

17 BBC News *UK economy rebounds more slowly than expected* BBC News; online July 14 2020 https://www.bbc.co.uk/news/business-53400721 [accessed July 2020]

is, if and when these offers are withdrawn, whether the affordable credit sector can be there to meet the credit needs of those again excluded from mainstream provision.

The recovery of consumption may be slower as people face uncertainty, or balance the benefit of avoiding spending in anticipation of a second wave of Covid-19. It is possible that lifestyles may alter for some, now seeing the benefits of (enforced) reduced consumption. It is also possible that some of the FCA measures may remain. It is impossible to know how long the £500 interest free overdraft may remain, for example.

The certainty of recession, if it follows previous recessions will see those who can, save more. In previous recessions the tightening of credit among mainstream lenders led to opportunities for non-mainstream ones. The CEO of Non-Standard Finance said on June 25th 2020 that:

> *"As the recession begins to bite, it is expected that more of the UK population will be unable to borrow from either their clearing bank or other mainstream lenders. Previous recessions have taught us that prime lenders are likely to become increasingly risk averse and tighten their lending criteria, leaving a large and expanding pool of higher quality applicants who require access to regulated and responsible credit markets. The Board believes this could represent an exceptional market opportunity"*[18]

The Resolution Foundation "*Return to Spender*" report highlights the more severe impact on lower income households with "*respondents on lower incomes more likely to say their ability to manage financially has worsened" with 36% of lower income quintile compared to 24% of highest income quintile saying it has worsened a lot or a little, and 54% of lower income quintile compared to 44% of higher income quintile saying they are a little or much more concerned about their family finances.*[19]

18 nsfgroup *Non-Standard Finance plc Audited full year results to 31 December 2019 nsfgroup*; online June 25 2020 https://www.nsfgroupplc.com/~/media/Files/N/Non-Standard-Finance-V3/reports-and-presentations/2019-full-year-results.pdf [accessed June 2020]

It is likely (and sensible) that Covid-19 will lead to, and accelerate mergers and consolidation in affordable credit. It is important that this happens in a strategic manner to preserve and prevent the hollowing out of the affordable credit offering to low-income communities.

Affordable credit providers have an important role to play in helping disadvantaged communities of place and interest cope with and rebuild after Covid-19. Given the welcome contraction of commercial high cost credit, households in these areas have few and a decreasing range of alternatives; friends and family is finite, and the danger remains of resorting to illegal online and local community moneylenders.

Therefore, monitoring the continued impact of Covid-19 over the coming months on the affordable credit sector and the providers serving the most vulnerable is of critical importance. Such monitoring would enable government and investors to design and target appropriate support and inform a strategic approach to mergers and consolidation and preserve, perhaps enhance, the membership numbers.

19 M Brewer & L Gardiner *Return to spender: Findings on family incomes and spending from the Resolution Foundation's coronavirus survey* Resolution Foundation; online June 2020 https://www.resolutionfoundation.org/publications/return-to-spender/ [accessed June 2020]

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The Carnegie UK Trust works to improve the lives of people throughout the UK and Ireland, by changing minds through influencing policy, and by changing lives through innovative practice and partnership work. The Carnegie UK Trust was established by Scots-American philanthropist Andrew Carnegie in 1913.

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Community Finance Solutions (CFS) is an award-winning independent research unit specialising in financial and social inclusion, and community asset ownership. Located within the University of Salford, CFS offers independent research and advisory services to social landlords, local authorities, national government, charities and other organisations and agencies. Founded in 1999 by Professor Karl Dayson and Dr Bob Paterson, CFS was established to help empower communities to solve local problems relating to land and financial inclusion. Between them they developed solutions for securing community ownership of land and also models for the provision of loans to low income households who found themselves excluded from mainstream lending. These solutions have gradually extended over time and now CFS remains at the forefront of pioneering social research.

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