# Tackling financial exclusion: the case for a community banking partnership approach

Conaty, P and Dayson, KT

# About the authors

Dr Karl Dayson is the Project Manager of Community Finance Solutions at the University of Salford. Karl's research interests are in financial exclusion, community banking, mutuality, corporate governance, and communities and capital.

Pat Conaty is a Senior Research Associate of the new economics foundation. He has led the development of Factor 4 services which integrate debt advice and third sector lending.'


## Acknowledgements

The authors would like to thank Bob Paterson, Mick Brown, Whitni Thomas, Geoorn Walker, and Jennifer Powell for their comments and contributions to this paper. In addition we would like to express our appreciation to Cliff Rosenthal, Executive Director of the National Federation of Community Development Credit Unions, for his research work into how community finance group structures operate successfully in the USA; Esmée Fairbairn Foundation for supporting the work on the legal structure model for CBP; Karen Bennett of Enterprise Credit Union, Mike Knight of Riverside Credit Union, Rina Clarke of Robert Owen Credit Union; all at Financial Inclusion Newcastle; Maureen Atkin from Yorkshire Moneyline; and all the various credit union and community reinvestment trusts staff and volunteers that have provided inspiration for this work.

Finally, thanks are due to John Spence and Lloyds TSB for their financial and intellectual support.





ISBN: 0 902896 91 1

# Foreword

The incidence and effects of financial exclusion have been well researched. A surprising number of people are known to be without access to financial services and experience all the associated disadvantages.

Overcoming social and financial exclusion is high on the present Government's agenda. We at LloydsTSB share this objective and support the Government in 'looking for a new commitment from all involved to achieve a step-change in the three priority areas of access to banking, access to affordable credit and access to money advice' .

This is a timely report setting out the background and goals of the Community Banking Partnership.

This emphasises the benefits of the partnership approach to achieve the 'joining up' necessary to tackle financial exclusion in robust ways that can be replicated and scaled up nationally.

At the moment, there are pilot projects rather than widely operating partnerships. Experience to date suggests that partnerships between Credit Unions, Community Development Finance Institutions, advice and support agencies and financial institutions can play an important part in promoting financial inclusion. I commend this report to all organisations with a stake in the community finance sector and encourage them to move their initiatives forward, so that larger numbers of people can be assisted.

John Spence

Lloyds TSB

August 2005

[1] Promoting Financial Inclusion December 2004 HM Treasury

# Executive Summary

Over one in four households has little connection to mainstream financial services. These households are also the poorest in the country and pay disproportionately high costs to settle a bill, cash a cheque or borrow a small sum to meet everyday needs. To address these issues, the Government has established a Financial Inclusion Task Force and a Financial Inclusion Fund.

The goal is to encourage partnerships that can practically deliver services in the areas of the country with the highest levels of financial exclusion. The Government's policy can be summarised as:

- Advice – solving money and debt problems at no cost to the household
- Banking services – increasing the take up of basic bank accounts and other similar services like those a credit union could provide
- Credit – providing affordable loans

This report endorses these but also adds 'D' for deposit making. Deposit making, or savings, is important because it creates a ladder to financial inclusion and over time can prevent households and individuals becoming re-excluded.

After reviewing existing financial inclusion initiatives, the report proposes an innovative Community Banking Partnership (CBP) approach with the flexibility and regulatory rigour necessary to bring together through joint venture arrangements: the specialist expertise of a credit union, community development finance institution (CDFI) and advice and support agencies. Our Community Banking Partnership is not a rigid model, rather, it is five aims based on a philosophy of a 'customer first' approach:

1 Access through a service-level agreement(s) to appropriate money and debt advice and support; involving financial literacy training and help with household budgets and paying bills.

2 Accessible affordable credit, based on the assumptions that the competition is doorstep lenders, and that the sustainability of the community finance lender is of paramount importance.

3 Access to mainstream banking services, with basic banking accounts being the start not the end of financial inclusion.

4 Access to a savings vehicle because this is central to any long-term solution to financial exclusion.

5 Efficient and effective delivery of services through the provision of integrated access points for both lenders and advice agencies.

To achieve these aims it is first necessary for partners and contracted service providers to accept that:

a) An understanding of who the client groups are and that their needs are central to any success.

b) Participants need to be willing to consult, mediate, and negotiate.

c) Partners and service providers need to be willing to accept their own limitations, and place working to achieve financial inclusion over and above narrow sectoral interests.

d) That doorstep lenders provide a service that many people find useful, but that the cost of this service detrimentally effects the local economy.

e) Resources will be required for advice support and also long-term technical assistance that cannot be offset by income from interest rates alone.

f) Credit unions and CDFIs are financial institutions, not social services. Therefore, they need to adopt a business model that is operationally sustainable and not unduly dependent upon long-term grant funding.

g) There is a need for benchmarks, common reporting standards, and public disclosure of information.

The report envisages that each CBP would be unique to its locality to reflect the nature of the existing suppliers and relationships. Broadly there are four levels of engagement in a CBP.

| Approach | Features – direct benefits to customers in bold |
|---|---|
| **Group structure** | **Seamless ABCD from a single office** – Very close working relationship between a CDFI and a credit union within a group organisational structure with a shared chief officer. |
| **Service Level Agreement** | **Single office, multiple suppliers but almost integrated services –** Partners remain sovereign but work in tandem to an agreed strategy for the whole community backed up by service level agreements. Many of the staff could work for one or more partners, and a joint charity may be established to finance the support and advice activity. No plans for any overlapping boards or mergers, though some individuals may sit on more than one organisation's board. |
| **Working Protocol** | **Single telephone number, access to diaries to make appointments** – This seeks to identify and develop some economies of scale and improve the customer experience. A working protocol would not include any reference to the merger of back office provision and/or enhancing staff understanding by working in the same location. |
| **Referral** | Refer to others and can describe what other services are available – In areas where existing relationships are not particularly effective and considerable time needs to be spent on building trust, then a memorandum of understanding between sovereign organisations may be the most appropriate solution. There is only limited commitment to seeking economies of scale. |

These levels of engagement offer an evolutionary way to deliver an enhanced customer experience and fulfil the Government's ambition of a fully inclusive society. The most important feature is the nature of the contracts between the parties and specifically the adopted performance targets. If the community banking partnerships are to grow and deepen, it is necessary from the outset that all parties understand what each are to deliver.

The report describes the progress to date – A partnership of nef (the new economics foundation), the National Association of Credit Union Workers (NACUW) and Community Finance Solutions at the University of Salford have completed feasibility studies in Mid-Wales, Portsmouth and Southampton, and are undertaking further studies in Devon, East London, Coventry, North East England, and Merseyside. By winter 2005/6, a national pilot demonstration project should be underway involving initially up to eight CBP pathfinders and with a growing level of investment support from charitable foundations, banks and government bodies.

The goal the National CBP Demonstration Project sets itself is to demonstrate how to tackle financial exclusion and provide affordable financial services to low-income households in a sustainable manner. The five main objectives are to:

1 Develop robust delivery prototypes.

2 Develop a set of common core services that can be used anywhere in the country.

3 Build strong local Community Banking Partnerships to assist in marketing the financial inclusion services.

4 Support the progressive transition of the Community Banking Partnership pathfinders to sustainable sources of financing and long-term, operational sustainability.

5 Build upon the best practices that evolve both from the CBP pathfinders and other similar innovators in this.

Over a three-year period the National Demonstration Project will have three main areas of activity:

a) Strengthen the organisational capacity of delivery partners to provide services on a larger scale and to achieve operational sustainability through capacity building, technical support and product development.

b) Mobilise local, regional and national resources to support the pathfinder organisations.

c) Refine and adapt the delivery mechanism based on an experiential learning approach appraisal. This includes the reflections of the partners, together with the economic performance and social impact of the Pathfinders.

The report concludes that if implemented, the CBP will lead to stronger community-based credit union and CDFI growth in England and Wales. This will increase access to affordable financial services by poorer households and provide a robust methodology for minimising the social injustices linked with financial exclusion. Conservative projections show an aggregate direct and measurable financial benefit to low-income households within five years of almost £700,000 in each Community Banking Partnership area. This additional income will not only directly increase disposable income of Britain's poorest households; it also means that there is more cash to spend in local shops and businesses. Tackling financial exclusion in this way is socially desirable, but equally it's good for the British economy.

# Background and rationale

The financially excluded are defined as those households unable to access conventional, low-cost financial services that most British consumers take for granted. According to government findings, almost six million UK households (over one in four) fall into this category of disadvantage. Eleven per cent of British households have no current account and six per cent have no bank or building society account of any kind (DWP 2004). Twenty eight per cent of households have no savings to deal with a 'rainy day' problem.

In its latest report on this issue, the National Consumer Council identifies a number of the excess costs, due to financial exclusion, as follows:

(i) An extra £70 a year to pay utility bills due to a lack of direct debit facilities with a bank;

(ii) Fees to cash a cheque of at least a £2 service charge plus 7 per cent commission;

(iii) Doorstep credit company rates for small loans often in excess of 300 per cent APR (NCC 2004).

The most severely affected are the poorest households, especially those with uneven expenditure patterns, such as young families and lone parents. In its Policy Action Team 14 report on reducing financial exclusion, the Treasury recommended a range of interventions by different organisations (H.M. Treasury 1999). A number of these recommendations such as the 'basic bank account' and wider access to household insurance through group policies from registered social landlords have been put into place. Other measures like the Child Trust Fund have been introduced nationally from April 2005.

However, despite best intentions from government, financial exclusion still persists, particularly as regards personal financial services. Over three million households regularly use high-cost moneylenders and other predatory finance providers whose loan rates range from 65 per cent APR for secured pawnbroker loans to over 1500 per cent APR for the most expensive and legal doorstep lenders (Palmer and Conaty 2002).

In such an environment it is unsurprising that over-indebtedness is rising year on year in Britain according to Citizens Advice casework findings (CAB 2003).

One reason for the persistence of financial exclusion is that the diverse initiatives to tackle it normally only address one element of the problem; predominantly these being access to a bank account, or access to a start-up loan for a business. There is no initiative yet that joins up the best innovations in the field to provide an integrated range of affordable financial services to poor households (Conaty & Mayo 1997, Brown et al 2003, Paxton & Reagan 2003). This is despite empirical evidence indicating demand for integrated provision (Collard and Kempson – Bristol, 2005). For example, research into financial exclusion and utility bills found that support for access to savings and loans, money advice, energy efficiency advice, and bill payment services, was greater than for bill payment service alone (Collard 2002).

Until 2004, the Government adopted a twin-track approach of supporting credit unions and promoting basic bank accounts. Although legislative changes have been introduced to assist credit unions, finance for institutional development has been less forthcoming. Meanwhile though the banks have developed and supply 'basic' accounts, the option of the Post Office Card Account (POCA) has proved attractive for over 5 million benefit claimants and pensioners, suggesting that either the product, marketing or indeed the providers, of basic bank accounts are yet to appeal to the targeted market.

# Types of Community Financial Initiatives Operating Britain

## Credit Unions[2]

Nationally, the majority of credit unions are community-based credit unions. In most cases because of their small size and lack of paid staff, they simply do not currently have the capacity to provide a viable and attractive alternative to the poor. Thus of the almost 500 community-based credit unions, the Association of British Credit Unions (ABCUL) has reported that over half are either not growing at all or are losing members (Brown et al. 2003).

Furthermore, the vast majority of community-based credit unions are run entirely by volunteers and as a result can only open for a few hours per week[3]. The scale of challenge is apparent in ABCUL's estimate that a community-based credit union needs to build up a lending portfolio of £1 million to generate a sufficient income level of about £100,000 per year to ensure long-term sustainability free of subsidy (Brown et al. 2003). One solution suggested by Paul Jones of Liverpool John Moore's University (1999) is that appropriate mergers can strategically secure significant growth. Evidence is emerging that this advice is being heeded with a marked rise in the number of mergers in recent years, occurring in tandem with an overall growth in credit union membership and assets (Jones 2005).

Since the debate on financial exclusion arose, credit unions have been seen as the solution (Jones 2002). However, there have been a number of challenges to this orthodoxy both within the credit union movement and by outsiders. Internally, Jones (1999 and 2005) and ABCUL have argued that credit unions cannot fulfil their role unless they become more professional. This usually entails the need to appoint paid staff, have shop front offices, and diversify products and services. There is also an acceptance that without additional capital, whether in the form of seed-corn finance, lending capital, or guarantee funds (Jones 2003 & 2005); credit unions will not be able to tackle financial exclusion.

The transfer to this 'more professional' approach (known by its proponents as New Model credit unions) has not been without its critics, particularly within the movement. An ideological division arose over whether credit unions were community owned and operated organisations and should therefore grow organically, or whether the best way to serve a community would be for a credit union to grow fast and thus with more members be in a stronger position to offer more extensive services to low income households (Fuller & Jonas 1999). However, Dayson (2002) found limited evidence for this neat dichotomy and instead pointed to the similarities in the arguments employed, even if the approaches differed.

Beyond the level of current debates, the extent of the role of credit unions can be questioned on the basis of their status as mutual organisations, which historically have been risk averse. In Britain, the most successful financial mutuals have been the building societies and mutual assurance companies. Common to both is a desire to minimise risk to protect investors' money. This financial model usually means mutuals grow slower than other corporate forms but in return investment is expected to be safer (though this is not always true). To achieve this, building societies predominantly offer mortgage type products and supply very few unsecured lending services. Although in recent years building societies have borrowed from the money markets for on-lending, city investors see even this form of capital injection as relatively conservative (Dayson 2002). Essentially mutuals are custodians of small investors' savings and have historically sought to preserve this income, even in the days before shareholder protection. Consequently building societies at risk are usually rescued by other societies, such as that following the Grays Building Society collapse in 1978.

A similar desire to protect investors' income was also apparent among credit unions, which resulted in strict lending criteria being applied. Most significantly this led to the 13-week rule being introduced by many credit unions (Jones 1999). This lending interpretation meant that all new members had to save for 13 weeks before they could take out a loan.

[2] A credit union is a mutual savings and loan scheme in which the 'members' are drawn from a legally defined area/community called a 'common bond'.

[3] At present only about one in five community-based credit unions employ any paid staff and usually only a part time person.

Another risk minimisation strategy was to limit loans to a specific multiplier of savings (often twice times savings for first loan and thereafter three times savings), while a member could not access existing savings whilst they had a loan. Although these cautious practices were not regulatory or legal requirements, the convention was nonetheless extremely pervasive. As the debate surrounding financial exclusion crystallised, critics highlighted the 13 week rule as an indicator of the failure of credit unions to serve the financially excluded (Dayson et al. 1999). However, criticism does not fully consider the implication of credit unions as mutuals, with a philosophical commitment to provide a safe home for savings.

With the extension of the investors' shareholder protection scheme to credit unions in 2003, it removed the existing informal cultural and trust based relationships between borrowers and lender and replaced this with a depersonalised mechanism. Though this improved the security of savings, it potentially alters, though we do not know in which way, the social contract between credit unions and their members. Regardless of this, credit unions are still mutuals and the extension of instant loan products to new members has been a gradual process (Jones 2003, 2005). Furthermore, credit unions have understandably wanted to ensure arrears and defaults on loans do not affect the financial stability of the business. Therefore, if credit unions are to offer loans to new members unencumbered by any savings they will have to find ways to enhance their repayment procedures and/or offset the risk. Both of these arguments contributed to the shift to more professional service, understandably, and enthusiastically, supported by ABCUL.

Initially the use of guarantee funds was seen as a suitable mechanism to offset higher risk lending, but as Jones (2003) demonstrated, this was not always successful, partially due to moral hazard. An alternative strategy was a change to the way money was collected by moving from cash based transfer to repayment by direct debit (a practice already widespread among employee based credit unions). Furthermore, the risk could also be afforded if the interest rate on loans genuinely reflected the likelihood of arrears and default. This shift has been a difficult challenge for the credit union movement, as it would require changing the maximum legal limit of 12.68 percent APR.

The most common argument against changing the interest rate is that all members will have to pay more; based on the philosophical assumption that as all members are equal they should all pay the same interest rate. Connected to this are the arguments that there is no evidence that the financially excluded are bad payers; and why should those most at risk pay more? In effect the latter is a manifestation of the former, as to date we are unaware of any independent British evidence indicating that lending to the financially excluded is more risky than lending to more included communities, rather the costs of delivery are higher. Instead this 'empirical argument' supports a social justice and redistributive moral philosophy. The difficulty for credit unions is that as cooperative and moral businesses they could find themselves torn between the competing pressure of economic prudence and the delivery of social benefit. The current Treasury consultation on the relaxation on interest rates (H.M. Treasury 2005) is where this tension will need to be resolved. Raising the ceiling at least allows for wider flexibility to be practiced and provides more scope to balance the different social and economic objectives.

However, credit union supporters would argue that offering flexible loan packages is only half of the financial inclusion services they provide. Most stress the importance of savings, believing that only through this can genuine financial inclusion be realised. Affordable loans should increase disposable income, but unless the individual begins to save for unexpected expenses rather than take new loans, they will always be at risk of falling back into financial exclusion. The challenge for credit unions is to encourage savings, while not 'punishing' those who chose an alternative way to manage their finances.

In summary, credit unions have been involved in huge shifts in thinking and approach as they respond to the sector's growth patterns and the Government's agenda on financial inclusion. However, it is impossible to argue, as it

was in 1999, that credit unions are still unable to serve poorer neighbourhoods. Whether all credit unions chose this path and how comfortable the journey will be, remain open questions.

## Cambridge New Horizons Savings and Loan Scheme (NHSLS)

The forerunner to non-credit union approaches to financial exclusion was created in Cambridge in 1997. NHSLS was and continues to be a joint venture between Cambridge Housing Society (CHS) and Cambridge Building Society (CBS) aimed at providing affordable credit and competitive savings rates to CHS tenants. NHSLS is not a legally incorporated body rather it acted as an additional function of CHS, with the loan management undertaken by CBS. The scheme operated with CHS placing £25,000 on deposit with CBS. Tenants were then encouraged to save with the building society and the interest rate they received was as if they had invested £25,000 themselves. Meanwhile, they are able to access loans on a similar basis to credit unions, being charged at 12.68 percent APR. Additionally, NHSLS has offered small immediate 'handy loans' of up to £150 for household emergencies. Part of the justification for the project was the perceived difficulty in establishing a viable credit union in Cambridge; this is partially borne out by the modest number of loans made since its inception. However, the significance of NHSLS was its partnership-based approach, and the involvement of a mainstream financial provider and a housing association in addressing financial exclusion. This approach has been further developed by Community Reinvestment Trusts.

## Community Reinvestment Trusts

The changes in credit unions have happened alongside the introduction of what some within the credit union industry see as competitors, Community Reinvestment Trusts (CRTs)[4]. Whether credit union changes are in response to the arrival of a perceived 'threat' or whether it is purely coincidence is not the purpose of this paper. What can be asserted with confidence is that CRTs offered a different way of addressing financial exclusion.

CRTs emerged from University of Salford (Dayson et al 1999) and were a response to the dominance of doorstep lenders within deprived communities. They were based on the premise that, with the withdrawal of formal banking services from many communities, the only way to compete against moneylenders was to offer a similar service but at an affordable cost. Furthermore, it was unrealistic to expect the capital for this process to come from within the very communities that needed the help. Instead a model was proposed, based on Industrial and Provident Society (IPS) legislation and the groundbreaking work of the Aston Reinvestment Trust (ART) and the Industrial and Common Ownership Fund (ICOF), that sought capital from public (UK and European regeneration funds) and private sources (charitable trusts, banks, and housing associations). An IPS for 'community benefit' can also raise a small amount of capital in withdrawable shares from local people, local businesses, and individual ethical investors.

By mid-2005, eight CRT projects were trading (South Coast Money Line, Salford Money Line, East Lancashire Moneyline, Derbyloans, Sandwell Advice and Moneylink, Preston Moneyline, Blackpool Moneyline, and Fair Finance in London). collectively to date, they have lent over £5 million to individuals and business through a range of products – personal loans, business start-up loans, consolidation loans, and home improvement loans.

The key operational features of a CRT are:

(i) Investment is distributed in the form of loans issued on the ability of local people to repay;

(ii) Loans can be for either personal or business enterprise use and repayments schedules are agreed between the client and the lender;

(iii) Except in limited circumstances, loans are collected by direct debit;

(iv) The lending team is not based on volunteers but paid professional staff;

(v) The IPS is mutually owned by shareholders who annually elect the directors on a one-member, one-vote system;

(vi) The loan charges are set at a cost recovery rate, which reflects both the risk involved and the cost of running the business;

(vii) As a not-for-profit institution, the loan charges are not set to achieve a surplus to enable a targeted dividend to shareholders.

[4] CRTs were subsequently classified as a type of Community Development Finance Institution (CDFI) that delivered personal as well as enterprise lending. By contrast, most CDFIs mainly lend to enterprises and for economic production. However, in response to the Treasury's financial inclusion strategy, this dichotomy is likely to dissolve as some CDFIs are considering extending their products to include individual consumption loans.

In respect to (vi), a number of interest rates were tested by the first few CRTs and at present they offer rates between 22-30 per cent APR for consumer and business/enterprise loans.

The most striking success has been East Lancashire Moneyline (*elm*). In its first two years of operation *elm* made 1,800 loans and assisted over 2,000 financially excluded customers. Among *elm* users, 95 per cent were indebted to sub-prime lenders when help was sought, 89 per cent had no savings, and 40 per cent had no bank account. A typical recent case was a young unemployed woman who borrowed £250 from a moneylender at more than 150 per cent to decorate and pay for basic furnishing for her flat. The company made her a further loan at Christmas and then she needed £500 to tide her over to start work until she got her paycheck. *elm* lent her £1,000 to refinance all three loans and rescued the woman from a downward spiral of insolvency.

Despite the attractions of this model, for some the absence of a savings facility has cast doubt on the capacity of CRTs to truly serve the financially excluded. Whereas such a CDFI can be seen as an immediate solution to affordable credit, both for the borrower and policymakers, it is unlikely to result in full inclusion. Thus, in being an alternative to moneylenders with a team of professional lending staff, it can be argued that CRTs perpetuate the same asymmetrical knowledge/power axis. Also critics state that CRTs do not seek to educate clients or offer services that will improve a user's situation over a period of time. Essentially this is a philosophical divide. Credit unions with their reliance on savings and the discipline of saving before borrowing provide a 'pathway' to improved financial health, based on asset accumulation and education, drawing heavily on the concept of thrift and self-help. In contrast CRT developers have been sceptical about the applicability of this model to the poor and raise the question: if users are unable or unwilling to develop a savings habit are they to be denied financial inclusion?

Furthermore, with the mass expansion of consumer lending is there a class hypocrisy lurking in the pro-savings argument: while the financially included middle class are encouraged to borrow billions, the working class are instructed to save in order to be included.

These philosophical arguments are rarely, if ever, discussed by practitioners, and CRTs have addressed the perceived weaknesses by making linkages with other agencies, specifically the high street banks. This connection benefits the CRT user by offering a causeway to the mainstream sector, which can then be accessed for conventional savings products. It also ensures the user has a bank account, meaning that the CRT can collect loan repayments by direct debit. As a result, the user learns how to use a bank account and is expected to ensure there is sufficient income in their account to cover direct debit repayments. East Lancs Moneyline has gone further still by acting as an agent for the HBOS and thus is able to offer a mainstream bank savings account to elm's clients. CRTs believe that this arrangement offers genuine financial inclusion for users and avoids financial ghettoisation in a low-cost alternative. This contrasts with some credit unions that are seeking to offer a range conventional banking services; perceiving themselves as mainstream providers.

Although important to the protagonists, the debate can never be resolved on the basis of philosophical preferences. Financial Inclusion Newcastle and Financial Inclusion Services Yorkshire have both sought to bypass the arguments and develop less ideological and judgemental perspectives.

## Financial Inclusion Newcastle

Alongside CRTs, another customer focused approach to financial inclusion has emerged in Newcastle. Research by Northumbria University identified high cost credit and consumer debt as significant issues in the West End area of the city. Subsequently this led to a broad coalition of groups coming together and a participatory appraisal approach being taken to ascertain the views of residents. Participants in this research argued that existing mainstream provision was either insufficiently available (due to closure of bank branches or inappropriate opening hours) or 'intimidating' (Fuller & Mellor 2004:10). By contrast, doorstep lenders were often seen as inclusionary, while credit unions and the post office were also viewed positively. Respondents wanted a service that was 'physically accessible, safe and secure, pleasant to be in and welcoming for all' (Fuller & Mellor 2004:11), with staff drawn from the locality. Services requested by local residents included savings and loans products, cash points, money advice, financial education, basic bank accounts, and insurance services. (Fuller & Mellor 2004)

In responding to these preferences, the development plan in Newcastle began from the premise that financial exclusion was as much a social as a financial matter. As a result, the potential role of credit unions was recognised. In addition, Lloyds TSB agreed to join the coalition as the banking partner. The partnership became known as Financial Inclusion Newcastle (FIN), and secured public funding to establish three credit union offices. Volunteers and support workers staffed the offices, while the credit unions were connected through a joint IT system and server. This approach differed from that proposed by Jones (1999) as it enabled small credit unions to remain independent rather than necessarily seeking growth through merger. However, more innovatively, the services also incorporated money and debt advice operated by the CAB, financial education, micro-enterprise advice, and a loan package for high-risk applicants backed by a guarantee fund. The entire range of extramural credit union activities were contracted through Financial Inclusion Newcastle Limited (a joint venture enterprise formed as a company limited by guarantee).

In the two years since its inception, the credit union members of FIN have seen membership grow by 198 per cent (comparing growth 2002-04 to 2000-02), the number of loans by 43 per cent, and total funds lent by 56 per cent. In addition the FIN loan guarantee scheme has granted 29 loans worth £10,500 with a default rate less than 20 per cent. FIN loans have assisted with bridging loans between jobs, furniture for young people leaving home, rent deposits, clothes for a new job, household repairs, white goods and maternity costs. (Fuller & Mellor 2004)

As FIN progresses, the partnership will need to secure greater funding for the credit unions, as at present the non credit unions have received greater support. If not addressed, this imbalance may cause tensions within the partnership. In their evaluation Fuller and Mellor (2004) also highlighted: the weaknesses about governance; the reliance of FIN on the credit unions to deliver services; and the inability through the terms of the partnership to challenge under performance of autonomous delivery agents. They also felt that, FIN's limited geographical area may restrict future growth and that the tensions in the partnership flag the risk of professionals supplanting community engagement in the direction of the project. Clearly, FIN's strength is that, unlike most CRTs, it includes savings products and has community ownership and control. However, a loose association between different agencies means that it is entirely reliant on goodwill for delivery, while there is a risk that objectives may become blurred and the project will ultimately follow the views of its strongest supporter.

## Financial Inclusion Services Yorkshire

In many respects Financial Inclusion Services Yorkshire (FISY) structure was created to address the problems experienced in Newcastle by FIN. Although much of the activity was very similar to that performed by FIN, the context was different, which highlights the importance of designing mechanisms that reflect local circumstances. Thus the scale of the operation was much larger (city-wide coverage initially and an extension of service across South Yorkshire thereafter), while the relationship with local credit unions was stronger. Like FIN, the originators of FISY wanted to place credit unions at the forefront of any solution; however, they also sought to establish a separate CRT (Yorkshire Moneyline) that would specialise in the higher risk lending. An outcome of this strategy was that Sheffield moved towards a citywide 'live and work' credit union through the voluntary merger of three small community based credit unions (some still remain outside of the merged credit union).

To avoid any disputes between the credit union and the CRT, FISY was established as the over-arching company with a single chief executive charged to pursue and ensure service delivery on the citywide strategy. FISY was also responsible for promotion, money management advice and financial literacy. To fulfil legal requirements, three organisations were established, and brought together to operate under the same management and from the same premises in Sheffield city centre. Another innovation is that all loan repayments for Yorkshire Moneyline are collected through the credit unions and until the end of the 2004 most transactions were made in cash.

In the first six months of trading since October 2004, Yorkshire Moneyline made 105 loans totalling £34,000 and Sheffield Credit Union has gained 244 new members (105 of those were introduced via Yorkshire Moneyline) and 97 new junior members.

Although it is too early to assess the effectiveness of the Sheffield model, it does offer a stronger structure than that operated in Newcastle and possibly as a result, FISY has overcome the limitations that both credit unions and CRTs face when working in isolation. By comparison to FIN, less prominent in FISY is the priority given to money and debt advice. Also by comparison to CRTs, its reliance on cash repayments to date may limit both its growth and its ability to reduce operating costs.

# Summary of UK Experience

Credit unions have clearly changed in recent years, with a stronger emphasis on professionalism and the gradual development of more innovative loan products. Ultimately these shifts should benefit lower income households, and credit unions as independent financial institutions. Though in one regard the mutual nature of credit unions will invariably make it difficult to serve those considered most excluded or higher risk clients, the capacity to take savings, and encourage a 'savings culture' offers a long-term approach to lifting people out of financial exclusion.

Although CRTs are nominally mutual organisations they differ from credit unions in two aspects:

1 They are 'community benefit' not 'cooperatively owned' organisations.

2 Their lending capital is not drawn from members' savings.

This enables CRTs to develop services aimed at the financialy excluded without risking the savings of small investors. These differences come at a price because CRTs cannot offer savings facilities. The inability to mobilise savings is a major constraint to their development – both because savings services are a vital financial service, which help people manage risk, accumulate assets and overcome indebtedness, and because savings can provide an important low-cost, capital base for achieving organisational growth and sustainability.

On the other hand, unlike credit unions, CRT loan charges are not restricted by law to a maximum of 12.68 percent APR. Thus they can and do charge somewhat higher interest rates for riskier, short-term, micro-credit loans. These loans may be in the region of 18 to 30 per cent APR but are still highly affordable compared to credit packages from high-cost lenders. As loan volume builds, the extra income from these higher-price loans enables CRTs to provide, on a sustainable basis, micro-credit finance for new start businesses/enterprises and other higher risk consumer lending. In this way, CRTs can earn enough interest income to cover operating costs, loan delinquency costs, and losses from write offs – something, which credit unions with their current statutory interest cap cannot feasibly do[5].

It is our view that both CRTs and credit unions can have a crucial role in addressing financial exclusion but this will only happen if they are prepared to work together. This new approach builds on the experiences in Cambridge, Newcastle, and particularly Sheffield. New Horizons demonstrated how building societies and housing associations could become partners, FIN showed how it was possible to retain small community credit unions while enhancing financial inclusion, while FISY attempted to bring a credit union and a CRT in close alliance[6]. Moreover both models place money advice at the heart of their approaches. Clearly, much local activity is already being delivered; the next stage is to connect this learning with the lessons from international experience to establish a replicable and effective community banking partnership.

[5] Under a local partnership with a credit union, a CRT could specifically provide the riskier and higher cost loans to new customers. If these loans prove to be good loans, thereafter the credit union partner on the strength of this 'credit track record' could offer through the partnership lower cost loans to the same household.

[6] A similar partnership is also being delivered at Blackpool Moneyline, and Sandwell Advice and Moneylink.

# Learning from International Experience

Research in 2003 by nef (the new economics foundation), the National Consumer Council and the National Association of Credit Union Workers (NACUW) has pointed to the potential for extending a Community Development Finance Institution approach in Britain to assist in upscaling community-based credit union growth (Brown et al 2003). This study drew on good practice in England and Wales among community-based credit unions and also the impressive success achieved through a strategic investment approach to credit union growth as demonstrated by the Community Development Finance Institution Fund in the USA, during the past decade.[7] In particular in respect of credit union support, the CDFI Fund has invested in over one hundred Community Development Credit Unions (CDCUs) in low-income urban and rural areas. Over half the American CDCUs have benefited from investment packages from the CDFI Fund. The average size of each CDCU investment award has been in the region of $250,000.

CDCUs are a special type of credit union that primarily have a social mission to tackle financial exclusion. Numerically they represent only a small fraction of the 10,000 plus credit unions in the USA. Notwithstanding this, in 2002, the 210 members of the National Federation of Community Development Credit Unions (NFCDCU 2003):

- Mobilized savings in low - income communities of $2.29 billion.
- Loaned $1.04 billion to their low - and moderate - income member borrowers.
- Saved some $300 million in interest otherwise payable to predatory lenders.
- Recycled over $34 million in dividends to low - and moderate - income members.

[7] Clinton approved the Community Development Financial Institutions Act in September 1994. This law set up the American CDFI Fund to invest strategically in the development of all CDFIs (including CDCUs).

## The 'Credit Path' and money advice

Banks find it difficult to assist low-income households because of the high transaction costs associated with unbanked 'cash managers'. These costs are typically 10-20 times higher than for conventional customers who operate their accounts electronically. Credit unions also experience the same transaction cost problems. Brown et al. (2003) identified innovative practices developed by credit unions and money advice agencies in Ireland and by Community Development Credit Unions in the USA to tackle this transaction cost problem. In Ireland, the Money Advice and Budgeting Service (MABS), supported by the Irish Government, has developed a 'local partnership model' to deliver to low-income households the core services the UK Government would like to see. These include: savings, free money advice, bill and debt repayment and affordable credit. Over the past 10 years, MABS has become a recognized national service. The local partners include local authorities, national utilities, financial institutions, charitable bodies, community advice services and other creditor bodies.

In the USA, Community Development Credit Unions (CDCUs), with the assistance of the US Government, have considerably widened access to affordable credit with a creative approach called the Credit Path. This identifies four stages to achieving financial inclusion among the poorest households:

**Stage 1:** **Transactor services** to help households budget and pay bills.

**Stage 2:** **Saver services** to help households save in flexible ways.

**Stage 3:** **Borrower services** to extend affordable credit to 'high risk' households.

**Stage 4:** **Ownership services** to enable households to become asset owners for the first time.

The Credit Path approach reveals the weaknesses of conventional approaches among credit unions that have not effectively enabled the lowest income households to join in large numbers. By tackling basic money management problems, as a priority, and assisting with the provision of transactor services, CDCUs have shown how credit unions can intervene to help the poorest households. To take this intervention further, American CDCUs, with support from the US Government and banks, have also developed special lending systems to overcome the problems faced by low-income households using high-cost predatory lenders. Such lending in the UK among licensed moneylenders alone is worth annually £3.5 billion with lending rates ranging from 160 per cent to 800 per cent APR (Palmer & Conaty 2002).

The key lessons from the success of both American CDCUs and the Irish MABS systems for tackling financial exclusion are:

(i) Pilot or pathfinder projects should be well resourced;

(ii) Advice services need to be separately funded from bill payment and debt repayment operations;

(iii) Affordable micro-credit facilities helps budgeting and can circumvent moneylenders and predatory credit providers if products are well designed;

(iv) Social housing organisations can become excellent partners.

In the USA a small but growing number of CDCUs have developed group structures that separate out higher risk lending and specialist lending, often in a sister CDFI company. Also services requiring ongoing subsidy such as financial literacy and business advice can be delivered through a third charitable or non-profit company in the group. The Community Banking Partnership approach has taken considerable inspiration from this group company methodology, as the American CDCUs with this structure are among the fastest growing and most successful CDCUs (Rosenthal, 2005).

# Tackling Financial Exclusion – Scaling Up

The complexity of the services required to effectively serve the financially excluded is most likely to be achieved if specialist agencies can work together. Two of the necessary elements for this are for the delivery agencies to have sufficient professionalism and be financialy stable. For the Community Finance Initiatives, whether credit unions or CDFIs, this will entail 'scaling up', [8]a situation recognised by Dayson et al (1999) in the case of CRTs and Jones (1999 and 2005) in the case of credit unions.

Among the largest 20 per cent of community-based credit unions in England and Wales, there are an identifiable number of credit unions able and keen to scale up and deliver financial inclusion services like their counterparts in the USA and Ireland. Indeed, there are many examples of innovative community-based credit union practice in the UK (Brown et al, 2003). Key strategic decisions by these credit unions to achieve growth are evident. Success factors include:

(i) Access to longer term investment funding for staffing and shop fronts.

(ii) Registering common bonds that can expedite a critical mass of assets and membership for rapid growth. This may be through merger, but equally many will have an existing critical mass, others will have expanded, either geographically and/or compositionally through federal systems.

(iii) Strong social business leadership from the credit union board and staff to achieve success.

An example is Riverside Credit Union in south Liverpool, which has trebled in size to over 4,400 members in the past six years and expanded its asset base over the same period by over 400 per cent by raising member savings levels from £181,000 to £850,000. Two other good examples are the Enterprise Credit Union in Knowsley and the Robert Owen Credit Union in rural Mid-Wales. Enterprise CU has grown from 500 to almost 4,500 members over the past seven years and increased its assets in share capital by 2000 per cent since 1998 from a savings level of £45,000 to just under £1 million. With only two part time paid members of staff, Robert Owen CU in the past few years has been growing at a rate of almost 30 percent annually and has achieved a membership in a very sparsely populated area of 1,400 and an asset base of £350,000.

Like CDCUs, these successful community-based credit unions have diversified their services sensibly to attract a broader base of members. Today they each offer a range of loans, household insurance and ways for their members to budget and manage money more affordably. Enterprise Credit Union has been the first credit union in Britain to offer a MABS service. Robert Owen Credit Union has developed a successful loan service for the rural self-employed. Equally, the CRTs have found that their affordable instant personal consumption loans have proved particularly popular.

[8] This doesn't necessarily mean individual credit unions having to expand, as it may be possible to 'scale up' through a federated structure of smaller credit unions.

# Tackling Financial Exclusion – The Sustainability Challenge

It is also necessary to understand that tackling financial exclusion can be expensive; though methods can be identified to minimise these costs. Research by Community Finance Solutions, which was funded jointly by Lloyds TSB, Barclays Bank, and the Housing Corporation, examined the transaction cost problem faced by CFIs in providing microcredit to low-income households in Britain. One of the main findings was that loan processing time is very high for both CDFIs and credit unions, and that further economies of scale were possible. The researchers concluded that there was a need for a more integrated approach between all the agencies involved in addressing financial exclusion to assist the poorest households most efficiently and effectively.

The need here is two-fold: On the one hand there is the need for community finance lending services to be scaled up by sharing back office services thereby economising on time spent processing loans; on the other hand there is also a strong need for integrated advice and support services. A group structure involving a CDFI and charity is common to the operation of CRTs such as South Coast Money Line, and Salford Money Line. CFS concluded that the potential integration of a credit union within such a group structure or through a close local partnership could provide a 'one-stop shop' solution (Dayson 2004). Separately and simultaneously, nef and NACUW were reaching a similar conclusion.

When discussing the performance of entities with a social mission, sustainability has both a financial and non-financial element. With regards to reaching the target audience, Dayson (2004) found that both credit unions and CRTs served deprived communities, with the only tangible difference being that credit union clients tended to be slightly older, wealthier and more likely to be in a stable relationship. However, it should be noted that Dayson's case study research only examined one credit union and three CRTs, so it would be inappropriate to apply these findings universally. Similar caution should be used when examining the financial sustainability of these organisations, but regardless of the numbers examined, credit unions, savings and loans schemes, and CRTs, have widely different business models, regulatory frameworks, and stages of development so it is virtually impossible, as well as inappropriate, to directly compare them.

Primarily reliant on the surplus from loans for most income, credit unions must produce a surplus in order to build a sufficient reserve ratio compliant with FSA regulations and to pay a dividend that is satisfactory to members. In the case study, most of the staff costs were met by public funds, though the credit union was prepared to reduce staffing if required once the funding ends. Ultimately, sustainability is dependent on expanding the business and reducing bad debt. (Jones 2005). By contrast most savings and loans schemes are not pursuing sustainability, being part of much larger organisations. Therefore most costs were not discernable from the respective partner's standard activities. By contrast, business plans for the CRTs originally forecasted that sustainability would occur in five years. When comparing the performance of the CRTs against their original budgets, all three organisations surpassed their year 1 targets. In year 2 (see table below), the two oldest CRTs missed their goals, while the newer CRT reached its income target but overshot its expenditure budget.

| Ratios | Year 2 Budget | Year 2 Actual |
|---|---|---|
| Total cost per loan | £284 | £435 |
| Staff cost per loan | £139 | £237 |
| Average loan | £1044 | £784 |
| Bad debt & provision | 6.77 | 9.33 |
| Annual income per loan | £112.16 | £81.94 |
| Cost Income | 2.53 | 5.3 |

As the table shows, the CRTs were struggling to match their budgets because the average size of the loan was 25 per cent lower than expected, while the staff costs were 62 per cent above estimates. It should be noted that subsequent to these research findings, one of the CRTs has declared that it is now 80 per cent sustainable.

The research offered four explanations of why CRTs have not achieved their original budgets (this assumes that the budgets were realistic):

1 Were they too successful in serving their target audience? In reaching the financially excluded, CRTs found that the unstable personal finances of clients have resulted in erratic repayments and much smaller loans being requested.

2 Capped interest rates? The least successful CRT had its interest rate capped at 15 per cent. This limited operating income and restricts the capacity of the CRT to engage in higher risk lending. By contrast the most successful CRT charged 29 per cent APR with no apparent detrimental impact on its client base.

3 Difficulty opening new markets? All CRTs were expected to make home improvement loans linked to private sector housing renewal. To date these schemes have not materialised, removing a key source of relatively stable income that was forecast to come from such larger loans.

4 Doing the job of others? All the CRTs and the credit union in the survey believed that one main contributory reason for missing targets was the need to undertake advice and support work with clients. This was unexpected and has taken considerable staff time, thereby preventing other activity. Staff timesheet analysis highlighted that on average a fifth of time has been spent on advice related tasks and that CRTs and credit unions are frequently engaged in the unpaid delivery of financial literacy, money advice and support tasks.

Based on these findings, in order to improve sustainability, Dayson (2004) stressed the need for more hands-on relationships with advice agencies. To be successful, this may involve advice agencies changing some of their practices, such as recommending credit unions and CRTs to users, rather than the current guidance of maintaining neutrality when discussing lenders. The Treasury implicitly accepted this argument with the announcement of the relaxation of the FSA's financial advice rule for money advice workers. The experience of FIN and FISY showed that there was also a need to build more productive relationships between CRTs and credit unions. Too often relationships were ambivalent or even hostile, with personalities and organisational development being prioritised over social policy objectives.

Partnerships with banks also need to become more sophisticated, particularly in the delivery of basic bank accounts between credit unions, CRTs and local bank branches. Operationally there is a need for more strategic investment in integrated IT systems and duplication in staffing also needed to be examined. Finally, only the credit union and one CRT demonstrated sufficient community engagement – thus increased participation and improvement in governance was required. It was these collective shortcomings that helped inform the evolution of our thinking on financial services for the financially excluded, which ultimately led to the Community Banking Partnership approach.

# Integrating Community Banking Partnerships into the Financial Inclusion Strategy

Over the past eight years the Government has shown a willingness to test new financial inclusion ideas, before settling on its policy outlined in the Pre-budget report in December 2004. The priorities being:

Money and debt **A**dvice

Access to **B**anking services

Access to affordable **C**redit

All these are required in any Community Banking Partnership approach, but we also believe that a D needs to be added to the ABC of financial inclusion. That is to 'encourage Deposit making'. To be fulfilled the D has two elements: recognising the importance of credit union savings facilities; and developing effective financial literacy training, to enable users to understand the importance of savings. Deposit making is important because it creates a ladder to financial inclusion and over time can prevent households and individuals become re-excluded. It is also connects with the Government's wider agenda on creating a stakeholder society through policies like the Child Trust Fund, and the Savings Gateway. By adding 'D' the financial inclusion strategy moves beyond addressing current problems to building a financially included society that lasts.

Though deposit making is central to any financial inclusion policy, the Community Banking Partnership's crucial contribution could be in the operationalisation of the financial inclusion strategy. In effect it provides a joined-up answer to the question: how to do it?

The cornerstone of our approach is that we should begin from the assumption that financial inclusion is of itself desirable, both from economic necessity and on the basis of citizenship rights.[9] From here it is necessary to place the individual user at the centre of any solution and therefore accept that users may wish to exercise choice in the ways they can be financially included. It is also a requisite that if financial inclusion is a matter of citizenship, then it is appropriate that the state should ensure barriers to inclusion are minimised, through funding inclusion projects and preventing private concerns from causing exclusion.

However, if the private sector is to engage, the community finance sector needs to improve its effectiveness. This means looking for efficiency savings, developing working protocols, and managing and promoting interrelationships. It is our opinion that financial inclusion can only be achieved through a holistic approach. By judicious use of its funding and astute drafting of terms of conditions on these contracts, the Government should encourage existing agencies to coordinate service delivery so that a consumer focused approach is achieved. This means learning lessons from the work in Sheffield and Newcastle and promoting productive partnerships. It means acknowledging the excellent work performed by existing advice agencies and community finance initiatives but insisting that serving the customer requires working outside of silos. Clearly, the move to relax the rules on financial advice provided by advice workers for a two-year period is a welcome step in this direction, but this needs be the beginning of the process. We need to adopt and adapt concepts of 'delivery clusters' that are prevalent in hi-tech growth areas, such as Silicon Valley. This does not necessarily mean organisations losing their identity but that services are arranged collectively with the single purpose of maximising the benefit to the customers. Such an approach, may lead to financial inclusion 'drop-in centres', based on the same principle now being rolled-out across the NHS. These drop-in centres would not only benefit the users but they enable different agencies involved in delivering different aspects of the financial inclusion strategy to work in close proximity and thus share knowledge, working practices, and ideas. Just as in the private sector this should produce a more productive and faster growing sector. In this way the Government gets more 'bang for its buck'.

[9] Drawing on Marshall (1980) there are many non-state services that are needed to enable a citizen to fully participate in modern society. Access to bank accounts can be seen as one of these.

# Community Banking Partnership: A Joined-up Solution for Financial Inclusion

Might CRTs and community-based credit unions supported by advice and support agencies find ways of partnering more closely together in a way that builds on their relative organisational advantages? This is the key question.

The goal of the CBP model is to achieve the joining-up necessary to tackle financial exclusion in robust ways that can be replicated and scaled up nationally. CBP is a practical response to the Government's call for "partnership both with the financial services sector and with voluntary and community bodies to help where financial exclusion still persists, especially in relation to paying bills, accessing affordable credit and obtaining free debt advice." (H.M. Treasury 2004:114-5). It is also a view shared by Debt on Our Doorstep (Rossiter & Cooper 2005), a coalition of 150 organisations committed to campaigning to end financial exclusion.

In line with one of the lessons from the UK experience – that service provision must reflect local circumstances – our proposed Community Banking Partnership is not a rigid model. This five point approach is based on a 'customer first' philosophy:

1 Access through a service-level agreement(s) to appropriate advice and support, involving financial literacy and help with household budgets and paying bills.

2 Accessible and affordable credit provision, based on the assumptions that the competition is doorstep lenders, and that the sustainability of the lender is of paramount importance.

3 Access to mainstream banking services, with basic banking accounts being the start not the end of financial inclusion.

4 Accepting that access to a savings vehicle is central to any long-term solution to financial exclusion.

5 Efficient and effective delivery through the provision of integrated access points for the services of both lenders and advice agencies.

To achieve these aims it is first necessary for partners and contracted service providers to accept that:

a) An understanding of who the client groups are and that their needs are central to any success.

b) Participants need to be willing to consult, mediate, and negotiate.

c) Partners and service providers need to be willing to accept their own limitations, and place working to achieve financial inclusion over and above narrow sectoral interests.

d) That doorstep lenders provide a service that many people find useful, but that the cost of this service detrimentally effects the local economy.

e) Resources will be required for advice support and also long-term technical assistance that cannot be offset by income from interest rates alone.

f) Credit unions and CDFIs are financial institutions, not social services. Therefore, they need to adopt a business model that is operationally sustainable and not unduly dependent upon long-term grant funding.

g) There is a need for benchmarks, common reporting standards, and public disclosure of information.

## What could a Community Banking Partnership look like?

The original promotional literature published in late 2004 suggested that a Community Banking Partnership would be a single organisation combining a community reinvestment trust, a credit union, and a charity. Though this could happen, following extensive discussions with practitioners, our thinking has since evolved. Instead we recommend a more á la carte approach with a strong emphasis on performance and execution through effective delivery arrangements. We envisage that each Community Banking Partnership would be unique to its locality to reflect the nature of the existing suppliers and relationships. Thus there are four levels of engagement in a CBP.

## Community Banking Partnership

What they would get from a **referral approach**. Refer to others and can describe what other services are available.

What they would get from a **working protocol approach**. Single telephone number, access to diaries to make appointments.

What they would get from a **service level agreement approach** e.g. single office. Seamless BCD, close to A.

What they would get from a **group structure approach**. Seamless ABCD.

## Group structure approach

This is where there is a very close working relationship between a CDFI and a credit union within a group organisational structure (or as near as financial regulation allows), with a single chief officer. These organisations could be based in the same office and clients would receive a seamless service. In addition, the organisation could be connected to a charity that may act as a conduit to raise funding to deliver money and debt advice. However, the group structure approach is unlikely to happen in most areas and can be seen as an ultimate objective.

## Contractual service level agreement approach

Partners remain sovereign but work in tandem to an agreed strategy for the whole community backed-up by service level agreements. Customers would expect to access services through an integrated process, many of the staff could work for one or more partners, and a joint charity may be established to finance the support and advice activity. What would not happen is a full merger or transferring assets between the parties.

## Working protocol approach

This approach seeks to identify and develop some economies of scale and improve the customer experience. For example, the service providers may have a single telephone connection and partners would have access to each other's diaries to enable appointments for clients to be made. What a working protocol would not include is any reference to the merger of back office provision and/or enhancing staff understanding by working in the same location.

## Referral approach

In areas where existing relationships are not particularly effective and considerable time needs to be spent on building trust, then a memorandum of understanding between sovereign organisations may be the most appropriate solution. In this structure, credit unions, advice agencies, and a CDFI are fully aware of each other's activities and make extensive referrals but they have little engagement in seeking economies of scale and improving the customer experience.

All these levels of engagement present alternative types of community banking partnerships, but the most important thing is that they offer an evolutionary way to deliver an enhanced customer experience and fulfil the Government's ambition of a fully inclusive society. The starting points in different communities will vary; in some all the required components of supply will be in place whereas in others there may be a relatively blank canvas. The most important feature is the nature of the contracts between the parties and specifically the adopted performance targets. For if the community banking partnerships are to grow and deepen it is necessary from the outset that all parties understand what each other are to deliver. Therefore, if a full merger is not the preferred option, the CBP will need to have contractual obligations with stringent performance levels that need to be achieved. In this respect, it is taking lessons from the way private sector manufacturers effectively control contracted-out component manufacturing. Trust may be central to the personal relationships, but each party has clear legal obligations to each other that must be fulfilled. There is no reason why a similar system could not operate when addressing financial inclusion, particularly as each component of the overall strategy is the responsibility of different agencies and organisations.

# What is happening now with regards to promoting community banking partnerships?

The CBP model has developed out of work by nef, the National Association of Credit Union Workers (NACUW) and Community Finance Solutions at the University of Salford. The approach combines the best practices of community-based credit unions and community reinvestment trusts in Britain. It also draws upon service delivery lessons from Community Development Credit Union (CDCU) practices in the USA and Money Advice and Budgeting Services (MABS) projects in Ireland. The first prototype model is now fully funded and will go live in Birmingham in summer 2005.

Four charitable trusts and the Welsh Assembly have provided funding to undertake feasibility studies and business plans for CBP pathfinders. These studies have been completed for a second CBP in rural Mid-Wales, and a third CBP in Portsmouth and Southampton. Furthermore, feasibilities studies are underway in Devon, East London, Coventry, North East England, and Merseyside. Overall by summer 2006, a national pilot demonstration project should be underway involving initially up to eight CBP pathfinders, with a growing level of investment support from charitable foundations, banks and government bodies.

In addition, to the work in Birmingham and the seven feasibility studies there are other areas developing groundbreaking initiatives along similar lines, including Sheffield, Blackpool, and Sandwell in the West Midlands. We applaud this and believe it indicates that some form of community banking partnership is the most appropriate and practical solution for those primarily interested in addressing financial exclusion.

The goal the National CBP Demonstration Project sets itself is to show demonstrably how to tackle financial exclusion and provide affordable financial services to low-income households in a sustainable manner.

The six main objectives are to:

a) Develop robust but flexible prototypes – the Community Banking Partnership approach – that is able to provide financial services to an increasing number of low-income households.

b) Develop a set of common core services including savings, affordable credit, household insurance, bill and debt repayment alongside money advice and financial literacy services.

c) Develop a prototype whose core services provide a strong infrastructure upon which can be added other financial services.

d) Build strong local community banking partnerships to assist in marketing the financial inclusion services and with the hands on involvement of local authorities, CABx, independent advice agencies, banks, housing associations, utility companies and other essential service providers.

e) Support the progressive transition of the Community Banking Partnership pathfinders to sustainable sources of financing and long-term, operational sustainability.

f) Build upon the best practices that evolve both from the CBP Pathfinders and other similar innovators in this field, to develop a national strategy that attracts additional government and private sector support for community banking partnership ventures across Britain.

## Areas of Investment: Sustainability and Social Return – Key Goals

The National Demonstration Project will have three main areas of activity over a three-year period:

(i) **Community Banking Partnership resource mobilisation strategy –** Investment will be sought from local, regional and national resources to support the pathfinder organisations. Within these areas, existing bodies will be assisted in the development of community banking partnerships in their region.

(ii) **Capacity building, technical support and product development –** This covers the costs of pre-development and capacity-building work, business planning, technical support, training, product development and management. Experience from the USA has demonstrated that organisational development and technical support are as important as investment funding itself. This will help advice and support agencies, credit unions and CDFIs to strengthen their organisational capacity to provide services on a larger scale and to achieve operational sustainability.

(iii) **Monitoring and evaluation –** Measuring the economic performance and social impact of the pathfinders will be crucial to understanding whether and how the CBP is cost effectively contributing to alleviating financial exclusion. Results of such performance evaluation and impact analysis will be fed back to the participants and the funders during implementation. In addition, being partnerships the influence of human interactions is likely to be a key variable in the relative success of the projects. Thus it is planned to develop an experiential learning approach appraisal, which will inform project design, implementation, and delivery strategies, drawing on process and output findings. The overall policy results will also be fed back to policy-makers.

In relation to tackling financial exclusion, a key measure will be the ability of pathfinders to make inroads into the estimated six per cent of the local market of low-income households currently using high-cost doorstep lenders (Brown et al 2003). If a proportion of these could be persuaded to use a urbanised CBP pathfinder we estimate that if a credit union is one of the partners, the pathfinder would see an increase of credit union membership to at least 2,500 over five years (including 1,000 directly from doorstep lenders)[10]. Assuming an average charge of 177 per cent APR, the savings in interest costs by helping 1,000 low-income households move from moneylenders to affordable credit union loan rates would amount to about £700,000 in wealth retained in each of the six pathfinder areas.

It is our view that if implemented, the CBP will lead to stronger community-based credit union and community reinvestment trust growth in England and Wales. This will increase access to affordable financial services by poorer households and provide a robust methodology for minimising the social injustices linked with financial exclusion. Conservative projections show an aggregate direct and measurable financial benefit to low-income households within five years of almost £700,000 in each Community Banking Partnership area. This additional income will not only directly increase disposable income of Britain's poorest households; it also means that there is more cash to spend in local shops and businesses. Tackling financial exclusion in this way is socially desirable, but equally it's good for the British economy.

[10] This may be less in rural areas where a lower total population may be served by a CBP and thus proportionately less will use doorstep lenders.

# References


Brown, M., Conaty, P., Mayo, E. (2003) Life Saving – Community Development Credit Unions, New Economics Foundation, National Association of Credit Union Workers and the National Consumer Council.

Citizens Advice Bureau (2003), In too deep – CAB clients' experience of debt, London: Citizens Advice

Collard, S. (2002) Ending Fuel Poverty and Financial Exclusion: A Market Feasibility Report, London: Ofgem

Collard, S. & Kempson, E. (2005) Affordable Credit: The Way Forward, Bristol: Policy Press

Collard, S. Kempson, E. & Whyley, C. (2001) Tackling Financial Exclusion, An Area Based Approach, Bristol: Policy Press/JRF

Conaty, P. and Bendle, S. (2002) Ending fuel poverty and financial exclusion – a Factor Four approach, New Economics Foundation and National Energy Action.

Conaty, P and Mayo, E (1997) A Commitment to People and Place, London, NEF

Dayson, K. (2002) Carpetbaggers and Credit Unions: A Sociological Study into the Paradox of Mutuality in the Late Twentieth Century, Salford: University of Salford PhD Thesis

Dayson, K. (2004) Community Finance Initiatives: A Policy Success Story? Salford: University of Salford

Dayson, K., Paterson, R., and Powell, J. (1999) Investing in People and Places, Salford: Academic Enterprise,

Dayson K, Paterson B, & Conaty P (2001) Investing in People & Land, Salford: University of Salford

Department of Work and Pensions (2004) Family Resources Survey 2003-04, London: HMSO

Fuller, D. and Jonas, A.E.G. (1999) 'Exploring future geographies of financial inclusion: the British credit union movement'. Paper presented at the 'Creating sustainable communities: public policy and academic research' conference, University of Manchester, June 23, 1999

Fuller, D. & Jonas, A.(2002) 'Institutionalising future geographies of financial inclusion: national legitimacy versus local autonomy in the British credit union movement', Antipode, 34 (1) pp. 85-110

Fuller, D. & Mellor, M. (2004) 'Advancing Financial Inclusion in Newcastle-upon-Tyne, UK'. Paper presented at the Countering Urban Segregation Working Conference, Free University of Amsterdam, 14-15 October 2004.

Fuller, D., Mellor, M., Affleck, A., & Dodds, L. (2003) 'Local to Me': Advancing Financial Inclusion in Newcastle-Upon-Tyne, Newcastle: Northumbria University

Jones Paul (1999) Towards Sustainable Credit Union Development – A Research Project, Manchester, ABCUL

Jones, P. (2002) Access to Credit on Low Income: A study into how people manage on low incomes in Liverpool access and use consumer credit, Manchester: The Co-operative Bank

Jones, P. (2003) Credit Unions and Loan Guarantee Schemes, Liverpool: John Moores University

Jones, P. & Barnes, T (2005) Would You Credit It? Manchester: The Co-operative Bank

Jones, P (2005) Creating Wealth in the West Midlands Through Sustainable Credit Unions: An Action Research Project, Manchester: ABCUL

H. M. Treasury (1999) PAT 14 Access to Financial Services, London, H.M. Treasury

H. M. Treasury (2004) Budget 2004, Prudence for a Purpose: Building a Britain of Stability and Growth, London: The Stationery Office.

H. M. Treasury (2004b) 2004 Spending Review: New Public Spending Plans 205-2008, Cmnd 623, London: The Stationery Office

H. M. Treasury (2004b) Promoting Financial Inclusion, London: HM Treasury

Marshall, T. H. (1950) Citizenship and Social Class and Other Essays, Cambridge: Cambridge University Press

Mayo E, Fisher T, Conaty P, Doling J & Mullineux A (1998) Small is Bankable: Community Reinvestment in the UK, York: Joseph Rowntree Foundation

Murphy, R. (2003) The Case for an Interest Rate Cap, London: nef, Debt on Our Doorstep

National Consumer Council (2004), Why do the poor pay more……or get less? London: NCC

National Federation of Community Development Credit Unions (2003) Building Community Assets, Annual Report, 2002-2003, New York: NFCDCU

National Federation of Community Development Credit Unions (1989) World View – NFCDCU @ 25, 25th Anniversary Journal, New York: NFCDCU

Palmer, H. & Conaty, P. (2003) Profiting from Poverty: Why Debt is big Business in Britain, London: NEF

Regan, S. & Paxton, W. (2003) Beyond Bank Accounts: Full Financial Inclusion, London: IPPR

Rosenthal, C. (2005) Credit Union Group Structures to Tackle Financial Exclusion, National Federation of Community Development Credit Unions, New York, USA.

Rossiter, J. & Cooper, N. (2005) Scaling Up for Financial Inclusion: A national strategy for expanding access to affordable credit and financial services, Manchester: Debt on Our Doorstep

# Notes

# Notes

# Notes